Annual Report & Financial Statements 2018–19

Transforming together

from Southern Water

Contents

Southern House
Yeoman Road
Worthing
West Sussex
BN13 3NX

Registered number. 02366670

Strategic report

Who we are

Our vision

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

Our purpose

We provide water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy.

Our values

We work on behalf of and with our customers, partners and communities. With them, we provide water for life by:

Succeeding together

Collaborating to build better relationships across our region, helping our many different customers to better understand the true value of water and safe disposal of wastewater.

Doing the right thing

Providing consistently good services at prices that are affordable for all within the parameters of an ethical business framework. As well as looking for new ways to adapt and evolve our infrastructure to protect and enhance the environment.

Always improving

Constantly evolving our technology and searching for new ways to make our operational and customer services more resilient in the face of both unexpected incidents and regional and global challenges, such as population growth and climate change.

What we do and where we do it

We provide essential water services to 2.5 million customers and wastewater services to more than 4.7 million customers across Sussex, Kent, Hampshire and the Isle of Wight.

Water

2.5 Million people served

205 Service reservoirs

1.1 Million properties served

0.9 Million Metered properties

559 Average daily water supply millions of litres per day

13,929 Kilometres of water mains

84 Water treatment works

Wastewater

365 Wastewater treatment works

2.0 Million properties served

739 Average daily recycled wastewater, millions of litres per day

39,808 Kilometres of sewers

3,321 Pumping stations

4.7 Million people served

Our finances

	2018–19	2017–18 (Restated*)
Turnover[1] (before regulatory settlement)	£876.3m	£857.7m
Operating profit (before regulatory settlement)	£256.4m	£263.3m
Provision for regulatory settlement[2]	(£138.5m)	–
Profit before interest and tax	£118.8m	£275.3m
(Loss)/profit for the financial year[3]	(£232.9m)	£170.7m
Capital investment	£442.2m	£440.2m
Non-current assets (excluding debt)	£6,125.9m	£5,955.6m
Return on capital employed (ROCE)[4]	2.1%	4.9%
Average water and wastewater customer bill	£436	£420

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

1 Non-appointed activities (these are not regulated by our licence but related to our business, such as property search information) were 1.2% of our statutory turnover.

2 Following its investigation into our wastewater treatment works compliance reporting, subject to the outcome of a public consultation, Ofwat has confirmed its intention to impose a penalty under Section 22A of the Water Industry Act and we have also proposed undertakings to make rebates to customers over the period from 2020 to 2025. We have provided in full for this proposed regulatory settlement in the financial statements for 2018–19.

3 The loss of £232.9 million in 2018–19 was as a result of the provision made for the regulatory settlement together with the fair value movement on derivative financial instruments.

4 ROCE is presented as the ratio of profit before interest and tax (£118.8 million) to non-current assets excluding debt (£6,125.9 million) less current liabilities (£366.5 million).

Our business model

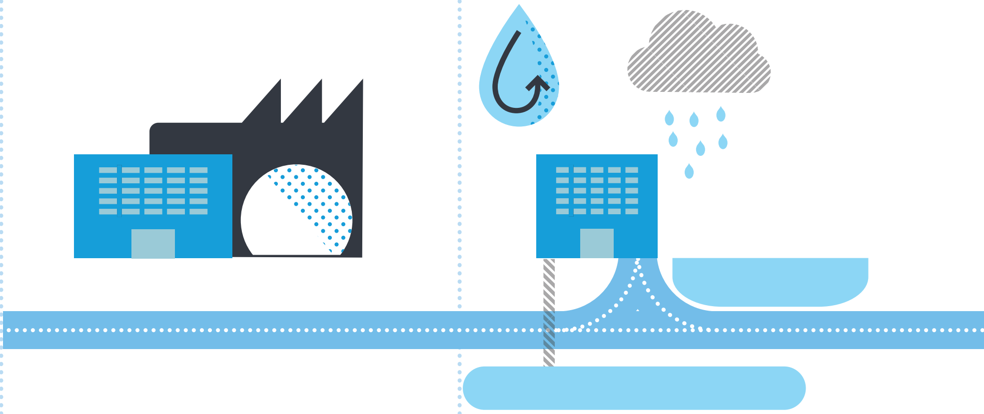
As a regulated company, providing essential water and wastewater services to customers across the South East, our business model is reliant on a number of key resources and relationships that enable us to meet our obligations for customers, stakeholders, the wider community, regulators and our shareholders. These include:

- **Natural resources** – managing water resources, protecting the natural environment and processing waste to generate renewable energy.
- **Employees** – developing and motivating our employees, incentivising them to deliver a high-quality customer experience at every touchpoint with consumers of our services.
- **Active participation** – engaging customers with the role we all play in valuing water, encouraging behaviour change to protect resources and sharing ownership for how water is used, viewed and valued.
- **Suppliers** – building a strong relationship with those companies who work on our behalf.
- **Assets (infrastructure)** – efficient maintenance of our sites, equipment and networks, significant capital investment to construct new assets and innovation to inform future development.
- **Financing** – maintaining a robust capital structure, long-term cost-effective debt and proactive engagement with investors to maintain access to a range of financial markets.

The water cycle

The delivery of water and wastewater services to customers is detailed in this water cycle diagram. Our capital investment process maintains and constructs the infrastructure needed to support these services, and our various customer-facing teams act as a point of contact with our customers.

We engage with customers, stakeholders and partners as active participants across the whole cycle to underscore the role we all play in delivering high-quality service throughout.



Maintenance and development

We constantly monitor our water and wastewater sites and networks, conducting maintenance and developing new infrastructure where necessary.

Water is collected

Our water is mainly drawn from underground storage facilities or aquifers, rivers and boreholes.

Associated risks

At each stage of this cycle there are a number of opportunities and risks. We always seek to maximise opportunities, while quickly identifying, managing and mitigating any risks.

Failure to monitor, maintain and increase capacity of our water and wastewater sites and networks could result in life-threatening injuries to our employees and local residents, disruptions to water supply and damage to property. Any and all of which could potentially pose risks to public health.

In our densely populated and water-stressed region, we must balance the need to supply high-quality water to our customers with the need to preserve our natural sources.

Water is cleaned

Our 84 water treatment works clean raw water to the highest standards, making it safe to drink.

Clean water is put into supply

Our 13,929 kilometre network of pipes and 205 service reservoirs deliver a continuous supply of clean water to our customers.

Customers enjoy our water

Customers across the South East go about their daily lives, enabled by a supply of safe, clean drinking water and the removal of wastewater from their homes and businesses.
In 2018–19 we put 559 million litres per day into supply.

Failure of key assets during this phase could result in risks to public health from reduced water quality and/or disruptions to supply.
We also use a number of chemicals during the water treatment process which, if not handled correctly, could result in injuries to our employees or could present a hazard to our customers.

If we fail to meet required distribution performance standards, public health could be put at risk, our customers could experience supply interruptions or reduced water quality and we may experience increased leakage from our network.

If we do not constantly look to improve and maintain high levels of service and quality, we run the risk of not fulfilling our obligations to customers to provide high-quality drinking water and clean bathing waters.

Wastewater is collected

Our 39,808 kilometres of sewers and 3,321 pumping stations collect wastewater from our customers' homes and businesses and from outside drains.

Customers are billed

Our Customer Service teams calculate and distribute customers' bills and handle any related queries.

Wastewater is treated and returned to the environment

Each day 739 million litres of wastewater are carefully screened, filtered and treated at our 365 treatment works, meeting strict environmental standards, before being returned to the environment.

If we do not remove wastewater effectively and manage our network, we may cause sewer flooding, pollution of our environment and, ultimately, unnecessary distress to our customers.

Errors in our billing calculations or customer information could lead to increased levels of customer dissatisfaction and a rise in contact and complaints, all of which could irreparably damage our reputation. Failure to properly protect the data we hold could also lead to significant fines under Data Protection (GDPR) and Networks and Information Systems (NIS) directives. Ofwat has performance-based rewards and penalties, for which we may incur financial penalties if we do not continuously improve our customer service performance, relative to our peers and our own targets.

if we experience an operational failure during this phase, we could damage our environment. Potentially hazardous processes and substances are also used which could cause injuries to our employees. Our customers, businesses and others could be affected.

Resilience to flooding – changing rainfall patterns, more frequent and intense storms and rising sea levels could all lead to an increased risk of flooding if volumes overwhelm our assets. Excessive rainfall can result in high groundwater levels, which are not possible to control. This leads to flooding of private land and property, possible contamination of water supply, and infiltration/ inundation of sewers. Serious floods seen historically have highlighted the need to protect our water and wastewater treatment works and pumping stations from being affected during a flood.

For a more detailed explanation of our principal risks, see the 'Risks' section of our Financial Performance report on pages 103 to 117.

How we are regulated

Our regulated water and wastewater business works in five-year planning cycles. For each five-year period, we develop a business plan which is based on our customers' priorities and then reviewed by our regulator, Ofwat.

Our plan includes both the forecasted costs of delivery of services and what that means in terms of customers' bills, and sets measurable performance targets aligned to priorities that customers have told us are important to them.

The forecasted costs of delivery of our services include:

- **Operating costs** – the day-to-day running costs of the business.
- **Depreciation costs** – the cost of our assets or infrastructure over their lifespan.
- **A return on capital investment** – returns to shareholders who have provided funding for investment and interest on money borrowed to invest.
- **Taxation** – what we expect to pay in corporate taxes.

The costs include any penalties and rewards set by Ofwat for past performance.

Independent scrutiny of our plans

Ofwat scrutinises and challenges our plans, benchmarking the proposed costs of delivery, performance targets and incentives against the proposals of the other 16 water companies in England and Wales, to ensure best value for customers. As part of this review, it also determines the return our investors can earn, based on evidence from capital markets.

It then decides how much revenue we can recover from our customers through water and sewerage bills, and the performance targets that we must meet. Our directors' remuneration is linked to these performance measures and the value delivered to our customers and shareholders.

Our Five-year Business Plan to 2020 included 26 clear promises to address the issues that customers told us were important to them. A number of additional commitments were also made following a review by Ofwat. You can read these in full on page 40.

Almost as soon as we have completed a price review process, we start planning for the next. This begins with a comprehensive consultation with customers, stakeholders, interest groups, our independent Customer Challenge Group and our suppliers. We gather opinions through workshops, discussion groups, publications, community events and interactive online tools. We then collate these views and incorporate them into our plans.

This extensive consultation process has set our strategic direction in our next Business Plan for 2020 to 2025.

Ofwat reviewed our plan following submission in September 2018 and made its initial assessment in January 2019, placing us in the 'significant scrutiny' category, which means greater regulatory oversight to protect customers' interests. While it recognised our recent progress, it continued to have some concerns regarding our past performance as well as around specific areas of our plan including cost efficiency, long-term resilience and our track record in delivering for our customers.

Our response to this initial assessment has now been submitted and we will receive a Draft Determination from Ofwat in July 2019. We will then work with Ofwat to finalise a plan we are confident we can deliver, before receiving its Final Determination in December 2019. Our 2020–25 plan will officially commence in April 2020, but we are already working hard to deliver the improvements our customers want to see.

Customer participation

In order to deliver water for life and a resilient future for all of our customers, we must co-imagine and co-create it with them. We have started on a journey, which is building on our solid foundations and moving towards greater active participation with our customers and stakeholders.

This is for everything we do – in the design, production, delivery, consumption, disposal and enjoyment of water, water services and the water environment in the home, at work and in the community.

We need to engage with more customers than ever before so we have been implementing innovative new ways to increase active customer participation.

Through listening to our customers and stakeholders and reviewing best practice in and outside the water industry, we created guiding principles for how we approach active participation. In June 2018 we worked with our Customer Challenge Group to develop our participation strategy and implemented it immediately.

Our 12 principles are designed around our values:

Succeeding together

- **Shared planning**
  Working together to ensure our engagement activities happen at the same time.
- **Collaboration**
  With our customers, stakeholders, employees and other water providers.
- **Two-way dialogue**
  Ensuring we engage in a way which encourages open discussion.
- **Partnering**
  Working much closer with our partners to bring in their expertise.

Always improving

- **Innovate our approaches**
  Constantly testing new ways to engage.
- **Iteration by design**
  Ensuring we learn as we go.
- **Open to challenge**
  Actively seeking expertise and recommendations to help us improve.
- **Comparative learning**
  Looking inside and outside the industry at best practice.

Doing the right thing

- **Integration**
  Using different insight sources together from across our engagement.
- **One voice**
  Triangulating the sources to have a clear view of customer feedback.
- **Participation first**
  Starting with the customer and how they can play an active role.
- **Segmentation evolution**
  Understanding individual needs and tailoring our engagement.

Customers

Where we have been:

Over 40,000 direct interviews went into building the 2020–25 Business Plan through an innovative range of approaches to engage around customer priorities, service and support, complaints and communications.

Where we are going:

Greater active participation through closer working in communities, tailoring our engagement activities to individual needs and more collaboration in and outside the industry.

Customer action group – incident management

An active customer panel that provides feedback on current service and support issues, evaluates proposed solutions then reconvenes with fresh customers to further develop improvements. Customer Action Groups have also helped across our understanding of water scarcity, developing our brand and reducing water consumption.

Stakeholders

Where we have been:

Over 150 meetings, events and panels with stakeholders in 2018–19 through our regional and national networks to engage around priorities, incidents, service, policy decisions and our Business Plan.

Where we are going:

Greater active participation through strengthening our county partnerships and networks, developing consistent engagement approaches and increasing our national presence on the important issues for our stakeholders.

Strategic panels – environment panel

An active panel of environment and land management leaders that provides strategic advice and external challenges on key issues facing the water industry. Our panels support vulnerable customers and local issues impacting communities and we have held a number of water policy roundtables to stimulate debate on key issues of national significance.

“It has been a very worthwhile experience and has made me have a complete revaluation of what I think about water. I also now know of all the great things that our providers do to make water safe. In addition all they do for the environment we live in through to our rivers and coastal areas etc. It’s been an experience I have thoroughly enjoyed”

Customer feedback in being part of our water scarcity customer action group, September 2018

“We have welcomed the opportunity to engage with the company at stakeholder events, through consultations, and via the local groups on which we sit, including in particular the Hampshire Stakeholder Panel, Hampshire Water Resources Group and the Test & Itchen Catchment Partnership. It is through this engagement that we have been able to share our aspirations and priorities for the natural environment with Southern Water, and to highlight the areas where we strongly support the company’s proposals, as well as those where we would like to see greater ambition”

Stakeholder feedback in endorsement of our 2020–25 Business Plan, August 2018

Employees

Where we have been:

We mapped over 100 customer touchpoints, interviewed 400+ employees, hosted 16 roadshows and 70+ colleagues took part in engagement development sessions to build our vision, purpose and values – central to driving a customer-first culture.

Where we are going:

Greater active participation through building of an employee feedback hub, access to relevant and up-to-date performance and customer insight to help focus on areas of strongest importance to our customers and stakeholders.

Employee innovation – Rapid Start

Colleagues and partners coming together through our innovation lab (bluewave). Our Rapid Start programme brings expertise to develop ideas and solutions to improve services, such as how we manage customer-reported leaks and skills management for new starters.

Our Customer Challenge Group

Our Customer Challenge Group (CCG) was established as a result of a commitment made in our Business Plan 2015–20. Its purpose is to provide independent advice and to challenge us on the delivery of the commitments made in our plan, acting on behalf of customers where performance is less than promised.

As part of this, it produces an annual report – available at: **southernwater.co.uk/CCG** – which details its thoughts on our performance over the year. It also reviews our Statement of Risks, Strengths and Weaknesses and our data assurance processes. We have also consulted the CCG in relation to this report.

The CCG operates on a transparent basis so anyone who needs more information can write to:
Customer Challenge Group secretariat,
Southern House,
Yeoman Road,
Worthing,
West Sussex
BN13 3NX.

“Its purpose is to provide independent advice and to challenge us on the delivery of the commitments made in our plan, acting on behalf of customers where performance is less than promised”

Acting Chairman's statement

A second year of transformation against a challenging backdrop

Following the retirement of our Chairman, Bill Tame at the end of March 2019, I agreed to act as Chairman pending a permanent successor being appointed, and I am pleased to introduce our Annual Report and Financial Statements 2018–19.

It has been another testing year for the water industry, with companies facing challenges to long-term resilience and preparedness for extreme weather events, and further calls to tackle issues of trust and transparency. Potential changes in the political landscape, such as Brexit or a change in government, also present their own challenges and risks for the water sector. Throughout, Southern Water has continued to supply essential services to its many different customers across the South East to a high standard. At the same time, we have been focused on transforming the business to answer these challenges, addressing very serious failings from the past which I refer to below, while also preparing to deliver our ambitious Business Plan 2020–25. Many improvements have already been made but there is still a lot to do.

Our Chief Executive Ian McAulay will address these changes, the progress made over the past two years of our transformation plan and the work that still needs to be done to continue the transformation of the business into the next five-year period. The rest of the Strategic Report (pages 26 to 117) then details our performance against the Business Plan 2015–20 commitments, highlighting areas where improvements have already started to deliver better results for all our customers, but also areas where performance is still below expectations and more work needs to be done.

> **"The majority of our customers do not have the option to switch supplier and therefore it is right that we are held to account for our performance"**

Paul Sheffield

Our duty of care

Southern Water currently supplies water and/or wastewater services to around 4.7 million people. The majority of our customers do not have the option to switch supplier and therefore it is right that we are held to account for our performance.

At the heart of our 'Water for Life' philosophy lies the understanding that we rely on water for everything we do, and it recognises everyone's right to have access to a clean and safe supply of water and acceptable standards of sanitation. As such, the water industry is rightly one of the most strictly regulated sectors and we accept that the highest standards should be expected.

Rebuilding trust and confidence

As reported in recent years, where we have fallen short of meeting standards required by our regulators, customers and ourselves – for example, compliance or data reporting and assurance – we have been working to materially improve our business systems and processes, including corporate governance processes underpinned by values-based ethical business practices to ensure the mistakes of the past are not repeated. We are also continuously engaging with our customers and other stakeholders in this process.

Since June 2017, we have been assisting Ofwat and, prior to that date, the Environment Agency with their investigations into historic issues relating to wastewater compliance between 2010 and 2017. The results of the Ofwat investigation have recently been made public and we have agreed a package of customer rebates totalling £122.9 million (at 2017–18 prices) that will benefit our wastewater customers over the five years to 2025, details of which can be found in the 'Ofwat investigation' section of this report on page26 and at **southernwater.co.uk/ofwat-investigation**.

Ofwat has indicated its intention to fine us £3 million for our failure to identify and prevent the activity that led to the licence breaches. The Environment Agency investigations are ongoing.

Details of our failings can be found later in this report and both I and the Board apologise on behalf of Southern Water for the actions that led to the manipulation of wastewater flows through that period and for misreporting data to our regulators. Those actions resulted in us being overpaid for the service we delivered and the reparations now being made are intended to put that right. We must also now work hard to regain the trust of our regulators and customers.
We started the overhauling of our business practices as soon as these failings came to light two years ago. In order to start that process of regaining trust we have agreed that we will provide external independent audit of our processes for the next five years.

A comprehensive transformation programme, led by our Executive Leadership Team, has already started to deliver change across the entire business. It is aimed at improving the efficiency of our operations while at the same time delivering the level of service our customers expect, in a way that engenders trust and confidence in all that we say and do.

More information on our assurance processes for reporting data is available in our Statement of Risks, Strengths and Weaknesses (November 2018), the Final Assurance Plan (March 2019) and Data Assurance Summary (July 2019), which can be downloaded at: **southernwater.co.uk/our-reports**.

"Southern Water is working hard, every day to become a better business"

Financial governance

In our Annual Report for 2017–18, we committed to close our Cayman Islands financing company in order to make our structure more transparent and this work is nearing completion. As reported in our Interim Report in November, we also committed to reduce the company's gearing to maintain strong financial resilience, and I am pleased that this refinancing was concluded during 2018–19. Please refer to pages 96 to 97 for further details. In October 2018, Southern Water agreed a deficit recovery plan with The Pensions Regulator and the trustees of the Southern Water Pension Scheme, following the 2016 valuation (please refer to note 23 to the financial statements for further information).

We feel the significant progress made on these three financial governance issues over the year strengthens the business and aligns it more closely with our customers' expectations.

Our year on the Board

With our Business Plan 2020–25 needing to be submitted to Ofwat in September 2018, the first half of the year saw the Board very focused on ensuring we had the best possible plan, which delivered resilience across our operations and the best outcomes for customers and the environment. We submitted an ambitious plan in September 2018 and, while Ofwat recognised this, it also set us some tough challenges in its initial response. We have responded to these, submitting our revised proposals in April 2019, the highlights of which our Chief Executive will discuss in his summary on page 19.
We are now awaiting the outcome of Ofwat's Draft Determination, which will be released in July 2019.

Our five-year business plan to 2025 proposes a significant increase in our investment from £3.2 billion in 2015–20 to £4 billion, while at the same time reducing bills by more than 5% in real terms for water and wastewater customers.

Securing confidence and assurance

We fully support the expectations outlined in Ofwat's publication 'Putting the sector back in balance'. In our Business Plan 2020–25 we embraced Ofwat's executive pay and dividend policy expectations.

Our revised remuneration policy clearly demonstrates how executive pay is linked to overall and individual performance and, together with annual bonus targets, how these are linked to delivering for our customers, stakeholders and communities. The policy and executive pay will continue to be closely monitored by our Remuneration Committee.

We have revised our dividend policy to align it with Ofwat's expectations. Our policy is published annually, alongside a transparent explanation of how it has been applied, highlighting how any payments continue to reflect our promises, obligations and commitments to customers. Rather than a complex set of rules, we share a simple set of principles, which embody our commitment to ensuring a fair deal for all, in line with ethical business practices.

We also support Ofwat's revised Board, Leadership, Transparency and Governance Principles, which applied from 1 April 2019.
We have adapted our governance to ensure we comply with the Principles, and will continue to do so. Our Board approved our revised governance terms of reference in February 2019. This can be seen at: **southernwater.co.uk/board-committee-terms-of-reference**.

Strengthening our leadership

In last year's report our then Chairman, Bill Tame, reported that the Board had presided over some key changes to Southern Water's Executive Leadership Team (ELT). These were interim adjustments to support rapid business change. However, further evolution of the ELT has come about during 2018–19, with a new governance structure established and further supporting roles created to ensure the company's transformation can continue at pace. Our Chief Executive will outline this structure in more detail in his summary (pages 19 to 25).

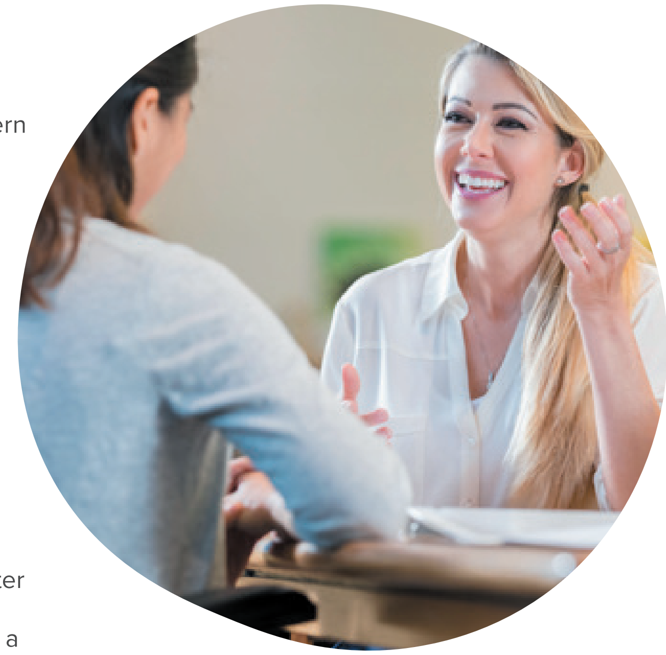
My thanks go to my fellow Board members for their level of commitment to providing that stable base on which Southern Water can continue its journey to becoming a better business. In particular, I would like to thank Bill Tame for steering the company through a time of significant change and transformation. Recognising the need for continuity through the rest of the five-year period, he resigned to allow a new chairman to lead the company in 2019–20 and beyond. Our search is well advanced and we hope to announce a new chairman shortly.

We also welcome Gillian Guy to the Board. Gillian joined in November 2018 and has brought a rigorous focus on governance and business performance, as well as on customer insight and transformational change management. We are also recruiting two more independent non-executive directors to support our transformation.

We were pleased to appoint Sebastiaan Boelen to the position of Interim Chief Financial Officer in December 2018, replacing William Lambe. I would like to thank William for his contribution to the company.

Thanks are also due to the members of our Customer Challenge Group (CCG), which continues to be chaired by Anna Bradley, for providing an independent and critical eye, from a customer perspective on both Southern Water's ongoing performance, but chiefly on the development of its plans for the future. The CCG members provided a lot of support and insight as we prepared our Business Plan submission.

“We are pleased to see that we are rapidly improving our engagement rating among our employees”



A better place to work

To continue to provide essential services to customers, Southern Water needs to recruit and retain skilled employees, and to do this we need to ensure all employees are treated fairly and respectfully. Over the past two years, we have conducted a Gallup feedback survey and are pleased to see that we are rapidly improving our engagement rating among our employees. We are also working hard to embed an ethical culture of 'doing the right thing'.

The company's Gender Pay Gap report published in March 2019 stated its median gap for 2018 was 7.5% (2017: 9.0). This reduction is largely due to talented female candidates being appointed to some of our key roles through external applications and internal promotion.

We know there is more to do. This year, the company has taken active steps to ensure its talent pipeline has strong female representation. These include a development event designed solely for female employees, alongside a programme of visits to local schools and colleges to encourage young people to consider science, technology, engineering and mathematics (STEM) careers, and think about working for Southern Water when they leave education.

A full report on Southern Water's management of its gender pay gap can be found at: **southernwater.co.uk/gender-pay-gap**.

> **"Adjusting to change can be hard, but with change comes the opportunity to innovate and improve, something that is encapsulated in the company's new values"**

A new sense of purpose

To live and breathe the new purpose that sits at the heart of our 'Water for Life' brand – to enhance health and wellbeing, protect and improve the environment and sustain the economy – everyone who works for and on behalf of Southern Water needs to pull in the same direction. This is why a huge amount of time and effort has been invested during 2018–19 to define this sense of purpose and galvanise the passion and dedication felt for our communities within three new values: succeeding together, doing the right thing and always improving. These values, alongside a renewed focus on ethical business practice at the same time, form the foundations supporting real and lasting cultural change within the business so mistakes made in the past are prevented from happening again.

By working these values into our decision-making, our employees – and, indeed, our customers, stakeholders, shareholders and regulators – can be sure that Southern Water is working hard, every day to become a better business; a business everyone can trust and have confidence in.

On behalf of the Board, I would like to take this opportunity to thank all Southern Water employees, partners and contractors for their continuing hard work, especially during this period of transformation and rapid change within the business. Adjusting to change can be hard, but with change comes the opportunity to innovate and improve, something that is encapsulated in the company's new values.

A look ahead

Southern Water has a long-term transformation strategy in place to ensure it can deliver on its commitments to customers, stakeholders, shareholders and regulators efficiently and cost-effectively. Our plans are set out clearly in our Business Plan 2020–25, Water Resources Management Plan (which looks 50 years into the future) and Drought Plan (which is reviewed regularly to reflect changes in weather patterns).

Those plans for 2020–25, and beyond, include:

- building further resilience into our water supply network by continuing to help our customers reduce consumption, increasing our water reuse and renewing our efforts to drive down leakage
- working with stakeholders to keep rivers, lakes and coasts clean and healthy
- investing to improve the resilience of our wastewater network
- investing more than £800 million to meet the demands of the Water Industry National Environment Programme
- creating sustainable communities by working with local partners
- making the most of our most valuable natural assets to boost the economy of the South East
- delivering on plans to create new water resources to counter a number of new restrictions in water supply that we face, for example, on the Rivers Test and Itchen in Hampshire.

The coming year will present many challenges for the business as we enter the final year of delivery of our Business Plan 2015–20 and ready ourselves to deliver our Business Plan 2020–25 (**southernwater.co.uk/our-business-plan-2020-25**). Extreme weather incidents, climate change and a growing population will continue to put a strain on our existing assets. As we continue with our transformation programme, we see big opportunities to harness innovation, technology, IT and data to make us a more efficient and forward-thinking organisation.

Our leadership team has a plan to achieve this and the Board and I are confident we can do what is required to reinforce a cycle of continuous improvement into the next delivery period and beyond.

Paul Sheffield
Acting Chairman

Chief Executive's summary

Transforming together for a more resilient future

When I joined the business in 2017, I was keen to separate dealing with our legacy issues from the need and ambition to undertake a rapid transition of the business to enable us to deliver a new Business Plan 2020–25 and to create a resilient water future for customers in the South East.

In last year's report I talked about how we had made progress in terms of our customer service performance and the strengthening of processes and reporting procedures and accountability. We were, and still are, focused on becoming brilliant at the basics and providing high-quality services at a price that's affordable to all of our customers while protecting our environment and preparing ourselves to meet the challenges of an uncertain future.

We are now two years into an ongoing programme of transformation. A lot has happened over that time and we have achieved a number of successes we can be proud of, while of course recognising there is still more to do to build trust with our customers, stakeholders and regulators.

"We have achieved a number of successes we can be proud of, while of course recognising there is still more to do to build trust with our customers, stakeholders and regulators"

We have built new systems, developed new processes, are establishing values-based ethical business practices and, most importantly, we have brought in the right people to deliver that step change, with new skills and talent acquired at Board, Executive and Senior Management level, as well as throughout the rest of the organisation.

In consultation with our regulators and partners, we have developed a stronger governance structure, with detailed plans, which we are aligning to our risk process. These plans are monitored regularly by the Executive Leadership Team, Board, our Customer Challenge Group and our regulators.

Ian McAulay

As our Acting Chairman has already outlined, in a number of areas our historic performance has not been as good as our peers and we are working hard to make improvements. We have also been addressing historic challenges from our regulators Ofwat, the Drinking Water Inspectorate and Environment Agency.

The investigations by the Drinking Water Inspectorate (noted further on page 66) and Environment Agency (noted further on page 26) are ongoing.

Since June 2017, our wastewater treatment compliance has been under investigation by Ofwat due to breaches of our licence conditions and statutory obligations during the period from 2010 to 2017. We have fully supported these investigations and completed our own internal review, which has highlighted failures of people, processes and systems during that time.

I was brought into the company in 2017 to drive change and transformation. Since then we have been working hard to understand past failings and implement the changes required to ensure we better deliver for our customers and meet the standards they deserve.

We are deeply sorry for what has happened. There are no excuses for the failings that occurred between 2010 and 2017 outlined in Ofwat's report. We have clearly fallen far short of the expectations and trust placed in us by our wastewater customers and the wider communities we serve.

We are fully committed to continuing the fast pace of change delivered since 2017. There is a lot more work to do but we are pleased to have agreed with Ofwat a package of reparations that enable us to fully make amends to our customers and regain their trust as quickly as possible.

For full details of the Ofwat investigation, read page 26 or visit **southernwater.co.uk/ofwat-investigation**.

A strong set of values and a clear purpose will help us meet future challenges

A good company delivers great performance results, while making sure it can continue to do so tomorrow and into the future. It must also have an ambition, a sense of purpose and a clear set of actionable values. How we do things is just as important as what we deliver.

This is why we have reviewed our vision, purpose and values to align them clearly with our business strategy and commitments to our customers. By succeeding together, doing the right thing and always improving we will be better placed to meet the challenges we, and the rest of the industry, are facing.

When Sir James Bevan, Chief Executive of the Environment Agency, spoke about the 'jaws of death' in March 2019 and how our country could run out of water in less than 25 years, he crystallised what for many is the defining challenge facing our industry.

Climate change and population growth are no longer distant spectres haunting our future, they have become our present reality. We face this challenge at a time of exceptional uncertainty at the social and political level, when our industry is firmly under the microscope. But we cannot succeed alone.

There has never been a better opportunity to change our society's perception of the value of water and the benefits it brings to our communities and economy, and the part we all play in securing our future.

I am proud to lead Southern Water as we transform our relationships with our customers, our environment and the communities we serve.

A brief look back on our performance during 2018–19

Southern Water faced a number of key challenges and risks during 2018–19. We met these head on by working closely with our regulators and stakeholders to develop and start implementing our transformation plans.

Our leakage performance for this year has been worse than expected, at 102 Ml/d (2018: 89 Ml/d), following the unusual Freeze/Thaw event in March 2018 and the hot, dry summer. This means we will not achieve our year-end target. This performance is disappointing against the backdrop of having one of the best leakage performances in the sector and we have invested significant resources to bring our leakage figures down. We have taken action and now have 30 new teams dedicated to finding and fixing leaks and changed the way we work with our partners. As a result we are fixing more than ever before – approximately 36,000 during 2018–19 alone.

The Secretary of State has now signed new abstraction licences for our western region, which reduces the amount of water we can take from the River Test and River Itchen in Hampshire. The licence reductions aim to secure the health of these rivers while reducing the amount of water we can take from them during drought. The changes mean a shortfall of some 135 million litres of water a day during a drought – about 80% of the amount needed to supply our customers in south Hampshire, which will likely mean putting in place water restrictions for some of our customers right through to 2027.

> **“There has never been a better opportunity to change our society's perception of the value of water and the benefits it brings to our communities and economy”**

We have until 2027 to meet the new conditions and plan to invest more than £800 million to make up the deficit, while ensuring water resources continue to be resilient and environmentally sustainable. Our wide-ranging plans, some of which will need Ofwat and Environment Agency approval, include desalination, new pipelines from neighbouring water companies, reducing leakage and improving water efficiency.

Following the Freeze/Thaw incident last winter and subsequent summer heatwave we have made further improvements in how we prepare for and manage incidents. We invited directly affected customers to take part in a two-week community exercise to get their views on how we can manage events more efficiently. This is part of an ongoing programme of work, which includes further action groups to ensure an ongoing dialogue with customers.

Pollution performance has deteriorated during 2018, including three more serious pollution incidents than in 2017. To address and understand root causes we have put in place a Pollution Reduction Plan, including both the development of a dedicated Pollution Task Force as part of our Environment+ programme.

Our Environment+ and Water First transformation programmes have been developed to refocus core activities on quality and compliance.*

Our Risk and Compliance directorate is leading improvements in our business processes and systems, governance and controls as well as data integrity and planning, scheduling, monitoring and performance reporting for our regulators. Further information can be found in our Final Assurance Plan 2018 and our Data Assurance Summary 2019, which are available at: **southernwater.co.uk/our-reports**.

Brexit, and its consequences, are top of our customers' minds right now, and its wider implications have the potential to create a significant impact on our sector over time, with many of the chemicals used in water treatment historically imported from the European Union. We made sure that plans were in place for all scenarios to ensure our supply chain was secured such that we can continue to deliver on our promises to customers and we have supplied a list of these chemicals to be included in the British Chambers of Commerce risk register.

While we have been focused on addressing these and other challenges, we have also delivered some significant achievements as part of our ongoing transformation programme during 2018–19. These have included:

- Improvement in our bathing waters: a further nine bathing waters were classed as 'excellent' in 2018, taking our total to 62 (2017: 53 'excellent', 2016: 51 'excellent') with none 'poor'.
- A steady performance in terms of our Service Incentive Mechanism (SIM) or customer satisfaction score of 80 (2018: 79) moving us from 15th in the industry league table to 13th position. This is a significant step forward, although we recognise there are still improvements to be made. (See page 44) for more detail on our customer service performance.)
- In 2018 we celebrated receiving our 20th consecutive Order of Distinction from the Royal Society for the Prevention of Accidents.
- External recognition for the marked improvements we have already made from Ofwat, the Drinking Water Inspectorate and, most recently, the Consumer Council for Water (CCWater).
- A Blue Star award for innovation or stand out ambition in environmental commitment, for our Target 100 programme, awarded by the environmental coalition Blueprint for Water. We were one of only six companies to receive this accolade.
- A renewed focus on catchments to improve how we collaborate with key stakeholders in the water quality chain. (Read more about our Catchment First approach in 'A constant supply of high-quality drinking water' on page 62.)
- The appointment of a dedicated Wellbeing and Health Manager and a team of wellbeing champions across the business with a roadmap in place, helping us achieve both the Workplace Wellbeing Charter and Time To Change (mental health awareness) standards. For the charter, documentary evidence, interviews and site tours are used to assess our performance in eight wellbeing-related fields. During 2018–19 we met the minimum commitments in all eight areas and exceeded these standards in six – achieving 'excellence' in the field for health and safety. We are really proud of this recognition and believe this accreditation demonstrates our commitment to improving the lives of those who work at Southern Water.
- The roll-out of our Operational Excellence (OE) programme to more than half of our operational teams, improving collaboration, compliance and resilience. OE will continue to be embedded across our remaining water and wastewater teams in 2019–20.

* You can read more about our Pollution Task Force activities, Water First and Environment+ in the 'Constant supply of high-quality drinking water' and 'Looking after the environment' chapters on pages 62 and 74 respectively.

Our financial performance

As described above, 2018–19 has been a busy year in which we have continued our transformation journey and prepared our Business Plan 2020–25. The associated costs are reflected in our operating profit for the year (excluding the impact of the regulatory settlement) which fell by £6.9 million to £256.4 million.

In particular, as part of the transformation programme, we have spent an additional £5.9 million, redesigning processes and systems as well as the structure and culture of the business, to ensure that we are ready to deliver our Business Plan for 2020–25.

I am pleased that the first year of our transformation programme is already delivering benefits and, having made improvements to the structure of our Customer Services department and contracts, we realised efficiency savings of £5.1 million in the year. In addition, improvements to our debt collection processes resulted in a further cost reduction of £1.7 million. These will all help us to reduce bills to our customers in the coming years.

In order to achieve the targets set by Ofwat for what we spend on serving customers, together with an overall water bill reduction for householders of more than 5% over the next five years, we need to keep on improving. To meet these challenges we are making further changes in Customer Services and are creating a centralised delivery model with specialist partners establishing a new Retail team to lead and deliver our customer strategy.

“I am pleased that the first year of our transformation programme is already delivering benefits”

As I mentioned earlier, we have committed additional resources to tackle the increased level of leakage experienced and this resulted in additional investment of £1.7 million in the year.

During the year we submitted our business plan to Ofwat and responded to Ofwat's Intial Assessment of our plan. This work, which included consultations with customers and stakeholders, increased our operating costs in the year by £2.7 million.

Following its investigation into our wastewater treatment works compliance reporting, Ofwat has confirmed its intention to impose a penalty under Section 22A of the Water Industry Act. This penalty comprises a fine of £3.0 million together with a reduction to future revenues of £122.9 million (at 2017–18 prices) which will be made by way of a rebate to wastewater customers over the period from 2020 to 2025. We have provided for these in full in the financial statements for 2018–19 resulting in a reduction to operating profit of £138.5 million (at outturn prices). As a result operating profit after the regulatory settlement was £117.9 million. For more information please see page 26 of this report or visit **southernwater.co.uk/ofwat-investigation**.

In 2018–19, our capital investment programme continued at pace as we completed the fourth year of our current business plan. In total, we spent over £440 million investing in our assets during the year. This included a scheme designed to improve the quality of bathing waters at seven sites to an excellent standard (as defined by the EA), the ongoing redevelopment of our Woolston wastewater treatment works, work to upgrade our Millbrook wastewater treatment works and improvements to our sewer network in Thanet.

As our Acting Chairman stated in his introduction, the water industry has been the focus of considerable scrutiny during the year, not least in relation to how the industry is financed. We have responded to this by refinancing to reduce our gearing and are in the process of closing our Cayman Islands registered subsidiary.

Any changes we make to our financial structure, along with the continued capital investment in our assets and transformation activities, will be focused on ensuring we have a stable financial base to deliver on the commitments made in our current and future business plans.

We must act on what we hear from customers in order to meet their expectations

We exist as a business to provide high-quality water to our customers and take their wastewater away efficiently. This is an accurate description of what we do, but it understates our wider social responsibilities, which is why we have now broadened our outlook.

Through consultation with customers, employees and key stakeholders, we have arrived at a much more compelling purpose statement: to provide water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy.

However, I think even this still underestimates our potential and ability to influence a much larger conversation with our customers, our peers and government about the value or wider societal and economic benefits of water.

Our customers' expectations are changing and people's perceptions of big businesses, like ours, is that they do not always work for the optimal benefit of society. We want to change that and be seen to take the lead in areas like protecting the environment and developing young talent in our communities.

With this in mind, I have recently been involved in a Water UK group, which came together to develop a series of sector pledges with like-minded chief executives from across the UK water industry. In practice, this will mean water companies: working together to pool resources; offering education, incentives and support to local communities; and working to reduce leakage, secure additional supplies and lobby for changes in key areas such as housing development, metering and water labelling. In turn, this would give all companies more credibility in conversations with customers and community partners about actively reducing water use. In my position as Chair of the Greater Brighton Infrastructure Panel, I have already seen examples of this collaboration in action; our Water Plan, supporting water usage reduction targets in the city and surrounding area, is just one example.

However, the social contract goes beyond industry collaboration. Our customers want to be active participants but, to get there, they need help from us and our partners in the community. Our Target 100 programme, to drive down individual customer water consumption, is fundamentally a modern social contract, perhaps the first of its kind in the industry. It embodies our commitment to, and agreement with, our customers and consumers to manage water resources wisely. We will help customers to contribute through providing education at all levels, incentivising reduction through community reward schemes and more direct support through many thousands of water-saving home visits. We know that customers associate water efficiency with leakage and there is, rightly, an expectation that we fulfil our side of the bargain as a water utility provider by playing our part and substantially reducing leakage.

Putting all of this together, for me, is what enshrines Target 100 as a social contract. It is the right thing to do but we cannot do this alone. To achieve greater efficiency more action is needed by water companies, government, regulators, non-government organisations and citizens across all our communities.

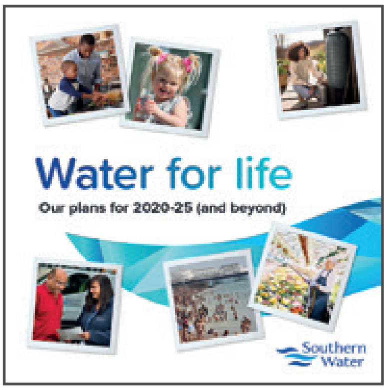
Preparing to deliver our business plan

As I have already mentioned, a number of changes are taking place across the business, as part of our transformation programme, to make sure we can deliver the cost efficiencies asked of us by our regulators and are ready to deliver our Business Plan 2020–25.

During 2019–20 these changes will include:

- a renewed focus on a set of clearly defined performance indicators to encourage employees to shift their focus to achieving our targets in critical areas
- further development of our Water First, Environment+ and Operational Excellence programmes, promoting cross-team collaboration, a focus on compliance and cost efficiency
- a halt on projects that are adding least value so resources can be redirected to more critical tasks
- the promotion of our innovation lab bluewave as a problem-solving resource for the business
- a new cost-management system to integrate key capital project scope, cost, schedule and risk data
- implementation of a new buyer/supplier portal allowing costs to be controlled more efficiently
- further embedding our revised company values to drive culture change within the business
- investment in our IT infrastructure to bring services back in-house.

"Every day affords opportunity to turn Southern Water into a better company"



Our Business Plan 2020–25, co-created with our customers

In September 2018, we submitted our most ambitious five-year business plan yet following a comprehensive consultation with customers and stakeholders. It outlined our proposed plan to achieve our vision to create a resilient water future for customers in the South East.

That consultation involved us broadening the conversations we were already having with customers. This included capturing their views on a range of new topics via a series of workshops, interviews and surveys. To increase our level of insight, we used new techniques, such as choice experiments, apps and online polls. All of this rich insight we gathered helped us create our Business Plan and will continue to help us better tailor our services to customers' needs but, more importantly, ensure our plans for the future reflect their priorities.

In January 2019, we received Ofwat's Initial Assessment of our Plan, placing us in the 'significant scrutiny' category. This means greater regulatory oversight to protect customers' interests. While Ofwat recognised our recent progress and highlighted some high-quality elements, it continued to have some concerns around our past performance as well as around specific areas of our plan including the areas of cost efficiency, long-term resilience and our track record in delivering for our customers.

Our Board and ELT recognised the significant challenges Ofwat made to our Business Plan. In our updated submission in April 2019, although we accepted a number of challenges, we also presented new evidence and analysis to provide greater confidence that we will efficiently deliver our environmental and customer responsibilities. We also made a clear commitment to continuous improvement, efficiency and long-term resilience.

In headline terms, we have:

- reduced the forecasted costs of delivering our plan
- provided evidence, analysis and argument in support of the remaining difference between our forecasted costs and Ofwat's assessment of the efficient costs to deliver our plan
- committed to delivering business improvement plans for past performance, incident management and operational resilience, with our delivery of these plans independently assured and reported regularly to our Board, Ofwat, the CCG, and other key stakeholders. These new ways of working are actioned through a number of groups:
  - **Opcom** – led by me and focused on the management of Business as Usual performance and compliance, delivery of targets and customer commitments. Opcom is made up of all operational directors.
  - **Transcom** – focused on all the transformation activities needed to deliver on our Business Plan 2020–25. It is accountable to the new role of Managing Director.
  - **Excom** – delivers liaison with the Board and Shareholders and is accountable for enterprise-level risk management and reporting.
- accepted the challenges on our Outcome Delivery Incentives in all but two areas, where we have assessed the targets to be undeliverable in the proposed timeframes
- committed to closer collaboration with other water companies to explore alternate strategic water resources to meet the supply deficit in our western region.

The actions outlined in this response are intended to reassure our regulators, customers and stakeholders that we will meet our regulatory, environmental and societal obligations and deliver on the promises we made, while reducing customers' bills by 5%.

We are improving and have a clear plan to achieve our goals. We fully understand the historical failings and we are urgently driving change across all areas of the business.

We have well established, structured, governed and detailed plans for our transformation. We understand what we need to do to be efficient for the next five-year period and our plans reflect that.

Our plans are driven through strong governance and application of risk management processes to ensure we are building an efficient and resilient organisation now and in the future.

With challenge comes opportunity

Changing the way we do things is hard and it will take time, effort and a lot of determination. It is a fact that, in spite of the progress we make every day, we are still dealing with legacy issues of the past. They are an unpleasant and difficult reality, especially where we let our customers down. The changes we have implemented over the past two years have delivered much improvement and we commit to driving relentlessly forward.

In doing so, we will make sure we continue to be open, transparent and honest, and co-operate with our regulators, key stakeholders and partners. We have introduced a new Code of Ethics in the organisation, asking our people to 'do the right thing' in everything they do which will help to build a culture that will, in time, engender trust and confidence.

As a business, we also recognise that our company is not yet as good as it could be, and we still have a way to go to improve. We are working very hard on transforming to enable us to deliver our Business Plan 2020–25. We have put in place a solid foundation to support that business strategy in arriving at an authentic purpose, set of values and an ethical business framework on which to base all future decision-making.

Every day affords opportunity to turn Southern Water into a better company and make it somewhere people want to work, a partner others want to do business with, a company at the heart of its communities and an organisation committed to continuous improvement for our customers, employees and partners, and for the environment.

Ian McAulay
Chief Executive Officer

Ofwat and Environment Agency investigations

In June 2017, our regulator Ofwat started an investigation into possible breaches of licence conditions and our statutory reporting obligations relating to the management and operation of our wastewater treatment works between 2010 and 2017.

We had already started our own internal review of these issues and as the review deepened we discovered a problem with sampling processes at some of our sites meaning that we needed to restate our wastewater performance for the period 2010–17. The findings of our own review were shared with our regulators at every stage.

The Ofwat investigation has since resulted in it giving notice that it intends to take enforcement action against us. To reflect the seriousness of the breaches identified, Ofwat has issued a Notice stating a proposal to impose a financial penalty of £3.0 million, details of which were published in June 2019.

In addition, we have agreed to make significant customer bill rebates, totalling £122.9 million (in 2017–18 prices), between 2020–25, in recognition of our failure to meet the expectations of our customers and wider stakeholders, as well as our regulators. This total will be made up of a rebate of £111.7 million, to be broken down and shared in equal amounts with wastewater customers over the next five years, from 2020 to 2025, together with a wastewater customer bill rebate of £11.2 million (in 2017–18 prices), which will be made during 2020–21. A provision of £138.5 million (in outturn prices) has been made in these financial statements for 2018–19, referred to throughout this document as the "regulatory settlement".

We know that a number of failures of people, processes and systems allowed these breaches to occur and we are deeply sorry for what has happened. Over the past few years, we have acted promptly and decisively to make sure that all of the issues identified in the investigation are being addressed.

This has involved making fundamental changes to the way we operate. Over the past two years these changes have included a full company restructure, a new executive team and a strengthened Board. We have also put new systems in place to safeguard our services, our whistle-blowing procedures have been enhanced, and a revised set of company values are being embedded. These actions, along with a Modern Compliance Framework, are already changing the culture in Southern Water.

For more information, please visit **southernwater.co.uk/ofwat-investigation**.

We are also under investigation by the Environment Agency regarding the historic performance of certain wastewater treatment sites and the reporting of relevant compliance information. We are seeking to work proactively with them to resolve these investigations which are still evolving. At this time, there is no clarity of the findings of these investigations or further action or associated financial impact, if any. As a result no provision has been made in the financial statements for 2018–19. We have disclosed further details of this contingent liability in note 32 to the financial statements.

> **"Over the past few years, we have acted promptly and decisively to make sure that all of the issues identified in the investigation are being addressed"**

Our culture

Since 2017 we have thought long and hard about the kind of company we want to be and, more importantly, how we are viewed by our regulators, customers and stakeholders.

Our new Executive Leadership Team is driving cultural change and values-based ethical business practice across our company. During 2018–19 we embarked on a project to redefine our purpose and values, and ensure they are aligned to our business strategy and vision to create a resilient water future for customers in the South East. This formed part of a wider engagement process with our employees, customers and stakeholders to find out what they thought about Southern Water, what we stood for and what we needed to deliver.

We carried out research into admired brands, mapped more than 100 customer and stakeholder interactions, and used feedback from a series of employee and customer workshops to start to build a consistent story for Southern Water about who we are and why we exist. We also added a number of values-related questions to our Gallup employee engagement survey, which will help us track our cultural transformation going forward.

Our redefined purpose is to provide water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy. This is our definition of who we are. It is our DNA and is reinforced by every interaction we have with colleagues, customers and our wider communities.

Our values support this statement and reinforce how we do things for all of our customers by succeeding together, doing the right thing and always improving. These values allow us to build a solid decision-making framework across everything we do.

Ethical business practices and a Modern Compliance Framework support this wider culture change. A key element of this is a new Code of Ethics and Quick Check decision-making tool, which enable all employees to adhere to a set of common, ethical working practices and sense-check their actions against our values.

“Our redefined purpose is to provide water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy”

Our people

Our Board

The Board is responsible for the strategic direction of our business. The majority of its members are independent of Southern Water. As of 31 March our Board was made up of:

- one independent non-executive chairman
- two executive directors (the Chief Executive Officer and Chief Financial Officer)
- four independent non-executive directors
- two non-executive directors.

As reported elsewhere, Bill Tame, our Chairman, resigned from the Board on 31 March 2019. Pending the appointment of a permanent successor, Paul Sheffield, the Senior Independent Non-Executive Director, has acted as Chairman. We expect to announce the appointment of a permanent Chairman and two further independent non-executive directors shortly.

Members of the Board and Company Secretary at 31 March 2019 are pictured below. From left to right:

- **Wendy Barnes** – Non-executive Director
- **Mike Putnam** – Independent Non-executive Director
- **Sara Sulaiman** – Non-executive Director
- **Richard Manning** – Company Secretary (replaced Joanne Statton in July 2018)
- **Ian McAulay** – Chief Executive Officer
- **Rosemary Boot** – Independent Non-executive Director
- **Sebastiaan Boelen** – Interim Chief Financial Officer (replaced William Lambe in December 2018)
- **Gillian Guy CBE** – Independent Non-executive Director
- **Paul Sheffield** – Senior Independent Non-executive Director (Acting Chairman from 1 April 2019)

Not pictured:

- **Bill Tame** – Chairman (until 31 March 2019)

Our employees

To deliver our services across the South East we directly employed more than 2,300 people in Kent, Sussex, Hampshire and the Isle of Wight as of 31 March 2019. Many more people are employed by our partners.

Collaborating effectively with our partners is key to the success of every aspect of our business. Whether solving IT issues, supporting major construction projects, maintaining the buildings we work in or the systems we use, they, working with our own employees, enable us to meet our customer priorities.

Gender/diversity

We are committed to creating a diverse and inclusive workforce that represents the communities we serve. As an equal opportunity employer, we do not discriminate on the grounds of age, disability, nationality, ethnicity, sex, race, religious or cultural belief, sexual orientation or gender identity. We embrace diversity of backgrounds, cultures and perspectives and offer career opportunities based solely on each employee's ability to undertake their duties and responsibilities.

To make sure these values are reflected in our day-to-day activities, we have implemented equality training. We also offer ongoing equality-related advice, learning and development, so all employees are aware of their responsibilities around equality and diversity.

Before launching or changing any major strategy, project or process, we consider the potential impact on equality. We carry out equality impact assessments to make sure our decisions are fair to all employees and do not disadvantage any particular group. The assessment requires the potential impact on each protected group to be considered and evidence of any conclusions documented. Any concerns about inclusivity are given appropriate consideration beforehand.

One of our ongoing challenges is attracting female employees to our field and engineering areas in what has, historically, been a male-dominated industry. Overall, only 28.1% of our employees are female across the entire company. We are addressing this by promoting STEM careers at schools, colleges and community events. Meanwhile, we marked International Women's Day by celebrating women's achievements within Southern Water. We published a series of interviews in which women in a range of roles – from operations graduates to process scientists – shared their

experiences of the water industry and what they thought about gender-balance in the sector. We are also working to ensure our recruitment processes attract both genders and are free from bias.

In line with gender pay gap legislation, we report on data relating to salary, bonus and distribution of pay within Southern Water. For 2018, our report into gender pay differences revealed that – based on the median of all our employees' salaries – our gender pay gap was 7.5% in favour of men. This is ahead of our industry peers. Among the 16 regional water and wastewater companies that reported their gender pay gap – including us – the average was 13.6% in favour of men.

We are pleased that we have reduced our pay gap by 1.5% since last year, and that the initiatives we introduced for 2018 are starting to generate results. However, we acknowledge that more work needs to be done to continue reducing the gap, including promoting flexible working and our family-friendly policies, encouraging more women to be successful in senior positions, and expanding diversity monitoring. Our report on gender pay is available at **southernwater.co.uk/gender-pay-gap**.

To celebrate LGBT employees, families and communities, we took part in the first Worthing Pride in 2018. Our Community Ambassadors represented Southern Water at the event. In the lead up to the day, we promoted it on our intranet and shared details of how our employees could register to join the parade and be part of the celebration.

> **We have rolled out operations, business skills and management training to drive performance across all areas of our business**

Health and safety, security and wellbeing

The safety and wellbeing of our employees remains a top priority. To achieve a more joined-up approach, we have restructured our Health, Safety, Security and Wellbeing function, bringing together individuals from different departments into one team. This will help us drive best practice consistently throughout our business.

During 2018–19, we upheld our industry-leading health and safety record with some of the lowest accident statistics in the water industry. We recorded two periods of more than 100 days free of any reportable injuries among our own employees – and one 100-day period across our supply chain.

Our overall goal is still to have zero injuries. However, our target was to keep the number of reportable injuries below 0.28 per 100 full-time employees. We did even better with just 0.19. Major supply partners included in the rate are: Siemens, MTS, Cappagh Browne, GSF, MGJV, Galliford Try Southern Water Partnership, PN Daly, BTU, 4D Woolston, CMDP and Clancy Docwra.

To encourage our employees to voice any safety concerns, we continue to donate £2 to our company charity for every hazard reported.

For the seventh year, our Health, Safety, Security and Wellbeing conference brought together people from across our business and our supply chain to share the latest developments within the health and safety industry. For the first time, we incorporated drama-based learning during the event to bring important topics to life – including the consequences of accidents and how better decision-making can prevent them.

Our efforts to reflect the standards expected from major projects have seen our scores increase under the Considerate Constructors Scheme. Two of our £8 million upgrade projects were awarded marks above 40 out of 50.

Promoting employee wellbeing

While the impact of getting safety wrong can be severe, we recognise health must be taken just as seriously. As part of our restructure we have appointed a new health and wellbeing manager to spearhead our activities in this area. Following a detailed audit, we have also been awarded the Workplace Wellbeing Charter for our commitment to employee health and wellbeing. Documentary evidence, interviews and site tours were used to assess our performance in eight wellbeing-related fields. We met the minimum commitments in all eight areas and exceeded these standards in six – achieving 'excellence' in the field for health and safety.

To further promote workplace wellbeing, we ran a calendar of regular events throughout the year. These ranged from fun group competitions – like our Static Bike Challenge – through to taster sessions where employees could learn techniques such as mindfulness. We also ran information sessions on topics as broad as diabetes and resilience.

As part of our first Wellbeing on Tour campaign, our Wellbeing team visited sites across our network to raise awareness about the help and resources employees can access to support their mental health. We used the events to recruit mental health first aiders and now have over 30 trained individuals across our business. This reinforces our commitment to the Time to Change pledge – signed by our Chief Executive in 2017 – which aims to end the stigma around mental health.

Developing talent

We are committed to developing our employees and this remained a key focus during 2018–19. Our emphasis has been on making sure our employees are able to confidently carry out their roles to a high standard. In support of this, we have rolled out operations, business skills and management training to drive performance across all areas of our business.

At an operational level, we have focused on compliance and regulatory training – with particular attention given to our Wholesale Water, Wholesale Wastewater and Networks teams. We used a training needs analysis to identify the training support required by our Wholesale Water team. We created seven new learning modules for our Wastewater employees – and we have three additional modules under development. Meanwhile, to safeguard our network, we have trained over 180 employees on Level 3 water quality. In addition, we enrolled

300 people in incident management training to support our new incident framework and structure, which we implemented based on lessons learnt during last year's Freeze/Thaw and heatwave events. This is making us more resilient for the future.

In addition, we have revised our Code of Ethics which includes simple, easy-to-understand references to our policies and compliance procedures to embed values-based ethical business practice and enable all employees to assume a higher level of accountability for their actions.

To foster a culture of continuous improvement, we launched our Business Essentials curriculum which gives our people the opportunity to learn new business skills or improve existing ones. The curriculum contains a variety of courses, delivered by external training providers, which are designed to improve skills such as project management, productivity, communication, and commercial awareness. Since we launched the programme in September 2018, over 250 employees have attended the courses – with more scheduled to attend. Feedback from attendees has been excellent and we are committed to developing this programme further by continuously assessing the courses' effectiveness, updating the curriculum and building awareness of the courses on offer. We also continue to support our employees with external professional training, gaining diplomas and higher qualifications.

Development for managers has focused on foundational management skills. Our Role of the Line Manager programme supports our managers with toolkits on discipline, grievance, performance and attendance, as well as mind-maps and training videos. We also ran a series of drop-in sessions with our training video provider and additional training by our employee engagement partner was attended by our Senior Management team and around a third of line managers across the business.

We recognise the importance of inclusivity in attracting, retaining and developing talent and seek to eliminate bias at every stage. As such, equality remains a priority throughout our recruitment, retention and development policies and processes. For instance, we are committed to making sure female employees are fairly represented in our talent pipeline and succession plans and appropriate development is introduced to enable women to achieve senior roles so we can increase the proportion of women among our most highly paid employees from the 26.2% reported this year.

Charity and community action

We encourage our people to support charity and community projects and offer every employee two paid days per year to volunteer. During 2018–19, our people spent over 3,708 hours volunteering – equivalent to more than 400 working days. Together, we also raised over £137,000 for charity.

We celebrated a successful conclusion of our two-year fundraising partnership with the Kent, Surrey & Sussex Air Ambulance Trust. We exceeded our two-year pledge of £100,000, raising over £137,000 for the Trust. As part of our fundraising, we held a Family Fun Day at Bewl Water, employees ran the Brighton Marathon and 10K events and we donated the proceeds from our Static Bike Challenge.

Our new charity partner for 2019–20 is the Alzheimer's Society. We have made a fresh pledge to raise £100,000 to help support people living with dementia and fund research towards finding a cure. We will also use insights from this partnership to improve our service for vulnerable customers. Our employees also nominated five regional charities to receive a one-off grant of £10,000 for causes including animal welfare, hospice care, homelessness and sustainability.

In addition, we renewed a five-year partnership with WaterAid and have already raised over £42,000 to fund water-giving projects in some of the world's poorest communities.

Working with our communities

As a provider of essential services, we understand we have a duty to our customers and stakeholders. They have no other choice of supplier. Therefore, we are solely responsible for making sure their water-related needs are met. This is why we take their interests so seriously throughout our decision-making.

Our transformation plan is designed to help us become the water company our customers and stakeholders expect and rightly deserve. We frequently gather feedback from our customers to shape our strategy. We sought input from customer stakeholder panels to make sure their priorities were addressed in our Business Plan 2020–25. Meanwhile, insights from our customers were used during the development of our new brand – which centres on the value of water for our health, environment and communities.

Throughout 2018–19, we attended community events across our region to highlight the link between our work and our customers' lives. We are delighted to have reached 25,300 people at 32 events.

Our work with communities includes helping people understand how to use water wisely, keep their drains clear and, where possible, save money on their bills. To make these topics engaging, we introduced talk-show style panels, virtual reality experiences and interactive education boards – delivered from our bespoke community vehicle.

We also shared water-saving and blockage-prevention messages via 42 free Waterwise and Sewerwise talks for schools and groups. Meanwhile, our Sporting Chance programme – delivered in partnership with coaches from five prominent sports clubs – engaged more than 8,700 children at 35 schools. The children got to improve their sports skills while learning why water is important for health and how to use it responsibly.

With 700 miles of coastline and several rivers in our region, teaching children to swim and be safe in the water is crucial. That is why we run Learn to Swim in partnership with Swim England. We partnered with pools and clubs across our region to deliver the scheme for the 26th year. We also promoted safe sea-swimming in our region by sponsoring five events run by the Royal National Lifeboat Association and Swim England, which reached more than 2,700 children.

Our region's waterways are rich in wildlife, so we promote an interest in nature. In partnership with the Freshwater Habitats Trust, we piloted a unique STEM-based school project called Water Detectives. Schools used eDNA kits to discover the species living in their local ponds. The results are then uploaded to a national survey examining the UK's pond life.

For the second year, we held a Community Engagement conference to encourage businesses to build strong relationships with local communities and charities. More than 80 attendees received talks on STEM education, volunteering and social insight.

A great place to work

During 2018–19, we have continued to focus on employee engagement as part of our ambition to be a great company to work for.

We recognise that giving our customers the best possible service relies on our people carrying out their duties with passion and commitment. Our six-monthly employee engagement survey is at the heart of achieving this. It lets us capture feedback from our employees so we can take action to improve. To achieve the fullest possible picture of engagement levels, we encouraged employees to respond by donating £1 to charity for every survey completed.

In early 2019, we completed wave three of the survey. The results showed a meaningful increase in the majority of criteria and 30% of our teams reported improved engagement. Based on insights from the survey, our line managers are working with their teams to address areas for improvement. To facilitate this, we have trained over 40 coaches to support line managers with these follow-up actions. We have also introduced a new performance management approach, 'Me and My Performance', to ensure everyone knows what is expected of them in their roles.

Our engagement survey is just one way in which the views of our workforce are taken on board. We encourage two-way conversations between employees and our leadership team, as this enables our employees' interests to be factored into our decision-making. For instance, as part of our Operational Excellence programme, we wanted to provide a framework to empower our people to drive change, rather than forcing decisions from the top. Part of this included setting up hubs at all levels of our business that allow front-line issues to be rapidly escalated to our leadership team, so our front-line employees receive the support they need to perform.

Another way of capturing our employees' feedback is Open Floor on Tour, which we ran again this year. Senior managers and members of our Executive Leadership Team hosted informal meetings with employees across our sites. The sessions had no agenda – employees were simply invited to put forward their questions and share any thoughts and feedback.

To give employees a forum to share what is going on around the business, we introduced Workplace in June 2018. This internal social media platform has become one of our most popular communication channels. A total of 68% of our employees registered in the first six months. Members have used it to set up groups, post articles and organise polls – as well as arranging social events.

Working side-by-side with our partners

Working collaboratively with our partners is key to the success of every aspect of our business. Whether that is servicing the buildings we work in, maintaining the systems we use to manage our sites or supporting major construction projects, they enable us to deliver for our customers.

We have a third-party supply chain comprising a wide range of contracted suppliers, with an annual contract value of over £400 million. They range from major construction companies building new infrastructure to specialist organisations. Each and every one of them is integral to the delivery of our water and wastewater operations, 24 hours a day, seven days a week, 365 days a year.

To enable Southern Water to achieve its ambitious vision to create a resilient water future, we work side by side with our suppliers to foster a culture of innovation.

Whether dealing with an incident such as the Freeze/Thaw event, or working on strategic planning for our next price review and beyond, our suppliers are essential.

“Giving our customers the best possible service relies on our people carrying out their duties with passion and commitment”

Case study

Phil Tapping, Water Demand Manager

Collaborating for our customers

Among Southern Water's various supply partners, our established working relationship with PN Daly has become a model of collaboration.

PN Daly employees work with us on a daily basis, and often share office space with our own employees. They have dedicated teams who respond to our customers' billing enquiries and provide them with information on how to repair faults with their pipes and plumbing devices.

Using innovative techniques, including drones and satellite technologies, PN Daly also identifies leaks on our network. This requires its employees to collaborate closely with Clancy Docwra, our repair and maintenance service partner, by producing a leak repair tracker which prioritises work and minimises water loss and disruption to customers. PN Daly has contributed to our action plans to reduce leakage further.

PN Daly is also a trusted partner during an emergency incident, working with our Customer Service and Networks teams to run bottled water stations, deliver water to our vulnerable customers and help maintain supplies to customer taps – we can always rely on its support and flexibility. Plus, its health and safety performance is excellent. PN Daly generates the largest number of reported safety hazards across all of our service partners.

"PN Daly generates the largest number of reported safety hazards across all of our service partners"

Case study

Ashley Marshman, Wholesale Services Manager

Inspiring young people to succeed

Young people choose their GCSEs during year nine. So, they have to start making choices about their futures. To give pupils the skills to succeed, Brighton Aldridge Community Academy was organising a workshop about the world of work.

Volunteers from local employers were invited to talk to pupils about working life and share key skills to equip them for the future – including tips on how to start their own business if they want to.

I used one of my volunteering days to meet pupils at the school and share some of my experience. Altogether, 16 of us volunteered from Southern Water, alongside people from other local companies. We were greeted by the Vice Principal, who told us what he hoped students would get out of the day. Then, we were introduced to the pupils.

We started with the basics of how to write a CV. Then we looked at job descriptions and talked about interviews. As a manager, I've interviewed a lot of people. I reassured pupils that being nervous is normal and encouraged them to research companies beforehand.

We also discussed the importance of positive communication and body language. Afterwards, we carried out mock interviews based on different job descriptions.

Even though many of the pupils had no work experience, some were great at relating skills from their hobbies and social lives to the world of work.

At the end of the day, pupils received a certificate and we nominated those who had impressed us the most. I found the day really interesting – some of the pupils had really ambitious ideas about starting their own businesses. They were really tuned-in with today's pressures and saw the potential of things like apps and social media. I hope the skills they learned on the day will help bring some of those ideas to life.

“I used one of my volunteering days to meet pupils at the school and share some of my experience”

Our Business Plan 2020–25

in developing our Business Plan 2020–25, we asked for feedback from more customers and stakeholders than ever before. We are confident that our ambition meets their expectations and demonstrates how our business will create a resilient water future for the South East.

However, we fully accept the concerns Ofwat expressed in the Initial Assessment of our Plan in January 2019, including the need to demonstrate a deeper understanding of the resilience challenges we face, that some of our performance commitments were not challenging enough and that we could deliver our promises more efficiently.

In our response, submitted in April 2019, we explained the actions already taken and those we had committed to making to ensure our regulators, stakeholders and – most importantly – our customers can be confident we will meet their expectations.

Examples of the actions we have committed to were outlined by our chief executive in his summary on pages 19 to 25.

These actions are intended to reassure our customers, regulators and stakeholders we will meet our regulatory, environmental and societal obligations and deliver on the promises we made.

We are transforming our business

Our transformation programme is delivering tangible improvements across our business. We accept there is still work to do to address historical issues and to improve our operational performance.

We have identified past performance failures and plans have been put in place to rectify them. Our transformation programme is coordinating improvements across the business to ensure we start the next five-year period on a sound footing. Our Operational Excellence, Water First and Environment + programmes, already discussed in this report, are increasing efficiency and productivity, reducing risk, improving compliance and reinforcing operational resilience.

We still have work to do

Despite the progress already made, we accept we still have to improve our performance in many areas of the business and, at the same time, regain the confidence of our regulators, stakeholders and customers.

We are committed to delivering an independently assured set of plans which further address the underlying issues that led to poor business practices and reporting. Our delivery against these plans will be reported to Board, CCG, Ofwat and key stakeholders to enable transparent scrutiny.

Creating a resilient water future

Our universal metering programme and water efficiency initiatives have already increased our resilience to extreme weather events, such as the long, hot summer of 2018. However, incidents such as the Freeze/Thaw earlier that year highlighted that there are still shortcomings in our resilience and incident response.

Ofwat has asked to see additional assurances around the resilience of our services and proof that we have learnt from such extreme weather incidents and the accompanying financial shocks to our business.

In response, we are putting in place a systems-based approach to resilience, a draft of which we shared with Ofwat in May 2019. Our resilience plan will be independently reviewed.

Our water resources face significant resilience challenges – most notably the changes to our abstraction licences on the River Test and River Itchen in Hampshire. Meeting this challenge requires urgent, but considered, action.

We are working intensively with colleagues, both regional and national, to identify the most appropriate strategic water resources for the South East. This includes undertaking additional analysis to determine the role of the proposed Fawley desalination plant as part of a mix of regional solutions.

Changing the way we work, innovating as we go

We are working with partners across our region to develop innovative solutions to the collective challenges we face; Ofwat also recognised this in its Initial Assessment of our Plan.

We have expanded our approach to identifying potential bio-resources trading opportunities and are exploring innovative and market-driven options as part of our work to secure strategic water resources. We will share fuller information about our approach to bio-resources trading and our delivery plan for our Drainage and Wastewater Management Plan (DWMP) by August 2019.

Our transformation programme is driving cultural change across our business, including embedding a culture of innovation. This is championed by our Director of Customer and Commercial Services and is being facilitated by our expanding bluewave innovation lab.

> **“Our transformation programme is driving cultural change across our business, including embedding a culture of innovation”**

Moving forward together

We recognise that outside of the five-year price review process there is an enormous amount of change and challenge in the water and environmental sectors. We are in a period of dynamic transformation.

Our customers have asked us to invest in the future to protect and improve the environment. With the support of Ofwat, the Environment Agency and the Drinking Water Inspectorate, as well as other stakeholders, we can ensure that catchment-based and natural capital approaches become a more established way of sustainably improving resilience.

We are delighted to say that we have signed an initial agreement of understanding with our region's three Wildlife Trusts to enter into a strategic partnership which will help support the delivery of a range of tangible outcomes to benefit residents, communities and the natural environment. We are also in advance discussions with the Rivers Trust and National Parks regarding signing similar agreements in order to further expand our partnerships.

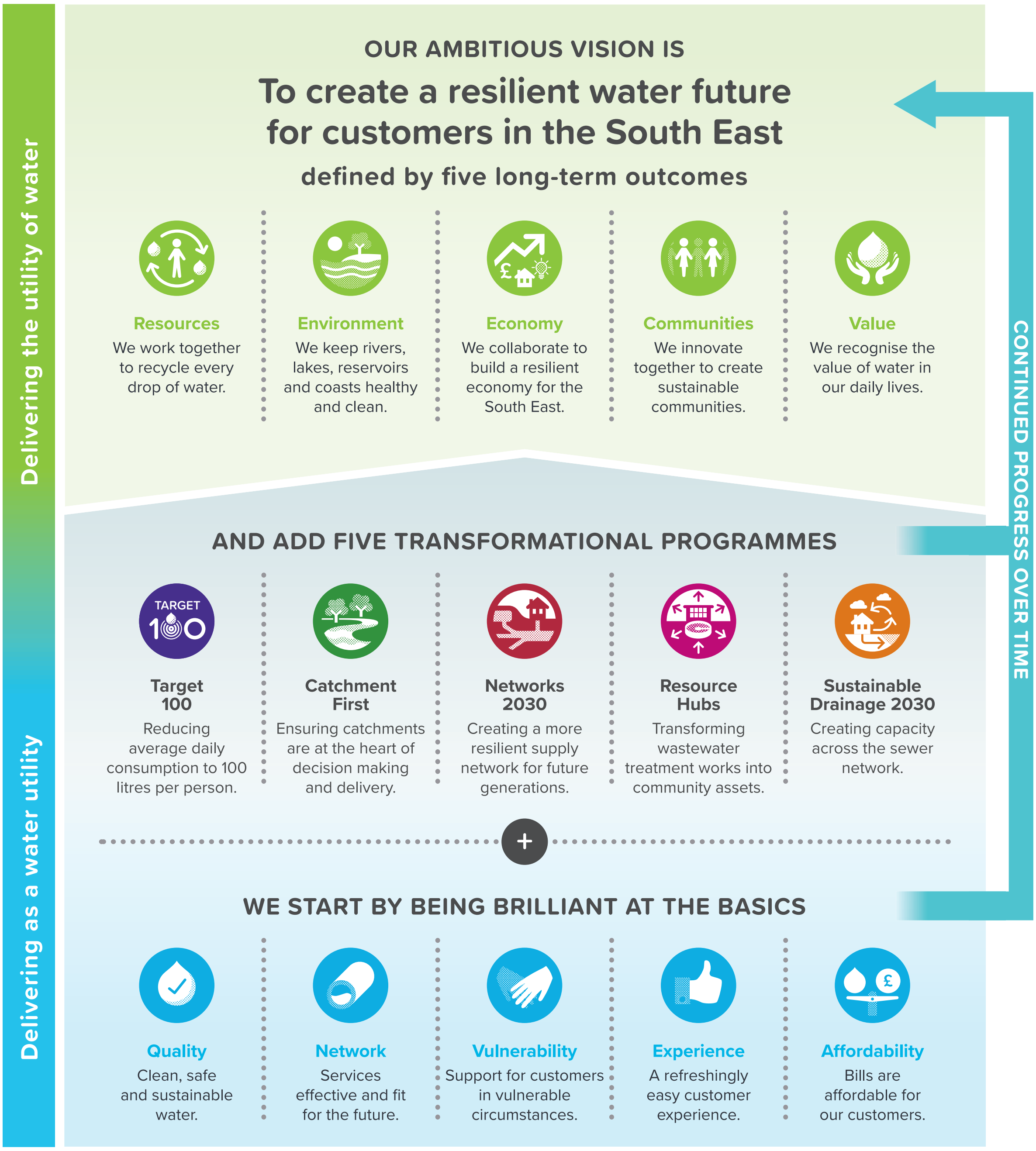
We look forward to continuing to work closely with Ofwat and our other regulators between now and the Final Determination in December, in particular to explore how we can take forward catchment-based investment and innovative approaches to environmental stewardship.

Our plan in summary

To create a resilient water future for customers in the South East we have developed five shared long-term outcomes, which will enable us to achieve our ambition through a combination of being brilliant at the basics and delivering five transformational programmes.

Being brilliant at the basics means delivering a number of key outcomes for customers in 2020–25. Successfully achieving these outcomes demands step changes in our approach, culture and some areas of performance, allied to a relentless discipline of continuous improvement.

Our transformational programmes support and build upon our plans to be brilliant at the basics. They have been developed from a combination of customer and stakeholder insight and innovative thought leadership. They have been tested and informed by UK and global best practice, and we believe they are examples of co-imagination and co-creation.



Case study

Lauren Tyler, Head of Innovation

Embracing smarter ways of working

We're under constant pressure from our regulators and customers to improve our service and bring down our customers' bills.

Plus, population growth means we face new challenges. We're always looking for new ways of working that will deliver better outcomes. However, we want to make sure any money we invest in innovation has the biggest possible impact.

With this aim, we set up our bluewave lab in June 2018. Based in a shared office space away from our operational sites, bluewave is a bit like a start-up. It gives our people a collaborative space to get away from their day jobs and get creative.

In the lab, we use agile working to innovate smarter and faster. Instead of long roadmaps, we work in sprints to quickly generate ideas and test them before we scale them up. For each sprint, we form a team to focus on a specific challenge. We spend the first 48 hours coming up with ideas, then select the ones that seem most viable. From here, we carry out rapid experiments to see which ones are worth developing. Once we've created a prototype or mock-up, we take it back to the business as a proof of concept to trial and progress further.

Ideas sparked at bluewave are already changing several areas of our business. So far, we've condensed the basic training we give new operations staff, so they can get going more quickly. We've developed new ways to remove phosphorus from the water supply. We've looked at how digitisation can make us more efficient – like using QR codes to autofill forms and save time for employees in the field. Meanwhile, as part of the EU-backed NEREUS project, we're exploring how to recover valuable nutrients from wastewater.

We already have over 25 research and development projects underway and we expect to achieve efficiency savings off the back of them. In future, we have plans to involve other water companies, utilities suppliers and tech firms in bluewave projects to deliver even better outcomes for our customers.

> **"Ideas sparked at bluewave are already changing several areas of our business"**

Our commitments to customers

In our Five-year Business Plan 2015 to 2020 we made 26 clear customer promises and a number of additional commitments following Ofwat's review.

Responsive customer service

- Quick and effective resolution of your queries – 90% resolved first time by 2020
- Improved service to you and your community – increase the number of customers who feel our service meets their individual needs and those of their community
- Improved ranking in our regulator's league table for customer satisfaction – be among the best by 2020
- Direct compensation paid if we let you down – this will be linked to the service standards set out in our updated Customer Charter

Looking after the environment

- No 'serious pollution incidents' affecting local rivers, streams and beaches caused by our operations by 2020
- Aim for 100% compliance by our wastewater treatment works with required standards – at least maintain performance at 98.6% (2014–15 target level)
- Increase by seven the number of beaches with 'excellent' bathing water quality by 2020
- Increase the proportion of renewable energy we use to 16.5% by 2020
- Reduce the amount of water we take from the environment by 1.4%, despite predicted population growth of 4%

A constant supply of high-quality drinking water

- No restrictions on water use, such as hosepipe bans, unless there are at least two dry winters in a row
- Reduce leakage by 2020 – target of 86 million litres a day by 2020, equating to a reduction of almost two million litres a day
- No increase in the average time you are without water, for example because of a burst water main
- Aim for 100% compliance with drinking water quality standards – at least maintain performance of 99.93% then 99.95% from 2017–18
- No increase in the number of households suffering from persistent low water pressure
- Help reduce the effect of hard water in homes and businesses – increased customer understanding through better information and advice

Better information and advice

- A 10% reduction (15 litres per person, per day) in average water use by 2020 with better advice on saving water, energy and money – we will reduce average water use from 148 litres (2012–13) to 133 litres per person, per day*
- Improved advice on how to prevent blocked drains to help reduce blockages – increase the number of customers who know how to help prevent blockages in drains and sewers
- A 50% reduction in bill queries by 2020
- Customers provided with better information about what we do, why we do it and what it costs – increase the number of customers who understand how we use the money they pay us

Removing wastewater effectively

- No increase in the number of blockages in our sewer network
- Significant reduction of 25% in sewer flooding inside your homes and businesses by 2020
- No increase in the number of incidents of sewer flooding affecting outside areas
- Reduction of 5% in complaints about smells from our wastewater treatment works and pumping stations by 2020

Affordable bills

- Efficiency savings made during 2015–20 to help keep bills as low as possible
- A 10% reduction (15 litres per person, per day) in average water use by 2020 with better advice on saving water, energy and money – this will reduce average water use from 148 litres (2012–13) to 133 litres per person, per day*
- Customers in genuine financial hardship provided with improved support – increase the proportion of customers who take up the support we offer around bills
- Customers provided with better information on how we are providing value for money – increase the number of customers who feel our services provide value for money

* Note this promise contributes to both better information and advice and affordable bills

How we track our progress

The table below shows how we have performed against our business plan commitments in 2018–19. Our Customer Challenge Group (CCG), regulators and technical auditors independently monitor this plan – see page 14 for more information on our CCG.

Further explanation of how we track our performance is set out in subsequent sections of this report.

Detailed definition and explanation for red/amber/green on each commitment, together with the potential reward/penalty associated with them, is given in Appendix 2 of the Annual Performance Report – this section of the report is also downloadable from: **southernwater.co.uk/annualreport**.

Responsive customer service

	Performance 2018–2019	Performance 2017–2018
Customer satisfaction Service Incentive Mechanism (SIM) score	Amber	Amber
Percentage of contacts resolved first time[1]	Red	Red
Percentage of customers who feel our service meets their individual needs[2]	Amber	Amber
Percentage of customers who feel our service meets the needs of their community[2]	Green	Amber
Number of compensation payments made to customers (Guaranteed Standards Scheme and Customer Charter)	Amber	Red

Our customer satisfaction score improved during 2018–19, taking us from 15th to 13th in the industry league tables.

The percentage of unresolved first-time contacts from customers remains high due to changes in the way it is measured since the target was set.

Affordable bills

	Performance 2018–2019	Performance 2017–2018
Customers in genuine hardship with improved support	Green	Green
Percentage of customers who feel our services provide value for money[2]	Green	Amber

As a result of increased engagement with our customers, we are very pleased to see that more of them feel our services provide value for money.

Better information and advice

	Performance 2018–2019	Performance 2017–2018
Water usage, per capita consumption (litres/head/day)	Green	Green
Number of unwanted billing queries (unwanted from a customer's point of view)	Red	Red
Percentage of customers who are aware of the causes of blocked drains[2]	Green	Green
Percentage of customers who are aware how their money is used[2]	Green	Amber
Percentage of customers who are aware of how to deal with hard water[2]	Amber	Amber

The root cause of every unwanted contact is analysed by our call centre teams, and we continue to review our processes.

In summary:

Green indicates where we have met or exceeded a performance commitment.

Amber indicates where we have missed a performance commitment but are still on target to deliver the outcomes we promised to customers over the five-year period.

Red indicates where we have not met a performance target and have not delivered the outcomes we promised to customers. In some cases we have incurred a penalty for the shortfall.

[1] 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.

[2] Our annual customer survey reached around 1,335 customers online or by post during March to April 2019 and is intended to give us a year-on-year customer view on a number of indicators from value for money to awareness of how to prevent blockages.

A constant supply of high-quality drinking water

	Performance 2018–2019	Performance 2017–2018
Water quality (Mean Zonal Compliance) (%)		
Number of contacts regarding discolouration per 1,000 population		
Number of properties with low water pressure		
Customer minutes lost supply > 3 hours		
Leakage (millions of litres of water per day)		
Number of customers affected by temporary use bans		
Maintain asset health		

Our water quality target for 2018–19 was 100% and we achieved 99.98%.

Residual damage to our network from the Freeze/Thaw incident in March 2018, rapidly followed by the prolonged hot summer, meant we were unable to meet our leakage target. It is likely, given current performance, that we will miss our five-year target.

Removing wastewater effectively

	Performance 2018–2019	Performance 2017–2018
Number of blockages per km/year		
Number of internal flooding incidents		
Number of external flooding incidents		
Number of customer complaints regarding odour		
Maintain asset health		

There was a spike in complaints about odour at our Portswood wastewater treatment works between April and August 2018 due to issues encountered during odour improvement works. Phase 3 of the improvement scheme is underway.

Looking after the environment

	Performance 2018–2019	Performance 2017–2018
Wastewater treatment works compliance (%)		
Maintain the number of bathing waters assessed with excellent water quality		
Number of serious pollution incidents (category 1 and 2)[3]		
Number of less serious pollution incidents (category 3)[3]		
Distribution input (Ml/day) (the amount of water put into supply)		
Renewable energy usage		

Our pollutions performance was unacceptable during 2018, with us recording 7 serious pollution incidents (category 1 and 2). As a result, a dedicated Pollution Reduction Plan has now been put in place, which was reviewed by the Environment Agency.

Our distribution input remained high due to the impact of the hot weather over the summer.

Our renewable energy generation decreased in the year due to maintenance work on our biogas assets.

[3] As we reported last year, following external assurance of the category 3 pollution data collected during 2016 and 2017, we identified a number of issues with the processes and systems used to generate that spills data, and we have now applied a confidence band to that data. The data is now subject to an ongoing improvement plan which is resolving long standing issues. The details of the steps taken to improve the robustness of the spill data collection, the data processing systems and the assurance of that data, have been shared with Ofwat and the EA. The improvements are being delivered although not yet completed; the spill data provided to the EA for 2018 was subject to a confidence band of +/- 10%. Improvements have led to a more granular understanding of process risk and enabled targeted interventions to increase quality. Our self-reporting of pollution incidents to the EA in 2018 has increased to 83%, one of the highest in the sector and well ahead of the industry average of 76%.

Financial impact of our performance

We highlight the financial impact of the Ofwat investigation into the historic management and operation of our wastewater treatment works on page 26 and this is excluded from the comments below.

A number of our Business Plan 2015–20 performance commitments have financial rewards and penalties associated with them. In 2015–16, we incurred a penalty of £1.5 million for not meeting our Maintain Excellent Bathing Waters commitment. In 2016–17 there were no penalties, while in 2017–18 we incurred a penalty of £0.3 million for our Supply Interruptions commitment.

Due to complaints resulting from the late delivery of a project to manage odours at our Portswood treatment works we have incurred a penalty of £1.6 million in 2018–19 and expect to incur an additional £0.2 million next year. We also incurred a penalty of £0.1 million due to not meeting our pollution incidents target.

For our 2015–20 leakage performance, there is now a forecast penalty of £2.7 million. We are, however, forecasting a reward for beating our target to reduce Per Capita Consumption (or average daily water usage) of £6.9 million and £1.2 million for bathing water improvements delivered ahead of schedule.

What we have achieved

	2018–19 Target	2018–19 Achieved	2017–18 Achieved	2016–17 Achieved	2015–16 Achieved
Customer satisfaction Service Incentive Mechanism (SIM) score	84	80	79	78	73
Contacts resolved first time (%)[1]	80	65	67	67	67
Customers who feel our service meets their individual needs (%)[2]	65	64	64	66	66
Customers who feel our service meets the needs of their community (%)[2]	35	35	34	35	33
Number of compensation payments made to customers (Guaranteed Standards Scheme and Customer Charter)	2,411	2,439	9,374	2,436	3,912

[1] 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.

[2] Our annual customer survey reached around 1,335 customers online or by post during March to April 2019 and is intended to give us a year-on-year customer view on a number of indicators from value for money to awareness of how to prevent blockages.

Responsive customer service

In two years our customer service transformation has delivered sustained improvements in customer satisfaction performance ranking and written complaints which reduced by 40%.

How we measure customer satisfaction

Ofwat's Service Incentive Mechanism (SIM) measures our customers' experience of dealing with us and provides an indication of how well we are serving those customers who have had reason to contact us. There are two elements to the SIM measure: an independent customer satisfaction survey and a summary of how many times customers have contacted us about a negative subject, including written complaints. The scores of each of these measures are combined to give an overall score out of 100.

We are pleased to report that, during 2018–19, our score increased to 80 (2017–18: 79). Although this is still below our target of 83.64, it means we have continued to steadily rise in the industry league tables, moving from 15th position for 2017–18 to 13th for 2018–19 out of 18 companies.

One reason for this improvement in satisfaction levels is a continued reduction in complaints. During 2018–19 we have recorded 1,603 (27%) fewer written complaints than this time last year, 66 (21%) fewer escalated complaints and 46,200 (20%) fewer unwanted contacts (unwanted from a customer point of view).

In the Consumer Council for Water's (CCWater) Consumer Complaints Annual Report, published in September 2018, we were still at the bottom of the industry league tables, despite having reduced written complaints by more than 60% over the past two years. Based on our continued performance improvement in this area, we hope to move off the bottom of its league table for 2019, with performance closer to the sector average.

A focus on root cause analysis of customer issues at our Complaints Action Group continues to drive this steady improvement, alongside proactive measures to address issues, such as higher-than-average bills, before they become a problem for customers.

A new measure of customer satisfaction

Our regulator, Ofwat, has decided that the SIM will only run for the first four years of the 2015–20 five-year business plan period while it trials and refines the new customer experience measure (C-MeX) to be introduced in 2020. As a result, it will not be carrying out the usual SIM scoring activity for 2019–20 and we are therefore focusing our efforts on understanding its new C-MeX methodology, while still trying to provide the best service possible for our customers this year and into the start of the next five-year period.

C-MeX is made up of two measures, a customer satisfaction survey and a customer experience survey. This means that it will take account of both what those customers who have been in contact with us think, along with those who have had no reason to be in contact.

There is also a new planned developer experience measure (D-Mex) being introduced. We have been told that, currently, it is not possible to forecast an opening figure for the new measures.

Faster resolution of customer queries

Our customers expect to be able to call us and have their problems or queries answered straight away. So we are disappointed that, again during 2018–19, we were unable to meet our target of 80% of contacts resolved first time, reaching 65% (2018: 67%). A large part of the reason for this measure remaining so low is the increased popularity of digital channels resulting in higher levels of contact. Our handling of this is under review.

A further restructure of our Customer Service area during 2019–20, creating a new, centralised delivery model, is expected to increase first contact resolution to at least 80%. This aligns with external benchmarking provided by the UK Customer Service Institute, which indicates an average of 81% of customers, across all sectors, are getting their enquiry resolved first time.

Looking after our customers' needs and those of the community

Each year, we carry out our own customer satisfaction survey, which indicated that, during 2018–19, 64% (2017–18: 64%) of customers felt our service met their individual needs and 35% (2018: 34%) felt that we dealt with the needs of their community. While we are disappointed that these satisfaction measures have not seen a substantial increase, we continue our efforts to improve our performance in this area. In June 2018, we presented our Customer Engagement Strategy to the CCG and, since September, started delivering on it with regular updates made to the group. Our engagement strategy has seen us ensure we have a much better understanding of customers' individual needs. This dedicated focus on customer insight has included work on operational complaints, incident management, pillars of great customer service and water efficiency.

> **“Our customers are clear about what they expect from us. They want a refreshingly easy customer experience, which means we need to do more to deliver the right experience, first time, every time”**

Ensuring guaranteed standards of service

Guaranteed Standards Scheme payments directly compensate customers that we have let down in some way, whether that is failing to meet an appointment time or an extended interruption to supply. This has exceeded the year's target of 2,411 payments. A flooding incident in Southampton was the primary reason for the rise in the number of payments to 2,439 at the year end (2018: 9,374).

Despite a decline in performance, this measure has moved from red to amber as there were fewer incidents than in the prior year and fewer than the starting point of the five-year period 3,711. Overall, we are expecting to come in under our five-year target by 2020.

Improving customer experience

Our **Customer Experience Strategy** group, made up of individuals from the business and our partners, was established during 2018 with the sole purpose of agreeing a business-wide approach to customer experience.

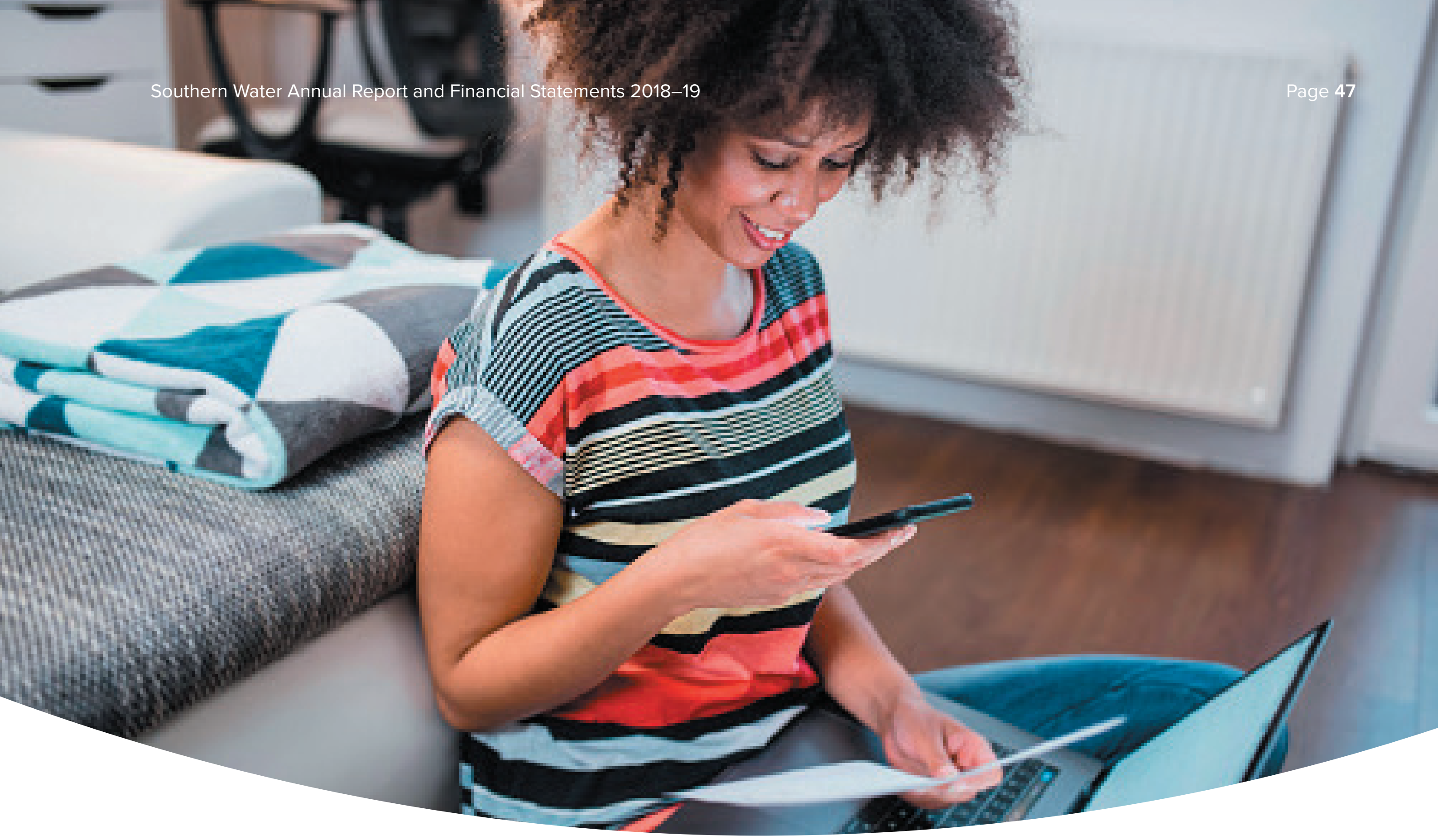
Our customers are clear about what they expect from us. They want a refreshingly easy customer experience, which means we need to do more to deliver the right experience, first time, every time.

The group agreed that we would do this by following these service principles:

- **We make it easy** – we work together to make every customer experience refreshing, going that extra mile for our customers and surprising them where we can.
- **We know our customers** – we ask the right questions to make sure we understand their needs and meet individual expectations.
- **We build trust** – we listen and always deliver what our customers need.
- **We make it count** – and get the most out of every interaction with our customers.

A similar set of principles has existed within Customer Service teams for some time, but will now be rolled out across all customer-facing departments across the business.

These service principles, and the delivery of them by our own teams and our partners – whether on our construction sites, out making visits, working to fix our network or in Developer Services – will ensure all of our many different customers receive a consistent, 'refreshingly easy' experience from Southern Water.



This strategy will also support further development of the Water for Life brand, encouraging customer participation and advocacy that are so important if we are to achieve our vision of a more resilient future for our region.

Delivering contact services with one experienced customer services partner, Capita, is at the centre of our transformation plan, and the transition is now well underway.

We have already moved all of our offshore billing and payment operations, customer correspondence work, onshore inbound mail processing, scanning and classification into Capita's operation. Over the coming year, there will be a focus on transitioning our outbound print and mail work streams from our existing partner into Capita. In addition, we will also be simplifying our bill to make it easier for our customers to understand.

Bringing these services under one strategic partner is key in driving enhancements to the customer experience, while allowing us to control our costs.

A newly established in-house Southern Water Retail team will lead this transition and deliver our customer strategy, including monitoring the quality of service our customers receive and focusing on continuous improvement, in liaison with our partners.

This will enable us to deliver a further improved service to our customers. However, it does mean existing customer teams will be impacted. Those affected have now entered a consultation process, during which they will be offered career advice and support.

In Developer Services, we introduced a number of changes throughout the year designed to give developers, self-lay providers and new appointments and variations an improved customer experience.

During 2018–19 we measured our customers' satisfaction using the new developer experience measure (D-MeX) for the first time. Our shadow reporting pilot taught us a lot about how we serve our customers and gave us the opportunity to feedback to our regulators, who responded directly by making changes to how survey scoring is distributed when more than one water company is involved.

Listening to feedback from our development customers, we grew our Key Account team, enabling us to improve the support we offer. This includes more frequent and better-segmented communication, new monthly progress meetings, and quarterly customer action groups with local authorities and our customers to encourage continuous improvement.

After carrying out a survey, we also streamlined a number of processes for our customers. All these changes have helped us to keep complaints at the same level as in 2017–18, while our levels of service have remained steady in an industry second-quartile position during 2018–19. We have also started our transformation programme which focuses on improvements to our services across growth planning, managing applications, delivery and customer account management.

Operating in an open market

Our second year as a wholesaler in the non-household market saw us make a number of improvements, as well as recognising challenges.

We launched our Wholesale Services Strategy and updated our commitment to retailers. We also improved our service by integrating non-household meter reading into Wholesale Services and offering an Accredited Entity scheme for disconnections, and payment performance credit support. Our operational performance for our non-household retailers has moved from bottom quartile in April 2018 to the top of second quartile in less than nine months. Our retailer satisfaction remains strong, with an average satisfaction score of 9/10 for customer experience during 2018–19.

By streamlining processes and introducing two inspectors dedicated to non-household work orders, we improved our operational market performance, jumping from the bottom to the top quartile. We also launched projects to improve our data and launched our leak allowance market guidance, making things simpler for retailers and customers, and aligning wholesaler policies across the industry.

Caring for customer information

It is our job to ensure the responsible handling of customers' personal information.

In May 2018 the General Data Protection Regulation (GDPR) came into force and introduced stricter rules on managing the use and storage of customer data. The legislation also addresses the broader issue of combatting cybercrime, something we take very seriously.

The new regulation is being adopted throughout the business but is particularly relevant for our customer-facing teams. As a result, we now have secure areas at our office sites, where information and conversations about customers can be restricted to relevant individuals only, and safely stored.

To read our full Privacy policy, visit: **southernwater.co.uk/privacy**.

"By streamlining processes and introducing two inspectors dedicated to non-household work orders, we improved our operational market performance, jumping from the bottom to the top quartile"

Case study

Customer letter to CEO, East Sussex

Excellent customer service

Early this year, I noticed a dramatic rise in my water consumption following a recent meter change.

I reported this fact to your engineers and, the same day, a technician called Darryl called. He was very thorough and after several tests and changing all the seals, was satisfied the problem lay in a faulty meter connection and arranged to have the meter chamber changed. Darryl continued to monitor the progress of the works and, when he was passing, took meter readings in order to calculate the amount of water lost, and consequently the necessary financial adjustments.

This week, I contacted Hannah on the Proactive team, who manages your Twitter account, and we discussed the situation. Having taken note of my weekly readings, she contacted me yesterday afternoon with her calculations. She asked my preferred way forward and we agreed the amounts, with the accounts being updated immediately. All this took place within 24 hours of my initial contact with Hannah.

The purpose of my email is to congratulate you, and your organisation, in employing people like Darryl and Hannah. They are friendly, professional, thorough and efficient; a credit to your organisation. Please pass on my congratulations to them both, and ensure they receive the recognition they deserve for their excellent customer service. I'm quite sure that I am not the only person that has been impressed with their professional confidence and assurance.

“[My] email is to congratulate you, and your organisation, in employing people like Darryl and Hannah. They are friendly, professional, thorough and efficient; a credit to your organisation”

What we have achieved

	2018–19 Target	2018–19 Achieved	2017–18 Achieved	2016–17 Achieved	2015–16 Achieved
Customers in genuine hardship provided with improved support	249,688	269,926	229,843	194,726	142,040
Customers who feel we provide value for money (%)[1]	56	60	55	57	61
Efficiency savings (£m)[2]	–	160	128	67	56

[1] Our annual customer survey reached around 1,335 customers online or by post during March to April 2019 and is intended to give us a year-on-year customer view on a number of indicators from value for money to awareness of how to prevent blockages.

[2] This is a cumulative figure over the five-year business plan period 2015–20.

Affordable bills

It is important to us to continue to increase the number of people on our range of support schemes and tariffs in need of financial assistance while also helping them to save water, energy and money.

We also made a commitment to drive efficiency savings to help keep bills affordable for our customers, whatever their situation and however it may change – £200 million as part of our £1.8 billion investment in our network from 2015–20.

The right support when it is needed

Our customers told us that providing those in genuine hardship with improved support was extremely important to them. We are pleased to report that we have exceeded our target providing tailored financial support to 269,926 (2018: 229,843) customers to date.

We launched a number of proactive campaigns using insight and data, from December 2018 and January 2019, which focus on renewing WaterSure payment schemes and supporting more customers in receipt of pension credits. Both campaigns have seen promising results so far.

We currently offer a range of payment schemes and tariffs, including:

- **Essentials** – for customers whose household income is less than £16,105, or for those in receipt of pension credit. The criteria for this tariff were changed on 1 April, 2019 to align them with those offered by our neighbouring water companies in the South, making the application process easier for customers and any support agencies they may be working with.
- **WaterSure** – for those who use a large amount of water as a result of particular medical conditions or large families.
- **Water Direct** – where bills may be paid from a customer's existing benefit schemes directly to us.
- **NewStart** – for those who owe us money but have not been able to make a payment for a while.

Additional services offered by our Affordability and Vulnerability team over the past year include:

- independent debt management counselling
- advice about how to access help from specialist support organisations within the community
- water-saving home visits, offering customers advice about how to save water, energy and money
- information and guidance about how to apply for one of our support schemes or tariffs
- training for Contact Centre and Customer Service teams so they can better serve customers in vulnerable circumstances at their first point of contact.

“We also made a commitment to drive efficiency savings to help keep bills affordable for our customers”

Working with our partners

It is only by further developing our relationships with local authorities, housing associations, debt advice groups and agencies like Citizens Advice that we will reach a better understanding of the needs of our customers in vulnerable circumstances, so we can offer the right support and help when it is needed.

Our dedicated Affordability and Vulnerability field team has continued to build on these partnerships to enable advice on water bills to be delivered to customers face to face.

The team, working with these partners, has also been focused on developing our Priority Services Register (PSR), which allows us to keep track of customers who require additional services, as well as prioritising those customers during an incident. We currently have around 18,200 customers on our PSR and we are aiming to increase this significantly over the course of 2019–20.

In 2018, we also improved the way we identify customers who need our help and built awareness of our services by collaborating with trusted partners that form our Customer Inclusion Partnership Network, such as Age UK and Citizens Advice.

Reducing the burden of bad debt on our customers' bills

By bad debt, we refer to the cost of accounting for bills that remain unpaid, and are likely to become uncollectable. Unfortunately, this has an impact on our charges for all our customers. It is also important we do all we can to help those in genuine financial hardship to reduce the burden of non-payment on others.

By improving the efficiency of our collection and debt management process, utilising segmentation to provide a more tailored customer experience, we have been able to take recovery action in the most appropriate way while also driving down bad debt for household customers during 2018–19 to £9.6 million (2018: 21.7 million).

Providing value for money

Around 60% (2018: 55%) of our customers currently feel we provide value for money. While we are very pleased to see an increase in customer perception here, we know we still have more to do to demonstrate the true value of our services to customers.

During 2018–19, the combined water and sewerage services for an average household was £436, costing less than £1.19 per day – around the same price as a loaf of bread. The same bill during 2019–20 will be £438, costing around £1.20 a day.

Our charges are set each January based on price limits agreed by our regulator, Ofwat. In addition, we seek assurance from our auditors and the Consumer Council for Water before they are finalised, ensuring transparency and independent scrutiny.

These charges are clearly broken down each year in the 'Making sure our customers know how their money is spent' (on page 58) section of this report so our customers can see, at a glance, how we use the money they pay us. An explanation of how these charges are set and reviewed is also available at **southernwater.co.uk/swcharges**, clearly signposted from our annual billing leaflet, which is sent out to all our customers.

“Around 60% of our customers currently feel we provide value for money”

Efficiency through transformation

Four years into our five-year business plan, we have delivered £160 million of cost reductions. We aim to make overall efficiency savings totalling £200 million by 2020.

To continue to drive efficiency savings, and ensure we are ready to deliver our Business Plan 2020–25, we are changing the structure and culture of the business. This means improving engagement with our colleagues and partners, and getting the basics right, so we can innovate and deliver better services for our customers and a resilient water future for the South East.

The transformation programme has already delivered:

- clarification of roles, accountabilities and business priorities, aligning teams behind them
- improvements in customer experience across the business
- closer and more collaborative relationships with our regulators and partners
- transition from costly, reactive operational processes to a more proactive model
- a more streamlined decision-making process, based on a measurable set of values and an ethical business framework
- a more agile approach to problem-solving and innovation, enabling us to test, review and deliver projects at pace
- a more consistent approach to leadership and management
- more visibility of performance and an increased focus on risk management and compliance.

To support this new way of working, we are focused on playing to our strengths, making sure we have the right skills and capabilities to keep up the pace of transformation. In doing so, we will show our regulators, customers and stakeholders that we have moved to new levels of improved performance and capability.

What we have achieved

	2018–19 Target	2018–19 Achieved	2017–18 Achieved	2016–17 Achieved	2015–16 Achieved
Water usage, per capita consumption (litres per head, per day)	133.7	129.9	128.9	131.3	129.7
Number of unwanted* billing queries[1] *unwanted from a customer's point of view	131,363	131,726	181,361	145,962	62,726
Customers who are aware of the causes of blocked drains (%)[2]	83	83	82	79	77
Customers who are aware of how their money is used (%)[2]	57	59	56	56	60
Customers who are aware of how to deal with hard water (%)[2]	56	55	55	56	57

[1] The call categorisation for unwanted billing queries was amended during 2016–17.
[2] Our annual customer survey reached around 1,335 customers online or by post during March to April 2019 and is intended to give us a year-on-year customer view on a number of indicators from value for money to awareness of how to prevent blockages.

Better information and advice

It is extremely important to us that our customers feel informed, not only about our services and how we spend their money, but about incidents in their area and how they can help us protect water quality and the environment.

As a result, we have focused on raising awareness and driving behaviour change to help our customers save water and energy and prevent blockages and flooding, as well as understanding how to address hard water issues in their homes and businesses.

Helping our customers reduce the amount of water they use

We all rely on water for everything we eat and drink, for washing ourselves and our clothes, and to help create the energy we need for heat and light. It is also essential to the products we enjoy, and the rivers, fields, forests and beaches that we love.

At the same time, we are all facing the challenges of population growth and climate change, which impact how we source and use our water resources both now and in the future. We can help to solve these challenges, with the help of our customers, partners and communities, by asking them to reconsider how they use and value water.

We made a commitment to our customers in our Business Plan to achieve a 10% reduction (15 litres per person, per day) in average water use by 2020. To deliver this, we have continued to inform customers about saving water and have completed more than 18,128 home visits since 2015 to install water-saving and energy-efficient products.

“We have continued to inform customers about saving water and have completed more than 18,128 home visits since 2015 to install water-saving and energy-efficient products”

During 2018–19 alone, our partner Aqualogic completed a total of 4,863 of these home visits, where it also talked customers through practical, everyday changes they could make in their daily routines to save water in the home and garden. In addition, the Water Efficiency team has spoken to hundreds of customers directly about the value of water at a series of community roadshows across our region and in classrooms and community centres via our Waterwise education programme. (See more in Working with our communities in the ‘Our people’ section of this report on page 28.)

We have continued our work with local authorities to identify customers with high water consumption and those in vulnerable circumstances who may benefit from water-saving home visits, products and advice to reduce their monthly bills.

During 2018–19, we recorded an average water use of 129.9 litres per person, per day (2018: 128.9), which is below our target for the year of 133.7. This target is based on a five-year average so it is in line with the target overall for the first four years. This figure increased slightly from 2018 as a result of the long, hot summer.

While we are extremely pleased to reach our targets, and that the introduction of metering and water efficiency visits to households and businesses continues to help customers to become more conscious of their water use, we know we need to help them to go further, while we work to reduce leakage on our own network (for more on leakage, see ‘A constant supply of high-quality water’ on page 62).

Included in our Business Plan for 2020–25, and in support of the Government's 25-year Environment Plan, we have set an ambitious, new reduction target to help our customers reduce their daily usage to 100 litres per person, per day by 2040. This is called Target 100.

We recently held our first Parliamentary reception to launch Target 100, which was well received by MPs across our region. Our work on a Water Plan, which sets water reduction targets, for the Greater Brighton Infrastructure Panel (which our Chief Executive, Ian McAulay chairs) is also underway.

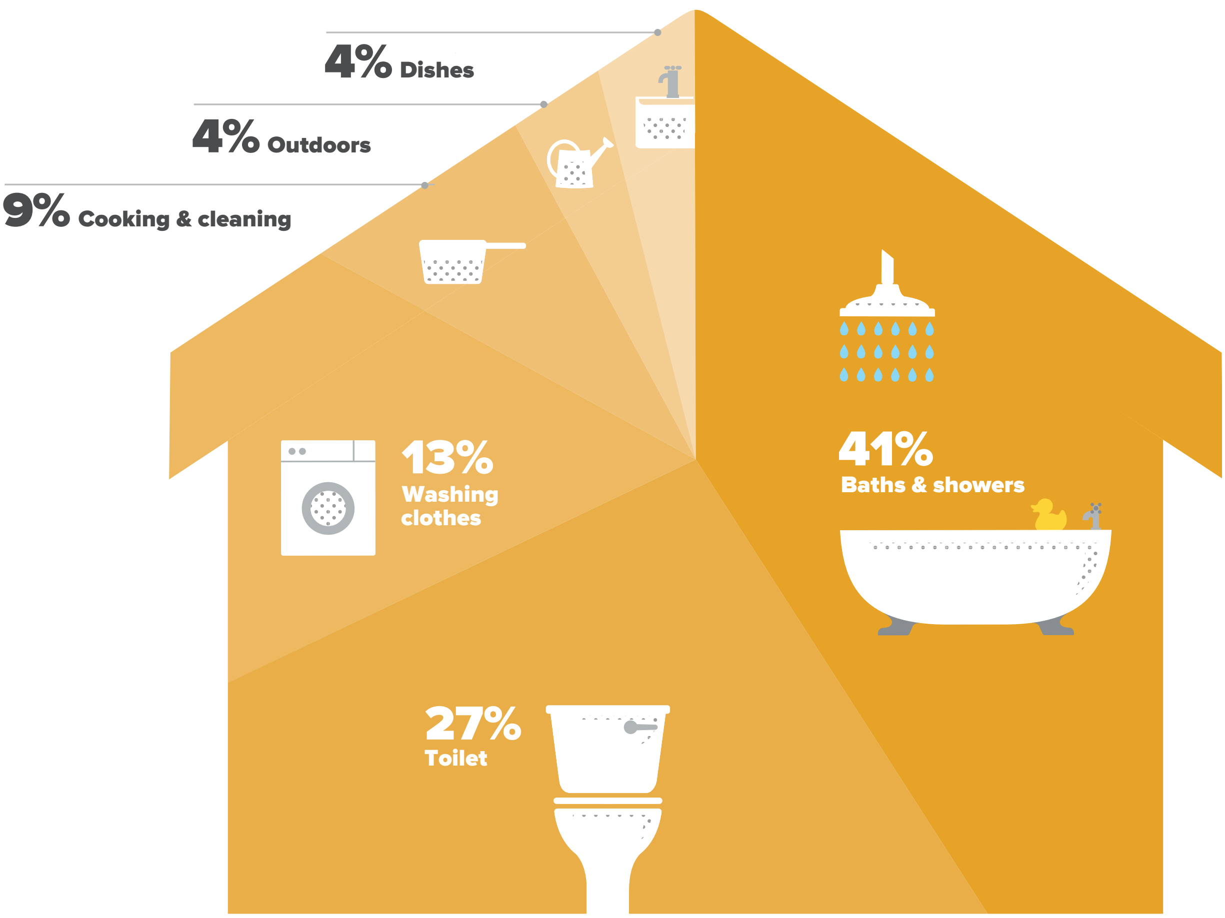
To support behaviour change across our customer base, we will be piloting a number of new initiatives during 2019–20, for example:

- we have commissioned research into the best blend of customer incentives to reduce their usage
- a new trial is underway with Eastleigh Borough Council, combining food waste composting and water-saving incentive points, enabling the sharing of scheme costs
- a device called H2OTrack (previously WaterBit) is being tested with our employees to enable us to track water use on a more real-time basis
- research has fed into plans for a major behaviour change campaign across our region – pilots will begin shortly
- plans are underway for a major water reuse scheme with a housing developer in Hampshire
- we are working more closely with the water retail companies to apply water efficiency in the non-household or commercial market.

We will be working in partnership every step of the way, using our influence with other water companies and stakeholders to push for universal metering – regardless of water-stressed status.

The Government is shortly due to announce a national consultation on setting a per capita consumption target. We have been calling for this target to be more widely 'owned' by society than simply being something water companies are responsible for. We were asked to feature in the consultation document, so we have submitted information about some of the incentives we are looking at and details of our successful River Itchen Challenge, carried out in 2017–18.

Average household water use per person, per day



Making our bills easier to understand

The number of unwanted billing queries we received during 2018–19 continued to be high against our original Business Plan 2015–20 target, hitting 131,726 (2018: 181,361) – these are unwanted contacts from a customer point of view. This performance is not acceptable and we continue to review our processes, and the root cause of every unwanted contact is analysed by our Call Centre teams.

When our customers cannot understand something on their bill, many of them turn to our website, which is why an end-to-end review of customer journeys is now being completed.

We are also improving some of our billing policies around high consumption, refunds and payment schemes to make it simpler and easier for our customers to avoid having the need to contact us.

“When our customers cannot understand something on their bill, many of them turn to our website, which is why an end-to-end review of customer journeys is now being completed”

Raising awareness about the impact of blockages

Our FOG (fat, oil and grease) and Unflushables team was created in 2015 to help us better understand people's instinctive behaviour around FOG and unflushables, encourage them to think more about what they flush down the loo or pour down the sink and to reduce the number of blockages in our sewers, which could lead to sewer flooding and pollution.

Our dedicated team, now four years into a five-year (£1.4 million) blockage reduction programme, is out there, every single day:

- lifting manholes and surveying sewers and organising CCTV and jetting of the sewers where needed to avert further problems – the team has lifted around 9,000 manholes over the past four years
- knocking on doors and talking to customers – each year the team visits around 600-700 postcode areas
- in businesses offering advice and enforcing the law – we have visited more than 2,300 businesses and seen repeat blockages fall from 30% to 6% following our visits
- in schools and communities raising awareness – more than 20 action days have been held since 2015, engaging more than 4,000 people
- in meetings influencing manufacturers and partners – we have engaged with 28 large food chains – like McDonald's and the brewery Greene King, which runs 3,000 pubs, restaurants and hotels
- at conferences sharing our expertise – we have been sharing our approach through Water UK, the British Water FOG forum and we have now conducted training days for eight other water companies. We have also initiated a national Network Protection Forum, with all 12 water and wastewater companies.

To deliver its important messages, the team has used a range of eye-catching and innovative tools during 2018–19 to drive engagement, and behaviour change, including an augmented reality game, a series of films made in partnership with City To Sea and another instalment of the Unflushables story – The Unflushables Assemble. The film blended puppetry, stop-motion animation and live action in a bid to highlight the scourge of the sewers – nappies, wet wipes and cotton buds – and prompts people to bin these items instead. It was also supported and promoted by the Consumer Council for Water.

As a result of its continued community engagement work, the team has met its target of making sure 83% (2018: 82%) of our customers are aware of the causes of blocked drains.

Making sure our customers know how their money is spent

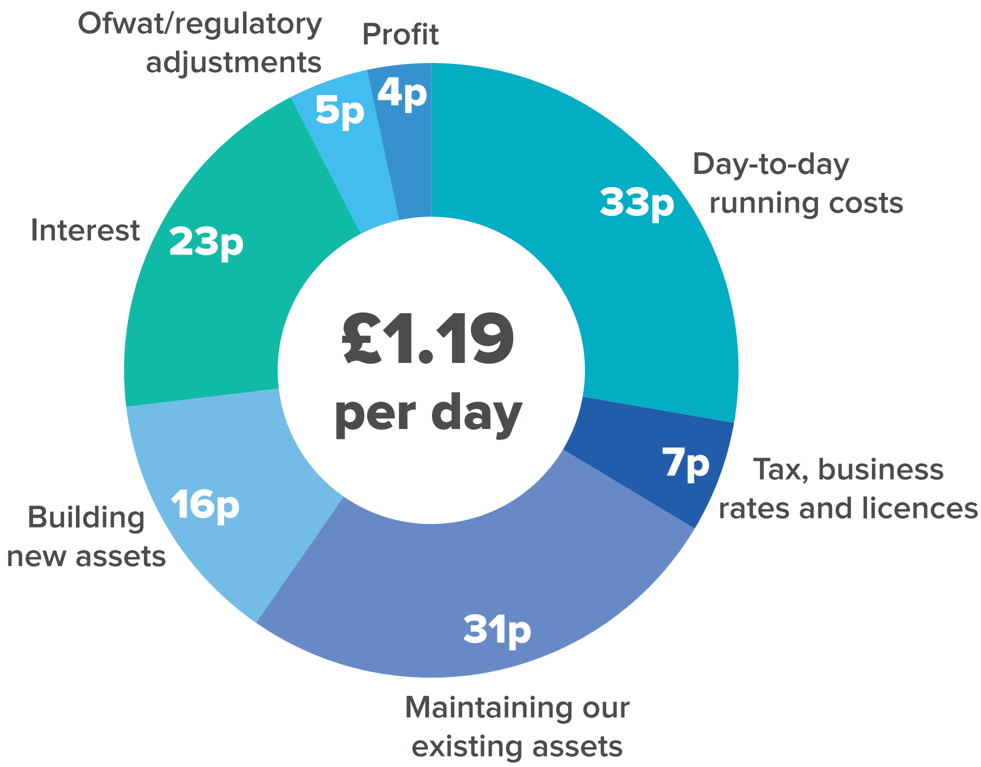
Our domestic customers cannot choose who supplies their water services, so we need to make sure we are crystal clear about our charges and how we spend the money customers pay us.

During 2018–19 we carried out a number of activities to build awareness and increase transparency by providing customers with:

- an update against our performance commitments through annual reporting
- a link to our annual performance information on our billing insert, circulated to all of our 4.7 million customers
- advice at community events about saving water, how to prevent blocked drains and how we can help customers struggling to pay their bills – our community team attended 51 events in 2018, talking to 253,000 people
- regular updates on our capital construction schemes, particularly for customers directly affected by our planned improvement work, as well as local media and key stakeholders.

At the moment, 60% (2018: 56%) of our customers are sure about how their money is spent, which we are pleased to see has increased from the previous year. To continue this improvement, we are completing some enhancements to our website, including more regular performance reporting, information about our investment schemes and the work we carry out in our communities.

Breakdown of average daily charge 2018–19



The impact of the proposed Ofwat regulatory settlement noted on page 26 is excluded from the above. No part of it will be borne by our customers.

Running costs – wages, power, chemicals, materials and bad debt

*Bad debt = the cost of providing for unpaid customer charges

Interest – interest on money borrowed to finance improvements to our infrstructure over the long term

Maintenance – of our pipe network, treatment works and capitalised employee costs

Construction – contributing to projects to enhance treatment standards and cater for growth

Tax, rates and licences – including corporate taxes, business rates on buildings, wastewater treatment and water supply works and Environment Agency licences

Ofwat/regulator adjustments – applied by Ofwat for the period 2010–15, relating to customer satisfaction, cost-savings and revenue collection

Profit – the return earned on shareholders' investment in the business

Retail – covers the cost of handling customer enquiries and providing services, from billing to debt collection

Water services – the treatment and distribution of water for supply

Wastewater services – the collection and treatment of wastewater for return to the environment

"Our domestic customers cannot choose who supplies their water services, so we need to make sure we are crystal clear about our charges and how we spend the money customers pay us"

Our charges are set in line with controls set by our regulator, Ofwat, and are scrutinised independently by the Consumer Council for Water.

What do they cover?

The cost of our operations and the cost of maintaining our assets (water pipes, sewers, pumping stations and treatment works).

Is that it?

No, we also raise finance to pay for the construction of new assets and to repay loans taken out in previous years. We are also partly financed by our shareholders so we are able to absorb financial risk and contribute to the construction of new infrastructure. More details of our finances and group structure can be found on pages 95 to 100.

How much are we spending on improving services?

We committed to spending £3.2 billion over five-years from 2015–20, with £1.8 billion of that assigned to maintaining and improving our infrastructure. This includes the renewal of mains and sewers, schemes to prevent flooding, protect water supplies, improve wastewater treatment and reduce leakage.

Helping customers deal with hard water

We take a lot of the water we supply to customers from underground chalk aquifers, which means it contains high levels of calcium carbonate, making it quite hard.

Although calcium carbonate does not affect the quality of the drinking water, we know that hard water can affect customers' household appliances so we offer advice at **southernwater.co.uk/how-hard-is-your-water**, which includes a postcode tracker. Our water distribution teams also offer Water in the Home advice leaflets to customers. These contain practical tips and useful contacts for homeowners.

In our annual survey to track customer awareness of our performance against our Business Plan commitments, 55% (2018: 55%) of customers said they were aware of how to deal with hard water. While we continue to publish water quality reports for our customers on our website, we know we need to do more to address this issue.

Great places for our customers to get outdoors

We have four reservoirs: Darwell, Powdermill and Weirwood in East Sussex, and Bewl Water on the Kent and Sussex boundary. These all offer outdoor activities such as fishing and sailing.

Bewl Water is our largest reservoir and is the biggest stretch of open water in the South East. Each year it attracts an estimated 98,000 visitors who take part in windsurfing, sailing, fishing, cycling, walking and boat trips. We have a number of information boards at the visitor centre highlighting water safety issues, but also displaying interesting facts about the water cycle and the construction of Bewl Water itself – these were updated in late 2017.

We have a long-standing partnership with the Hampshire and Isle of Wight Wildlife Trust, which manages our Testwood Lakes site near Southampton on our behalf. Testwood Lakes has a purpose-built education centre, which hosts environmental activities for the thousands of children who visit each year. To enhance this experience, we worked closely with the Hampshire and Isle of Wight Wildlife Trust in 2018 to refresh the centre and the information on display.

We concluded our Brighton Sewer Tours in 2018, but still delivered 68 educational tours to 1,456 visitors, giving them a look at the history behind the construction of our Victorian sewers.

Other visitor attractions in our region include the historic steam pumping engines at our water supply works in Brede, East Sussex, which are cared for and displayed by Brede Steam Engine Society.

Case study

Clare Rixon, Operational Resilience and Emergency Response Manager

Enhancing resilience and emergency response

Millions of customers rely on our network of over 50,000 kilometres of pipes across our region.

With this scale of operation, it's only natural incidents sometimes arise. When they do, our customers count on us to fix the situation swiftly – and keep them informed every step of the way.

In the past, our approach to incidents focused on the operational side. We'd leap into action to repair a broken pump or valve. We weren't so great at telling our customers what was going on. However, we wanted a more coordinated approach that took into account how the situation affects our customers every step of the way. Using lessons learnt from last year's Freeze/Thaw and heatwave events, we made further improvements to our incident management framework and structure.

To allow us to rapidly mobilise our people, we restructured our response team. On top of our usual standby team, we've also created a number of 24/7 standby roles to respond to major incidents. These span from communications to service recovery, as well as employees responsible for setting up alternative arrangements for our customers while we fix the problem – like supplying bottled water. In addition, we've recruited a wider pool of volunteers who are on-call to help with any incidents. This allows us to scale our response team to match the situation, so we can move swiftly and get information out to our customers quickly.

As well as restructuring the team, we've now put in place tools to identify incidents as early as possible, so we can respond efficiently. For instance, we've linked weather tracking to escalation triggers, so we can better foresee and plan for adverse conditions. We run regular test scenarios to check our plans are robust. Meanwhile, debriefings allow us to capture any lessons for continuous improvement. We've also built relationships with local resilience forums and community groups to share our emergency plans and gain feedback.

Most recently, we've been focused on preparing Southern Water for a no deal Brexit. By bringing together experts from across the business and working closely with other industry partners and regulators, we've been able to ensure robust preparations are in place to manage the many risks associated with this scenario.

> **"Our customers count on us to fix the situation swiftly – and keep them informed every step of the way."**

What we have achieved

	2018–19 Target	2018–19 Achieved	2017–18 Achieved	2016–17 Achieved	2015–16 Achieved
Overall drinking water quality index (%)	100	99.98	99.96	99.97	99.98
Number of contacts regarding discolouration (per 1,000 population)	0.82	0.68	0.82	0.74	0.80
Number of properties with low water pressure	257	209	243	222	288
Customer minutes lost supply > 3hrs	9	7	17	7	12
Leakage (million litres of water per day)	87	102	89	88	84
Number of customers affected by temporary use bans	0	0	0	0	0
Asset health	Stable	Stable	Stable	Stable	Stable

A constant supply of high-quality drinking water

Our customers expect an uninterrupted supply of clean, safe drinking water.

That is why we work 24 hours a day, seven days a week to ensure that water quality remains high, instances of discolouration and low pressure are kept to a minimum and that when we do need to turn off water supplies, we make alternative sources available while we carry out any repairs to the network.

Customers and stakeholders also expect us to care for the water environment, ensure we waste as little water through leakage as possible and protect future supplies.

Unfortunately, during 2018–19 we were unable to meet our target for leakage for the second year running. We have now invested further funds to improve our performance over the coming year, including increasing the size of our leakage teams and the resources available to them.

We are pleased to have maintained performance against our other measures for water quality, discolouration, water pressure and supply, despite the long, hot summer we experienced during 2018.

Our asset health was also reported as stable to Ofwat. This means we have met or exceeded all the performance measures required.

“We work 24 hours a day, seven days a week to ensure that water quality remains high”

Clean, safe drinking water is a priority

Our water supplies can be contaminated by organic matter, chemicals, bacteria and even radiological elements like radon. The effects of such an incident could be far reaching, not only affecting our customers, but also wildlife and supporting habitats.

The Drinking Water Inspectorate (DWI), the regulatory body for drinking water quality, sets particular standards for the water we supply in order to keep it free of such contaminants, ensuring it not only tastes and smells good, but also keeps our customers healthy and protects our environment.

We are pleased to report that the quality of the water we deliver remains high. We achieved 99.98% (2018: 99.96%) compliance with the DWI’s quality measures.

We have also made further progress in driving down instances of discolouration, recording our best performance for five years with 0.68 contacts regarding discolouration per 1,000 customers (2018: 0.82). This improvement is the result of historic changes to our network repair process made in 2015, requiring teams to complete preliminary impact assessments before starting any work and stopping any projects they believe might cause a discolouration issue. New acoustic logging technology installed along our network is also helping to reduce the number of bursts causing discolouration issues.

Minimising properties experiencing low pressure

The industry standard minimum level of pressure is the equivalent of being able to fill a 15-litre bucket from a tap in one minute and 40 seconds. To meet this standard, we regularly check water pressure across our network to make sure we can proactively identify customers who are not receiving the required standard and take action. We now have pressure-logging devices installed in every District Metered Area, each serving roughly 1,250 properties. This means we can use real-time data to react more quickly to dips in pressure.

The long, hot summer saw the number of properties on our Low Pressure Register increase temporarily while we moved water around our network to keep everyone's taps running. We are pleased to report that despite these adverse weather conditions, we recorded 209 properties out of 1.1 million served experiencing low water pressure, well below our target of 257.

> **“Our water teams have a 24/7 mind-set to keep water flowing for our customers”**

Reducing time spent without water

From time-to-time we need to turn our customers' water off. This might be to carry out planned repairs to our network or because there has been a major incident, such as a burst, which means we have had to temporarily divert supplies. Where we can, we will always warn customers about this in advance.

Our performance targets are based on interruptions that last three hours or more. These are added up to give a total time that customers were without water, which we then divide by the number of properties we serve. This gives an average time in minutes of how long we have interrupted customers for. Our performance for 2018–19 was seven minutes, coming in under our target of nine minutes.

To maintain this level of performance, our water teams have a 24/7 mind-set to keep water flowing for our customers. In addition, various initiatives have been launched this year to look at alternate supply sources during incidents, such as storage tanks which allow us to temporarily divert properties while we carry out a quick fix.

Focus on driving down leakage

We measure leakage from our network by calculating the difference between the amount of water we put into supply from our treatment works and the amount that each customer uses on a daily basis. That amount is measured in millions of litres or megalitres (Ml/d) over the course of an average day.

Like all water companies across the UK, we faced particularly challenging weather extremes during 2018 that made the management of leakage much more difficult. As a result of residual damage to our network from the Freeze/Thaw incident in March 2018, rapidly followed by the prolonged, hot summer, we have not met our leakage target, achieving 101.8 Ml/d (2018: 88.7). Our target is to average 87.1 Ml/d across the five-year period from 2015 to 2020. It is likely, given current performance, that we will miss this target. Although, we are working hard to try and keep our leakage levels as low as possible.

This performance is disappointing, which is why we have invested an additional £1.7 million during 2018–19 to increase the size of our leakage teams and improve the resources available to them. A further increase of £2.8 million has been put in place for 2019–20 to enhance our efforts further.

New teams of inspectors have been working to identify unaccounted-for water usage in customer neighbourhoods at night. Accounting for this water gives us a better understanding of where water is being lost, so we can target our leak detection resources more smartly.

Improvements in the technology available to the teams is also making a difference. We have now installed acoustic logging devices along more of our network of pipes, so we can better pinpoint leaks avoiding unnecessary disruption to customers. The real-time data they provide means we have not only been able to improve the accuracy of our reporting systems, but we are also able to work smarter deploying our teams to problem areas more quickly and proactively notifying customers about leaks on their own properties. Drone and satellite footage was also trialled to pinpoint problem areas on our network.

No customers affected by temporary use bans

During 2018–19, we are pleased to report that none of our customers experienced a temporary use ban – such as a ban on using hosepipes – even though we experienced one of the hottest summers on record during 2018.

Our vision is to create a resilient water future for our customers in the South East. This means always being prepared so we can secure customers' water supplies no matter what the weather brings. We continually update our drought plans to accommodate changes in weather patterns.

This means continuing to invest in our treatment works and pipe network. For example, a larger scheme nearing completion during 2018–19 was a new trunk main at Gaters Mill in Hampshire. This will enable us to transfer supply from our neighbours, Portsmouth Water, to our customers during periods of prolonged drought, easing pressure on the River Itchen and its ecology.

This work is particularly important given changes made to our abstraction licences by the Environment Agency, which aim to secure the health of the Rivers Test and Itchen while reducing the amount of water we can take from them during drought. The changes mean a shortfall of some 135 million litres of water a day during a drought – about 80% of the amount needed to supply our customers in south Hampshire, which will mean putting in place water restrictions for some of our customers to 2027.

We have until 2027 to meet the new conditions and plan to invest more than £800 million to make up the deficit, while ensuring water resources continue to be resilient and environmentally sustainable. Our wide-ranging plans, some of which will need Ofwat and Environment Agency approval, include water reuse, desalination, new pipelines from neighbouring water companies, reducing leakage and improving water efficiency.

Preparing to deliver our Business Plan 2020–25

The DWI has introduced a new risk-based approach to target areas where water quality performance should be improved. The new metrics – Compliance Risk Index (CRI) and Event Risk Index (ERI) – will highlight risks to individual consumers and are weighted by population, targeting issues at our larger treatment works. These new metrics will apply from 2020 onwards.

We were below industry average for CRI in 2017, and our ERI was the worst in the sector, due primarily to a single event at one of our larger water supply works. In order to address this, significant work is underway at large works such as Testwood and Otterbourne from 2017 to 2025, with major rebuilds taking place.

As a consequence of this – and historic issues regarding our performance reporting – we have also been under significant scrutiny from the DWI and are currently under enforcement. We were the subject of four Final Enforcement Orders, three of which were associated with new asset improvement schemes and one with improvements in water quality sampling and information management. We have successfully closed two of these orders but two remain in place – a final asset improvement scheme and water quality sampling and information management.

Where legal investigations are underway, they can take some time to conclude and relate to issues from as far back as 2012 and 2013. To illustrate, the most recent prosecution from the DWI, in August 2018, resulted in a fine of £65,000 and relates to an event that took place in 2013 at Cooks Castle on the Isle of Wight, well before new structures and improvement programmes were implemented. In addition, we are subject to two other cases: one from 2014–15 and one due to operational issues in 2018 on which we are awaiting decisions from the DWI.

Putting Water First

In collaboration with the DWI, a transformation programme has been developed to address the issues outlined above, which involves a number of overarching, legally binding notices and undertakings spanning 2018–2032. This programme has been incorporated into our Water First initiative.

Water First is a long-term improvement programme – which reaches beyond any five-year planning process – to embed public health protection at the heart of our water services. It is a ‘source to tap’ approach – spanning catchment sources, water treatment, network, customer service and monitoring – underpinned by improvements in people, processes, systems, culture, training, and risk and information management.

Improvements already realised include:

- **Hazard reviews** – a risk review process to identify potential water quality hazards on sites and catchments. So far a series of site audits have been completed, with those remaining due for completion by October 2019. We are now working with Thames Water and South East Water, as the DWI has advised them that they should adopt a similar approach.
- **Reservoir maintenance** – as part of a major programme of works to improve the condition of our treated water storage facilities we have made significant changes to improve our ability to deliver reservoir maintenance. This includes bringing the Cleaning and Inspection team in-house and awarding a new reservoir remedial work framework contract. In the year, we completed inspections at 59 of our treated water storage facilities.
- **Catchment First** – a team of 12 catchment management experts is now in place to assess risks to raw water quality and quantity, and design and implement catchment management measures to mitigate catchment risk. The team is working in partnership with a number of key stakeholders including Natural England, South Downs National Park, Brighton and Hove Council, the Environment Agency, Brighton University, Portsmouth University and the Rivers Trust. It is also working directly with a number of farm cluster groups to co-develop and deliver solutions to improve the deteriorating nitrate concentrations that affect many groundwater sources.

Working towards Operational Excellence

Trialled with a number of water and wastewater teams during 2018–19, our Operational Excellence (OE) initiative is supporting continuous improvement programmes like Water First and Environment+*. By asking our teams to collaborate on a regular basis, OE is enabling us to break down team structures and take more of a project-based approach to problems, finding faster and more efficient solutions to ongoing issues. Regular hubs allow team members to raise issues, which are then resolved straight away and reported on at the next meeting giving them a real sense that they are being listened to and that key issues are getting addressed. The approach has been well received by the teams involved in the trials and the hubs have driven a number of improvements to daily processes within the teams, so OE is now being rolled out across all operational teams.

“Our Operational Excellence initiative is supporting continuous improvement programmes like Water First and Environment+* and finding faster and more efficient solutions to ongoing issues”

*Read more about our Environment+ programme in the ‘Looking after the environment’ section of this report on page 74.

Case study

Andy Beebee, Head of Operational Excellence

Discovering better ways of working

In a water business, excitement should be rare. Things are meant to run smoothly, but we often found ourselves firefighting.

To tighten up the way we work, we launched our Operational Excellence programme. This programme puts our people and processes under the spotlight for continuous improvement.

Having been an Operations Manager for five years, I was ready for a fresh challenge and knew the operational side of the business first-hand. So, I was seconded to the programme early on. From the outset, we wanted to work with our field-based teams to empower change, rather than forcing it on them. That's why we began by running focus groups with over 40 teams to understand their key challenges.

Siloed working was a key concern. Ultimately, our business exists to supply fresh water and take wastewater away. So, our operational teams share these goals. But teams had focused on their own tasks, responsibilities and targets and communication between teams was not as good as it needed to be. To counter this, we introduced hubs. These weekly, one-hour meetings bring together members of field-based teams to agree how to achieve their shared goals. The teams have really embraced this approach.

Within each hub, everyone gathers around an information board. Together, they look at upcoming tasks and jointly agree how to tackle them. They also review KPI scores and discuss how these can be improved. Because the key people are in the room, they can agree a joint plan there and then. Plus, we've set up hubs all the way up to senior management, so teams can escalate anything out of their hands.

Reactive working was another common issue. To tackle this, we've introduced plan-do-review cycles. Teams are now taking time to plan ahead and reflect on lessons learnt, so our future activities can be more effective. To avoid short-term fixes, we've also rolled-out solution development training. Teams are encouraged to define the challenge and scope several solutions before choosing the best one to run with. This is paired with core skills training – including coaching, feedback, facilitation and meeting management – to foster better teamwork.

Operational Excellence has already addressed issues of all sizes. Local challenges have been solved, like agreeing who is responsible for refilling chemicals at one of our treatment works. Meanwhile, a large capital investment was cancelled at one site after a more cost-effective option was agreed. Our KPIs have improved too. As new hubs have been introduced, we've seen a jump in those teams' performance – sometimes in just weeks.

These improvements in efficiency, cost and performance show how smarter ways of working are allowing us to better serve our customers.

Case study

Mark Saywell, Network Connections Manager

Preserving water quality

Sometimes water needs to be accessed from public locations, and our hydrants make this possible – supporting the vital work of our fire service and our own maintenance work.

We also sometimes allow people and businesses to use our washout hydrants or tanker filling points as a temporary water source. However, if people don't connect to these properly or use the wrong equipment, water can become contaminated, which is a public health risk. As a result, we take any illegal or improper use very seriously, and want to raise awareness where we can about the risks.

In July 2018, I recruited a team of investigators to work alongside me in our new Network Connections team. Together, we have two key areas of focus. The first is proactive activities that include: surveillance for potential unauthorised connections, new development site investigations for potential illegal water service connections, and engaging and educating those who use our washout hydrants on how to do so properly. The second area of focus is reactive investigations from internal colleagues, external stakeholders and service partner referrals of suspected unauthorised connections, as well as those from customers who suspect water theft or who have experienced discoloured water due to possible unauthorised hydrant connections.

To share safe practices, we pulled together a list of our frequent standpipe users and arranged for them to receive Calm Networks training from our standpipe hire service partner, Aquam Water Services. The Institute of Water certified course covers the safe use of hydrants, valves and pumps. When they have finished the training, attendees receive a certificate valid for one year. We've also received access to Aquam's central database, so we can check who has successfully completed the training.

Our monitoring activities are wide-ranging. We review who hires standpipes and what for, allowing us to gauge potential risks and log them for investigation. My team conducts surveillance on 70,000 hydrants, frequently visiting sites and encouraging local users to complete Calm Networks training. We're also tackling lawbreakers by carrying out formal investigations where we suspect illegal access.

Since we set up the team, we've seen a steep rise in registrations and successful certifications for Calm Networks training. This has given our staff, partners, firefighters and local businesses a better understanding of how they can protect public health. At the same time, our investigations have led to the first ever trial for illegal use of a standpipe, with a West Sussex company now facing prosecution. So, we're already making strides to better safeguard the quality of our water.

What we have achieved

	2018–19 Target	2018–19 Achieved	2017–18 Achieved	2016–17 Achieved	2015–16 Achieved
Number of blockages per km	0.58	0.52	0.49	0.55	0.56
Number of internal flooding incidents	392	389	401	448	492
Number of external flooding incidents	8,500	8,255	7,106	8,009	8,314
Number of customer complaints regarding odour	390	543	381	326	262
Asset health	Stable	Stable	Stable	Stable	Stable

Removing wastewater effectively

We committed £3.2 billion to operate, maintain and improve assets between 2015 and 2020. £1.8 billion of this was specifically allocated to building new and upgraded wastewater and water services. This investment continued to deliver results for our customers this year.

The number of sewer blockages and internal flooding incidents continued to fall, and we met our external flooding incident target and our network remained stable. We also continued to drive down the total number of sewer collapses and bursts.

Odour complaints, however, rose in 2018, driven by the very warm weather and extended dry period in the summer.

Our performance in terms of blockage and flood prevention was made possible by our teams doing the basics better and taking a more holistic approach to wastewater management through our Environment+ programme, driving efficiencies and improving training opportunities through Operational Excellence* and continuing to explore new technology. As a result of this focus on improvement, we are slowly building more resilience into our wastewater network in order to prepare ourselves for a future with more people and less predictable weather patterns.

We have also worked hard to restore our relationship with the Environment Agency, building trust. More collaborative working practices have also delivered improvements which have benefited the environment.

“We are slowly building more resilience into our wastewater network in order to prepare ourselves for a future with more people and less predictable weather patterns”

Keeping our network clear of blockages

There are around 20,000 sewer blockages every year in our region – nearly two-thirds of which are caused by fat, oil and grease (FOG) and other items flushed down the toilet or discarded in drains. As such, our Field Customer Engagement teams focus on raising awareness in problem areas – all part of our £1.4 million blockage reduction programme for 2015–20.

By engaging our customers and businesses to do the right thing, this work can have a huge impact on the performance of our sewer network. It is a cost-effective way for us to provide a better service and protect our environment. To learn more about the work the team does in our communities, read the ‘Better information and advice’ section of this report on page 54.

During 2018–19, this work to raise awareness and affect behaviour change with our customers meant that we were able to meet our target of restricting blockages on our network to 0.58 per kilometre of sewer, achieving 0.52 (2018: 0.49). We are particularly proud of this achievement given the long, hot, dry summer we experienced in 2018, when sewer flows were affected by the redistribution of water across our network and a lack of rainfall.

This programme has already made a difference to the performance of our sewers and the behaviour of our customers so from 2020–25, we will be investing around £2 million to extend it.

*For more information on Operational Excellence, see page 67 to 68.

Keeping the number of flooding incidents to a minimum

Each flooding incident is hugely distressing for our customers. As such, it is an area of our performance that we take extremely seriously.

This is why we are pleased to report that we met our target of keeping incidents of internal flooding below 392, reporting 389 incidents during 2018–19 (2018: 401). This performance is a result of improvements made to our network and increased customer awareness of the root cause of blockages in their homes and businesses. Improvements in the technology we use to identify problems with our network have also helped us to be more proactive, fixing issues before our customers are affected.

In terms of the number of external flooding incidents, a total of 8,255 have been reported during 2018–19 (2018: 7,100). While this is an increase on the figure achieved last year, our target for the year was no more than 8,500 incidents.

There will always be factors beyond our control that put pressure on our sewer network, such as weather events. In addition, geographical features make some areas more prone to flooding. However, using techniques such as predictive modelling, we can use data to plan ahead for different scenarios.

A total of 136 properties have had flood mitigation work carried out during 2018–19 to reduce the risk of future flooding events. In addition, during a flooding incident our flooding prevention teams have daily calls to discuss any appropriate action to prevent repeat incidents. A pilot scheme is also underway, including multiple work streams, which will update our business-as-usual process as a result of any actions taken.

> **“Improvements in the technology we use to identify problems with our network have also helped us to be more proactive, fixing issues before our customers are affected”**

At the same time, our Zero Flooding project, which began in 2017, is aiming to bring down the number of sewer flooding incidents in 10 towns and cities across our region. It uses several innovative tools, methods and materials to help understand and improve the way our sewers respond to different circumstances. It will also try different targeted communications campaigns in different zones to see what works best in terms of changing the behaviour of our customers.

Reducing complaints about odour from our sites

The long, hot summer of 2018 had a significant impact on the number of complaints we received about odour from our wastewater treatment sites meaning that we did not meet our target of keeping complaints below 390, receiving 543 complaints in total.

There was a spike in complaints at our Portswood wastewater treatment works between April and August due to issues encountered during odour improvement works. Phase 3 of the odour improvement scheme is currently underway with an active odour management plan in place to mitigate emissions.

We are continuing to address issues at this site, and others, and will be installing additional monitoring systems that will help us to understand and better manage risks.

Part of the rise in complaints has been due to the adoption of over 600 pumping stations in 2017–18, which were previously privately owned and for which we had no prior control over standards.

Making sure our sites and networks are working as they should

Underlying risk to our wastewater assets – our sites and network of pipes – increased during 2018–19 due to impact of extreme weather events such as the Freeze/Thaw and the summer of 2018. It has since been managed back down for the start of 2019, as a result of focused action completed at the highest risk sites. This has seen a reduction in breaches and an increase in exceptions – an early warning similar to a health and safety near miss.

Investments made to improve our wastewater assets during 2018–19 include:

- an ongoing, multi-million pound redevelopment of Woolston wastewater treatment works in Southampton. Once completed, the redevelopment project will reduce smells coming from the site, ensure the treated wastewater leaving the site meets new, higher environmental standards and ensure the redesigned works fits in with the ongoing redevelopment of the area
- the continuation of a £16 million upgrade to our wastewater treatment works at Eastbourne. The site, which serves a population of around 140,000 people, is undergoing a major refurbishment to improve how it treats up to 86 million litres of wastewater a day
- a £15 million, 10-kilometre sewer pipeline that will run from the west of Chichester in Sussex, across the north of the city and through to Tangmere, where it will connect to our Tangmere wastewater treatment works. We will also upgrade and expand the existing sewer network and provide three new pumping stations to take away and treat wastewater from proposed new homes, identified in Chichester District Council's Local Plan.

Case study

Mark Newman, Project Manager

Thanet sewer upgrade

When our partner TPMD surveyed our sewers as part of the Thanet sewer upgrade, it got a lot more than it bargained for.

Some of the century-old tunnels which house the pipes had partially collapsed leaving, in some places, deep voids up to the road surface.

This is a very serious issue, as further collapses could lead to significant damage to the live sewer pipes, with possible flooding and serious harm to the environment and the general public. Urgent repair was required.

Working closely with us, TPMD used its relationship with the Kent County Council Highways team to get early access to the streets and enlisted the help of a direct specialist workforce from the mining industry to provide the highest quality standards.

It took the team less than two weeks to complete the work from the day it identified the issue. And most of that time consisted of negotiations to get the road space to do the work.

TPMD is a joint venture formed in 2018 by Terra Solutions, Pfeiffer and Matt Durbin Associates. Southern Water recently awarded it a £34.5 million rehabilitation project of century-old Thanet sewers, which is due to be completed in spring 2020. This is the second phase of a three-phase scheme to overhaul of the area's sewer network, protecting customers' home and the environment for the future.

What we have achieved

	2018–19 Target	2018–19 Achieved	2017–18 Achieved	2016–17 Achieved	2015–16 Achieved
Wastewater treatment works compliance (%)	100	99.70	98.38	99.32	99.32
Maintain bathing waters with 'excellent' water quality at 54	54	62	53	51	43
Number of serious pollution incidents (category 1 and 2)[1]	3	7	4	3	7
Number of less serious pollution incidents (category 3)[1]	158	144	131	143	160
Distribution input (the amount of water we put into supply in million litres per day)	526.79	558.75	541.00	532.28	520.64
Renewable energy use (%)	16.5	15.8	17.2	17.0	17.3

[1] As we reported last year, following external assurance of the category 3 pollution data collected during 2016 and 2017, we identified a number of issues with the processes and systems used to generate that spills data, and we have now applied a confidence band to that data. The data is now subject to an ongoing improvement plan which is resolving long standing issues. The details of the steps taken to improve the robustness of the spill data collection, the data processing systems and the assurance of that data, have been shared with Ofwat and the EA. The improvements are being delivered although not yet completed; the spill data provided to the EA for 2018 was subject to a confidence band of +/- 10%. Improvements have led to a more granular understanding of process risk and enabled targeted interventions to increase quality. Our self-reporting of pollution incidents to the EA in 2018 has increased to 83%, one of the highest in the sector and well ahead of the industry average of 76%.

Looking after the environment

Our purpose as an organisation is to provide water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy. This means doing the right thing and always improving, looking for ways to enhance our communities and the environment.

During 2018–19, we have worked with our partners to significantly improve bathing water quality, we have strengthened our relationships with our environmental regulators and we are adopting a more collaborative approach to water resources and drought planning, as well as flood risk management. However, pollution incidents have increased and specific improvement plans have been put in place to address this.

This section explains further some of the compliance metrics recorded during 2018–19 and highlights some transformational work taking place as part of our Environment+ programme that will help us to become brilliant at the basics by delivering better services while taking care of the environment.

A focus on compliance

The performance of our wastewater treatment works is critical if we are to ensure the water we recycle to our rivers, streams and seas does not harm the environment and the delicate wildlife habitats it supports. We achieved 99.70% compliance with the required standards set for us by our regulators for 2018 (2017: 98.38), however, we acknowledge that our performance still needs to improve, reducing pollutions and regaining confidence in our reporting processes.

This performance is the result of a focus on compliance, culture, ethical business practice and proactive transformation plans put in place across our wastewater teams in response to failings between 2010 and 2017 with our internal processes, systems, capability, controls and assurance (see details on page 26 or visit **southernwater.co.uk/ofwat-investigation**). We are committed to ensuring that these plans are sustainable and build on actions already taken to address these performance issues, as we strive to fundamentally change the way we work, both as a company and with our regulators.

Environment+ looks at all aspects of our environmental compliance and performance. Alongside wastewater treatment works compliance, it also focuses on improving river water quality, reducing pollution incidents and flooding, enhancing bathing water quality, water abstraction and sludge recycling.

“The performance of our wastewater treatment works is critical if we are to ensure the water we recycle to our rivers, streams and seas does not harm the environment and the delicate wildlife habitats it supports”

Progress made during 2018 as part of Environment+ includes:

- completion of permit compliance audits, flow to full treatment reviews and storm tank surveys completed across our wastewater treatment works. Almost 1,000 actions were identified, from relatively minor issues such as missing signs – through to investment for larger storm tanks. The majority of these actions have now been completed
- treatment works with high consequence pollution risks have been identified to support our planning and prioritisation processes, and we are now rolling this out to pumping stations
- simplified permit requirements for sites have been built into all our operating manuals, clarifying all permit requirements for operators
- environmental compliance training has been carried out with operators and management teams, and compliance performance has been built into our regular Operational Excellence hubs
- we have recruited a team of environmental compliance advisors and created environmental champions within the business to increase awareness and introduce cultural change
- all of our event duration monitors have now gone through end-to-end testing, with a number of locations added to our action list
- we have completed end-to-end process reviews for spill reporting and abstraction reporting, with risks and controls identified to improve accuracy
- our 'three lines of defence' model for regulatory reporting continues to be embedded, supported through the Risk and Compliance team.

More excellent bathing waters than ever before

Bathing water quality has been improved significantly in 2018, with the number of 'excellent' bathing waters in our region, using the annual assessment, increasing by nine to 62 in total (2017: 53).

This improved performance is the result of the hard work put in by those teams involved in the Bathing Water Enhancement programme and a number of actions being progressed before the start of the bathing season, which included:

- prioritising maintenance schedules
- updates to coastal models in advance of the 2018 bathing season, to be run at short notice if an unplanned spill occurs to the environment from one of our works, or if planned maintenance results in the need to spill to the environment
- our BeachBuoy initiative, which was trialled internally this bathing season, to improve the understanding of the wastewater assets that potentially impact bathing and shellfish waters within target areas.

The continued success of our Beauty of the Beach campaign, which is run in partnership with the Environment Agency and Natural England, has also helped to raise awareness with customers about the impact they have on the coastal environment. We will be continuing to ask customers and stakeholders in our target areas to help us grow this campaign during 2019–20.

Beauty of the Beach

Addressing our pollutions performance

Our pollutions performance was unacceptable during 2018, with us recording seven (2017: four) serious pollution incidents (category 1 and 2) mainly due to acute equipment failures on sites that have high environmental impact. As a result, a Pollution Reduction Plan has now been put in place and resourced. The plan identifies which of our sites have the highest potential environmental impact which allows us to prioritise improvement activity and response resources. It has also been shared with the Environment Agency.

While we met our target of keeping less serious (category 3) pollution incidents below 158, achieving 144 (2017: 131), we know we still have more work to do to reduce this number further.

To ensure we fully understand and direct our improvement activities in the right areas, we have implemented a widespread 'eyes and ears' engagement campaign across our operational teams and regional stakeholders. With a much stronger focus on reporting and learning from incidents and near misses from our field teams, we have seen an increase in the number of reported pollution incidents. By addressing the root causes of near misses, our plans should see a real reduction in our underlying risks of pollution incidents. One of the metrics used by the Environment Agency is the number of self-reported incidents, for 2018 we achieved our best ever performance of 83% (2017: 70%).

All pollution incidents and near misses for 2018 were reviewed to fully understand the underlying root causes, ensuring that our Pollution Reduction Plan focuses on a number of critical success factors. We recognise we need to continue to improve the basics of clear processes, improving the reliability of critical assets, having the right on-site alarms and ensuring a fast response should an asset fail. In addition, we are transitioning to a more forward-looking risk approach, making greater use of predictive analysis to identify actions that will prevent future incidents.

“Our Pollution Reduction Plan identifies which of our sites have the highest potential environmental impact which allows us to prioritise improvement activity and response resources”

This programme will embed a culture and a capability to prevent pollution incidents occurring. The completion of the work in this plan will contribute to a resilient water future and a healthy and clean environment for the South East, by reducing pollution to zero by 2040. Our pollution management processes will ensure that we do the right thing for our environment, our customers and regulators.

It forms part of the Environment+ programme – progress already made is detailed earlier in this chapter on page 75 to 76. Formal reviews of each serious pollution incident are in place and daily calls are required for pollution events (including near misses), while weekly update meetings continue to review key actions and progress.

Reducing our impact on our water sources

The past year has been exceptional from a weather point of view, with intense cold in the winter and a lengthy, dry, hot spell in the summer. The consequent increase in pipe bursts coupled with an increased consumer demand for water meant that distribution input was 559 Ml/d above our 536 Ml/d target. The past 12 months has acted as an acute reminder of how precious water is in our water stressed region with future growth and climate change expected to add further pressure.

To tackle this we continue to increase our resource dedicated to leakage reduction and will soon begin a new collaborative programme of activities with our communities to encourage sustainable behavioural change through our innovative Target 100 programme (see our 'Better information and advice' chapter for more on our progress with our water efficiency programme and T100).

You can also read more about our plans for creating a resilient water future for the South East in our Water Resources Management and Drought plans at: **southernwater.co.uk/our-reports**.

“The past 12 months has acted as an acute reminder of how precious water is in our water stressed region”

Increasing our use of renewable energy

We promised to increase the proportion of renewable energy we use at our sites to 16.5% by 2020. Although we exceeded this figure last year, achieving 17.2%, we are disappointed to have seen the amount of renewable energy used in our operations reduce in 2018–19, achieving 15.8%. Of this, 15% was from converting biogas generated as a by-product of our wastewater sludge digestion into electricity and 0.8% was from solar power.

The reason the amount of renewable energy we use to power our operations reduced was that we undertook a significant maintenance programme on our biogas combined heat and power (CHP) fleet in 2018–19. While this increased downtime and reduced generation in the year, it should lead to increased reliability and better generation performance going forwards.

We are doing more to look after our environment

External assurance of standards

During 2018, we have been externally audited for specific standards to confirm that we have adequate management systems as required by legislation. The systems were audited for ISO14001 environmental management, ISO17025 accredited by UKAS for sampling and analysis and the Mcerts accreditation specifically required by the Environment Agency to confirm the measure of flow accurately. We have successfully maintained our accreditation for all standards.

Reducing our use of plastic and promoting alternatives

Reducing single-use plastics has become a hot topic for our customers, stakeholders and partners. We were the first water company in the UK to publish a formal policy on managing plastic waste and we are working with colleagues, our supply chain and customers to reduce our reliance on plastic in our offices, operations and our communities.

Our Plastics Steering Group meets monthly to oversee the policy and chart our progress. Since its foundation in 2018, this group has already had a number of successes.

We have carried out an audit of our use of plastics and are using the results to set targets for reduction. We have rolled out a plastics training programme to raise awareness with colleagues and are working with our supply chain to encourage them to reduce plastic waste too. We are also supporting the national Refill water bottle filling campaign.

Although we are not the source of plastics in the marine environment, we recognise that water companies are a link in the chain and have an opportunity to intervene. While screens at wastewater treatment works are designed to remove large items of debris, such as wet wipes, from wastewater – they are not designed to remove microplastics such as clothing fibres. So, we are teaming up with local universities to look at the types of microplastics found in wastewater, the impact they are having on the environment and explore new technologies to remove them at our wastewater treatment works.

We are proud to be playing an active role in better understanding the challenge posed by plastics and to be helping our customers and communities protect the environment.

Conservation and biodiversity

It is important to us to enhance health and wellbeing, protect and improve our environment and sustain the economy, which means focusing on our region's rivers, reservoirs and its 700+ miles of coastline.

During 2018–19, Southern Water was awarded an 'organisational licence' from Natural England, which allows for a new fast-track approval process for engineering works affecting the habitats of rare or protected species. The licence was given in recognition of our high-quality work protecting vulnerable wildlife, including dormice, badgers and crested newts. We are one of the first four out of 17 major water companies in England and Wales to receive it.

"Whenever we start a new project, we conduct a careful ecological survey to assess the wildlife living in the area with emphasis placed on sensitive or protected species"

Whenever we start a new project, we conduct a careful ecological survey to assess the wildlife living in the area with emphasis placed on sensitive or protected species. If they are found then no work starts until a plan has been put in place to prevent and mitigate any possible damage to habitats.

We have also been working to develop an invasive non-native species (INNS) disposal strategy, aligned with the Environment Agency's guidance. Various research projects are underway, with partners such as the Centre for Agriculture and Bioscience International, with the overall aim of better controlling INNS, without resorting to herbicides, or labour-intensive processes. A series of biosecurity posters have been installed at our operational sites that link to identification sheets for invasive species and training sessions are now underway with our Enabling team, which have helped to improve site awareness about these species and how to deal with them safely.

In terms of conservation our current approach is to supply suitable habitats for insects such as 'bug hotels', providing birds with insects to feed their young during the nesting season. We also encourage and support our field teams to put up bird and bat boxes. Several sites also have wild orchids and we encourage appropriate grounds maintenance to protect these important species.

Case study

Nigel Hepworth,
Water Resources Policy Manager

The resource challenge

People living in south Hampshire have always relied on the Rivers Test and Itchen for their water. So changes to our abstraction licences by the Environment Agency pose a significant challenge.

The licence reductions aim to secure the health of these rivers while reducing the amount of water we can take from them during drought. The changes mean a shortfall of some 135 million litres of water a day during a drought – about 80% of the amount needed to supply our customers in south Hampshire.

We have until 2027 to meet the new conditions and plan to invest more than £800 million to make up the deficit, while ensuring water resources continue to be resilient and environmentally sustainable. Our wide-ranging plans include desalination, new pipelines from neighbouring water companies, reducing leakage and improving water efficiency.

We are working closely with the Environment Agency to ensure a constant supply of drinking water while these alternative supplies are developed. It has agreed to drought orders and permits, allowing us to continue taking water during lower flows. If these are granted, temporary use bans will have to be in place to make sure customers use water wisely.

Meanwhile, our plans for a desalination plant in Hampshire have been included, along with eight other projects, as part of Ofwat's new process for assessing and approving funding for strategic water resource schemes.

Ofwat has asked us to work with five other water companies to investigate which of these eight projects should progress through to construction and implementation and to identify possible alternatives.

Funding for the construction of a desalination plant within the next five-year investment period (2020–25) is not expected to be included in Ofwat's determination of our Business Plan, but there is an allowance to progress the feasibility of the scheme alongside the other projects, which include the development of Abingdon reservoir, an effluent reuse scheme in Teddington and various regional transfers.

The planned desalination plant is a key component of our solutions in the western region by the 2027 timescale. Alternative solutions are likely to take much longer, and, if they are preferred, we will be dependent on drought permits and drought orders on the Rivers Test and Itchen for a longer period of time.

“We are working closely with the Environment Agency to ensure a constant supply of drinking water while these alternative supplies are developed”

Case study

Tom Gallagher, Bathing Water Manager

Enhancing our region's bathing waters

We have over 700 miles of beautiful coastline in our region including 83 designated bathing waters.

Our bathing waters are critical for tourism, business and leisure. Here at Southern Water we take seriously our responsibility to ensure our assets keep bathing waters free of contamination from polluted rainwater or wastewater.

We're committed to improving the quality of our coastal waters. That's why we launched our Bathing Water Enhancement programme back in 2016. Under the programme, we planned £31.5 million of investment to bring seven of the region's bathing waters up to 'excellent' standard, as defined by the Environment Agency, by 2020.

We've worked closely with councils, conservation groups, charities, businesses and regulators such as the Environment Agency to take action against sources of pollution. We looked at our network of pipes, pumping stations and treatment works to identify repairs and renovations – while cracking down on public misconnections from improper plumbing. We've also partnered with local authorities to encourage beachgoers to do their bit. Water quality is affected significantly by the bacteria found in dog and bird poo and so we're encouraging dog owners to clean up after their pets and asking people to stop feeding the birds.

As a result of this collaborative approach and the continued support of local communities, we're very pleased that the South East continues to be home to among the best bathing waters in the country.

"[With the] continued support of local communities, we're very pleased that the South East continues to be home to among the best bathing waters in the country"

Ben Earl, Water Efficiency Manager

Inspiring behaviour change

Each and every day, we rely on water to keep our bodies healthy, our businesses running and our leisure time enjoyable. Yet, we're not the only ones who count on it. Water is crucial for plants and animals.

As water becomes scarcer, the threat on the natural world is huge. That's why England's largest environmental and wildlife coalition, Wildlife and Countryside Link, formed the Blueprint for Water Group – to work with water companies, regulators and stakeholders to put sustainability firmly on the agenda.

The group recently launched its scorecard, which is used to assess the commitments water companies have made in the business plans submitted to regulators as part of Price Review 2019. Our plans underwent this environmental assessment to check we are taking steps to ensure a better environment for wildlife and people.

Our region faces a future of more people and less water. Population growth is driving up demand for water. Meanwhile, climate change is bringing greater risk of flooding or drought.

TARGET 100

Southern Water has a good track record for promoting water efficiency. Our universal metering programme helped reduce water use by 16% and brought our customers' average water use per person, per day to under 130 litres. Compared to the national average of 141, this is progress. But we know more needs to be done. That's why we launched Target 100. The programme aims to educate, incentivise and support customers to reduce usage to 100 litres per person, per day by 2040.

We're collaborating with our customers to achieve real change. We're carrying out home visits to improve water efficiency, as well as launching reward schemes – like discounts on food shopping and gym memberships.

After reviewing our Business Plan against its scorecard, Blueprint for Water awarded Target 100 a Blue Star for innovation. Southern Water is one of just six companies to have received this award, which recognises our ambition to create a resilient water future.

“Our region faces a future of more people and less water. Population growth is driving up demand for water. Meanwhile, climate change is bringing greater risk of flooding or drought”

Case study

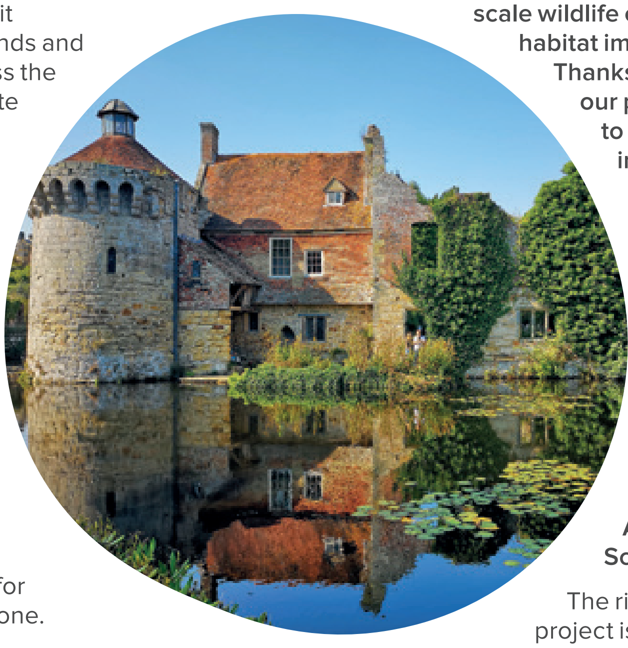
Sarah Feasey,
Stakeholder Engagement Manager, Kent

Working together to protect our environment

In spring 2018, we completed our important enhancement work on the section of the River Bewl, which runs through the grounds of Scotney Castle.

This work will benefit woodlands, grasslands and wetland areas across the Scotney estate, a Site of Special Scientific Interest, for many years to come.

Working in partnership with the National Trust was a natural fit with the scheme aligning perfectly with the Trust's goal of actively contributing to the improvement of the water environment for the benefit of everyone.



"As a conservation charity, it's our responsibility to look after the Scotney Castle estate for nature. This project sits hand in hand with the work we do here, with particular benefits in terms of landscape scale wildlife corridors and habitat improvements. Thanks to the work of our partners, we hope to see a real boost in the health of the river in the years to come. National Trust will survey for dragonflies, newt and butterflies while Southern Water continues to survey aquatic invertebrates."

Mark Musgrave, Area Ranger, Scotney Castle

The river enhancement project is a key element of our Bewl Water Mitigation Scheme to reduce the impact of releases from nearby Bewl Water reservoir, by creating a more natural flow that's closer to how nature intended.

"Thanks to the work of our partners, we hope to see a real boost in the health of the river in the years to come"

What we have achieved

	2018–19 Target	2018–19 Achieved	2017–18 Achieved	2016–17 Achieved	2015–16 Achieved
Greenhouse gas emissions – ktCO_2e	228	200	228	245	267
KgCO_2e per person supplied with treated water[1]	–	18	23	25	27
KgCO_2e per person supplied with wastewater services[1]	–	30	33	35	39

[1] There are no targets for these indicators

KgCO_2e – Kilograms carbon dioxide equivalent

Reducing our impact

We want to reduce the impact our business has on our environment, which is why we are working to reduce our carbon emissions, and the contribution we make to climate change.

During 2018–19, our carbon emissions (greenhouse gases) produced by our operations in order to provide services to our customers reduced.

We also continued to build low carbon design into our treatment works, pumping stations and processes and are looking ahead to how we can use efficient and integrated designs to improve even further in the years ahead.

We are using renewable energy where we can

During 2018–19 we were able to beat our target of restricting carbon emissions from our operations, achieving the equivalent of 200 kilotonnes of carbon dioxide.

We were able to do this by making our sites more energy-efficient and using our own renewable energy, so we take less power from the national grid, by:

- replacing inefficient systems to minimise energy demand and reduce our carbon footprint
- continuing our sludge thickening programme, reducing the need for transport and its associated emissions
- installing biogas monitors at our largest combined heat and power sites to measure methane and any leaks
- increasing the volume of our chemical storage tanks, reducing transport and associated emissions
- providing water-saving home visits to our customers. The potential savings from the water-saving devices installed equates to generating 1.4 kilotonnes less carbon dioxide
- partnering with engineering and environmental consultancy, Ricardo, to apply computer simulation techniques to maximise the efficiency of our water network
- replacing older types of lighting with LEDs to reduce energy requirements and associated emissions.

Recycling waste from our treatment sites

We are disappointed that we were unable to maintain our 100% biosolid recycling record during 2018–19. In November, we reported one incident of 'unsatisfactory biosolids recycling' from our Ashford wastewater treatment works.

To ensure this does not happen again, detailed plans are now in place alongside a region-wide operational review of the factors affecting pathogen compliance. Discussions have taken place with farmers affected by the incident and an independent report prepared by ADAS, a specialist agricultural consultancy, has been shared with the farmers, which has confirmed that risk to human health is extremely low.

Along with others in the industry, we have also begun discussions with the Environment Agency to address some of the controls and rules around sludge disposal to enable more accurate reporting in the future. This is an ongoing discussion and we fully support the process.

> **"During 2018–19 we were able to beat our target of restricting carbon emissions from our operations"**

Financial performance

Financial performance

Accounting policies

The accounting policies of the company are set out on pages 169 to 176 and include details of the impact of new standards, IFRS 15 'Revenue from Contracts with Customers' and IFRS 9 'Financial Instruments' which became effective for periods beginning 1 January 2018.

Income statement

Our income statement is summarised in Table 1 below.

Table 1 – Income statement years ended 31 March

	2019 £m	2018 £m
Revenue before regulatory settlement	**876.3**	857.7
Other operating income	**1.2**	1.1
Operating costs before regulatory settlement	**(349.3)**	(336.0)
Depreciation, net of amortisation	**(271.8)**	(259.5)
Operating profit before regulatory settlement	**256.4**	263.3
Regulatory settlement	**(138.5)**	-
Operating profit after regulatory settlement	**117.9**	263.3
Other income	**0.2**	11.2
Profit on disposal of fixed assets	**0.7**	0.8
Profit before interest and tax	**118.8**	275.3
Net finance costs	**(155.8)**	(118.7)
Fair value (losses)/gains on derivative financial instruments	**(216.6)**	46.3
(Loss)/Profit before tax	**(253.6)**	202.9
Tax	**20.7**	(32.2)
(Loss)/Profit for the financial year	**(232.9)**	170.7

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

Revenue before the proposed regulatory settlement increased to £876.3 million (2018: £857.7 million). This increase results from changes to our inflation-linked water and wastewater tariffs, in part offset by a reduction in the revenue now recognised under IFRS 15 for developer-related activities, most notably sewer adoptions, of £17.9 million. A detailed analysis of revenue is provided in note 5 to the financial statements.

Overall, operating costs before the regulatory settlement increased by £13.3 million to £349.3 million (2018: £336.0 million); removing the impact of inflation of £11.6 million, would result in operating costs being broadly in line with the prior year. The major movements are described below and in Table 2 (on page 89).

As described in our Strategic Report, 2018–19 has seen the continuation of our transformation journey. We have been improving systems and processes, as well as changing the structure and culture of the business, to ensure we are ready to deliver our Business Plan 2020–25. This transformation programme incurred additional costs of £2.8 million in the year together with IT transformation costs of £3.1 million incurred developing new systems, processes and investing in the right people as we insourced our IT support.

This transformation programme is already delivering efficiencies and improvements to our Customer Services delivery. Over the past 12 months we have successfully moved all our offshore billing and payment operations and customer correspondence work from a number of service partners to Capita's office in Bangalore. This transition along with organisational changes made during 2017–18 have led to efficiency savings of £5.1 million.

Table 2 – Year-on-year increase/(decrease) in operating costs before the proposed regulatory settlement

	£m
Inflation	11.6
Transformation programme costs	2.8
IT transformation costs	3.1
Customer Services efficiencies	(5.1)
Reduction in debt collection charges	(1.7)
Increase in leakage activity	1.7
Reduction in pension costs	(2.7)
Guaranteed Minimum Pensions equalisation costs	1.8
Business Plan 2020–25	2.7
Other	(0.9)
Movement in operating costs	**13.3**

In addition, by improving the effectiveness of our collection and debt management process and utilising segmentation to provide a more tailored customer experience, we have also been able to target our debt recovery action more effectively leading to reduced debt collection costs of £1.7 million.

As reported in the Strategic Report on page 64, we have experienced higher levels of water leakage this year and we are working hard to reduce this. We have therefore increased the size of our leakage team, changed the way we incentivise our partners to find and fix leaks and we are fixing more than ever before. This resulted in additional costs of £1.7 million.

The finalisation of the 2016 pension scheme valuation and agreement of a deficit recovery plan with the Trustees and The Pensions Regulator has resulted in a reduction in associated pension advisory costs of £2.7 million in the year. These savings have been partially offset by a one-off past service cost of £1.8 million following the ruling made in October 2018 by the High Court that guaranteed minimum pensions should be equalised between men and women.

During the year we submitted our Business Plan for 2020–25 to Ofwat. The preparatory work, including consultations with customers and stakeholders, required to develop this plan as well as responding to the challenge and queries raised by Ofwat resulted in additional costs of £2.7 million this year.

In addition to these movements in operating costs, depreciation increased to £271.8 million (2018: £259.5 million) as a result of our significant capital investment programme. New schemes commissioned during the year added £9.7 million to the depreciation charge.

As a result of the factors set out above, operating profit (before regulatory settlement) for 2018–19 decreased to £256.4 million (2018: £263.3 million), a 2.6% reduction.

As reported on page 26, following its investigation into our historical wastewater treatment works compliance reporting, Ofwat has confirmed its intention to impose a penalty under Section 22A of the Water Industry Act. This penalty comprises a fine of £3.0 million together with a reduction to future revenues of £122.9 million at 2017–18 prices which will be made by way of a rebate to wastewater customers over the period from 2020 to 2025. We have provided for these in full in the financial statements for 2018–19 resulting in a reduction to operating profit of £138.5 million (at forecast outturn prices). As a result, operating profit after the proposed regulatory settlement was £117.9 million (2018: £263.3 million). An investigation being conducted by the Environment Agency is also disclosed on page 26 and is ongoing.

The fall in other income to £0.2 million (2018: £11.2 million) was due to the one-off profit, recorded in 2017–18, from the sale of our non-household retail business.

The profit on disposal of fixed assets of £0.7 million (2018: £0.8 million) mainly relates to the sale of surplus vehicles and the release of deferred revenue from the historical sale of income rights relating to aerial masts.

Net finance costs increased by £37.1 million to £155.8 million (2018: £118.7 million). During the year we refinanced our business in order to reduce our gearing and this is described in detail on pages 96 to 97. As a result we incurred additional financing one-off costs of £27.9 million for repaying our Class B loan early as well as costs of £8.4 million relating to the refinancing in general and the ongoing project to restructure our finances by closing our Cayman Islands subsidiary company, Southern Water Services (Finance) (SWSF).

As part of the refinancing, Southern Water Services Group (SWSG) repaid £682.3 million of an inter-company loan. This resulted in a reduction in interest receivable of £13.9 million. The reduction in interest receivable was offset by an increase in the amount of capitalised interest of £6.5 million, and by lower indexation and preference share interest which fell by £4.1 million and £2.2 million respectively.

The fair value loss on our derivative financial instruments amounted to £216.6 million (2018: gain £46.3 million). To calculate the fair value of our derivative instruments we discount their forecast future cash flows using UK Government bond yields. These future forecast cash flows are predictable and match the future forecast movement in our revenues and 'Regulatory Capital Value', but government gilt yields are constantly moving, with the result that the valuation of our derivative instruments can be volatile. The changes in value that are recorded during the lives of derivatives do not represent cash flows.

We have recognised a total tax credit to the income statement of £20.7 million (2018: £32.2 million tax charge). This differs from the credit that may be expected of £48.2 million, based on the loss before tax of £253.6 million and the current period tax rate of 19%, as described in note 10. The difference is primarily due to not having reduced our taxable profits for the regulatory settlement provision, and the company receiving group relief losses surrendered by other companies in the Southern Water group for nil payment.

The loss after taxation for the year amounted to £232.9 million (2018: £170.7 million profit).

Cash flow statement – summary

Overall, cash and cash equivalents increased in 2018–19 by £207.6 million (2018: £120.9 million decrease). This movement of £328.5 million principally results from the refinancing activities that we undertook during the year, described on page 96 to 97. Further details of the significant year-on-year movements are provided in Table 3 below.

Table 3 – Cash flow statement years ended 31 March

	2019 £m	2018 £m	Movement	Explanation
Movement in loan to SWSG	682.3	–	682.3	In 2018–19 (FY19) SWS received a repayment of £682.3 million from SWSG of an inter-company loan as part of the refinancing exercise.
Net interest related transactions	(152.2)	(85.6)	(66.6)	The increase in financing charges payable was largely the result of our refinancing exercise. In FY19 we incurred additional costs of £27.9 million relating to early repayment of our Class B loan together with the payment of interest accrued on the loan of £10.0 million. In addition following the partial repayment of an inter-group loan by SWSG, interest receivable fell by £13.9 million and we incurred one-off charges relating to the refinancing exercise and the closing of our Caymans company of £8.4 million.
Net movement on borrowings	(255.1)	–	(255.1)	This movement mainly results from a repayment of our Class B loan of £247.6 million and preference shares of £22.7 million, offset by an increase in our credit facility of £20.0 million.
Payments on restructure of derivative instruments	(122.5)	–	(122.5)	As part of the refinancing exercise we incurred costs of £113.6 million extending the mandatory breaks on our swap agreements, together with the net cost for the early termination of swaps of £8.9 million.
Equity dividends paid	(34.8)	(117.3)	82.5	In FY19 our dividends to SWSG fell by £11.2 million due to the refinancing exercise. Other interim dividends also reduced to nil in FY19 from £8.0 million in the prior year. In the prior year we paid the final dividend of £63.2 million declared in March 2017 in relation to 2016–17.
Other	89.9	82.0	7.9	The net cash movement from operating activities and our capital investment programme.
	207.6	(120.9)	328.5	

Table 4 – Statement of financial position years ended 31 March

	2019 £m	2018 £m
Non-current assets	**6,302.1**	6,768.2
Current assets (excluding cash)	**337.2**	329.9
Cash and cash equivalents	**372.0**	164.4
Total assets	**7,011.3**	7,262.5
Current liabilities	**(871.0)**	(710.0)
Non-current liabilities	**(5,302.6)**	(5,427.0)
Total liabilities	**(6,173.6)**	(6,137.0)
Total net assets	**837.7**	1,125.5
Total equity	**837.7**	1,125.5

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

Statement of financial position – summary

Our statement of financial position is summarised in Table 4 above.

At the end of the year to 31 March 2019, we had non-current assets of £6,302.1 million (2018: £6,768.2 million), a decrease of £466.1 million from March 2018. This decrease results from the partial repayment of an inter-company loan by SWSG, as mentioned in the cash-flow movements, of £682.3 million offset by our ongoing capital investment programme which increased the value of property plant and equipment and intangible assets by £170.3 million and an increase in the value of our non-current financial derivative assets of £45.9 million.

Current assets increased to £337.2 million (2018: £329.9 million) principally as a result of the increase in net trade receivables. These have been impacted by the changes to our tariffs and improvements to our debt recovery processes which have improved the likely collection of certain outstanding balances and reduced the bad debt provision required for them.

Current liabilities increased to £871.0 million (2018: £710.0 million). This increase is mainly caused by the new credit facility of £170.0 million, which was part of the refinancing exercise undertaken this year, and classified within current liabilities as it will be repaid in 2019–20.

At 31 March 2019 non-current liabilities totalled £5,302.6 million (2018: £5,427.0 million). This decrease of £124.4 million was principally the result of a net reduction in long-term borrowings of £380.7 million, as a result of the refinancing exercise, partially offset by an increase in the derivative financial instruments liability of £136.0 million as described in note 21 and the provision for the reduction in future revenues as part of the regulatory settlement of £135.5 million

The fall in borrowings largely related to the repayment of the Class B loan of £247.6million, the Class B facility of £150.0 million and the preference shares of £22.7 million offset by indexation on loans of £34.7 million.

Overall, net assets decreased from £1,125.5 million to £899.7 million.

Dividend policy

Our dividend policy is formulated to ensure a fair balance of reward between customers and investors. 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.

These tests are not applied to the interim dividends of £34.8 million paid in 2018–19 to Southern Water Services Group (SWSG), as this dividend payment is instantly offset by a corresponding interest receipt from SWSG and is therefore immediately repaid to the company in a 'dividend loop' (see page 100).

Having undertaken its assessment for 2018–19 the Board has decided not to declare an ordinary share dividend for 2018–19 (2018: £8.0 million). The potential level of base dividend was calculated as £65.7 million. In addition the Board approved preference share dividend payments of £5.9 million in 2018–19 (2018: £13.1 million) and a further £5.0 million was accrued at 31 March 2019. Of this accrual a dividend of £4.4 million was approved and paid in June 2019.

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. This decision is a result of a combination of issues that will resolve over the next three to six months with a particular emphasis on our continued preparations for the Business Plan 2020–25, legacy wastewater compliance issues and ongoing financial resilience.

Further details are shown in note 11 to the financial statements.

Taxation strategy

We have a low risk approach to our management of tax. The foundation of our tax strategy is to comply fully with tax legislation, to focus upon maintaining a strong tax compliance culture and to manage our tax affairs in the best interest of our customers and stakeholders.

Our Tax Policy

Our Tax Policy is consistent with the overall values and corporate strategy of the company and considers 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 use 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.

Our approach to tax management is to be fully compliant with tax laws, rules, regulations and reporting requirements in all of its operations. This extends to following both the letter of the law as well as the spirit of the law. We also use the expertise of professional tax advisors to ensure we maintain best practice in our approach to compliance and in circumstances when additional advice is deemed appropriate.

We are open and transparent and we do not use tax avoidance schemes or take an aggressive stance on our interpretation of tax legislation when tax planning.

Our management of tax risk

As stated above in our Tax Policy, we adopt a conservative approach to tax risk, our tax management focus is on compliance and our tax planning is always aligned with our commercial and economic activity. All companies within the

Southern Water group are subject to UK tax, and all companies are UK tax resident irrespective of their place of incorporation, ensuring that each company is subject to UK tax.

Tax risk primarily emanates from the evolution and complexity of the Southern Water business along with the ever changing regulatory and legislative environment. We manage this risk by having an experienced tax team dedicated to tax compliance and the identification of tax risks in our business. Our Tax team works with the wider business to ensure there are sufficient processes and controls in place and to determine what level of risk is acceptable. We also have a support network of industry tax experts who provide specialist tax services, check what we are doing and provide advice and guidance on new tax compliance challenges. Our Internal Audit team also carries out assurance on the control environment relating to the transactional processes underpinning our payments to the Exchequer and our collection of taxes on behalf of the Exchequer.

Our relationship with Her Majesty's Revenue and Customs (HMRC)

A key factor in our management of our tax affairs 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 which goes beyond the normal filing of statutory returns, such as the sharing of internal audit findings so that we can be open and transparent in our approach to managing tax risk. HMRC share our view of our low risk approach to the management of our tax affairs with an HMRC assessment of us as a 'low-risk' company.

Maintaining public trust

As previously stated, we are committed to complying fully with tax legislation and on maintaining a strong culture of compliance as well as having open and constructive relationships with tax authorities.

We apply government and fiscal authority tax incentives and exemptions, where they exist. For example, the UK tax system recognises the benefit to the economy of investment in infrastructure and environmental protection through the availability of capital allowances which reduce the corporation tax Southern Water pays. Any benefits of this are passed to our customers.

Southern Water and all Southern Water group companies pay taxes in the UK and have never used offshore companies to avoid tax or levies. We have a Cayman Islands registered subsidiary company which was set up to issue debt in the UK, see page 99 for more information. Its Cayman Island registration does not have any impact on the tax due by the group. However, we know that this company has contributed to misconceptions about our business practices which is why we are working towards closing it. We hope to complete this process shortly.

Understanding our taxable profits and our corporation tax

Our taxable profits are generally different to our accounting profits for the following reasons:

- Capital allowances and depreciation – we have a large capital expenditure programme and this is deducted against taxable profits as capital allowances. Capital allowances are applied at different rates than the depreciation charged against profits in the financial statements. As a result, there is a timing difference between deductions made against our taxable profits and those made against our accounting profits. Due to the scale of our capital expenditure programme and the level of capital allowances utilised, our taxable profits are significantly reduced.
- The treatment of interest costs – we borrow money to finance our capital expenditure programme. The interest associated with this borrowing is recognised as both an accounting and tax expense, so reducing profit and the amount of tax we pay. There are however, differences between the amounts of interest recognised for accounting profits and for taxable profits. Examples are that movements on the fair value of our financial derivatives are not recognised in our taxable profits, and interest that is capitalised in our financial statements is deducted in calculating our taxable profits.
- Group relief – Southern Water is part of the Greensands Holdings group of companies as set out on page 97. All of these companies are taxable as UK companies and profits or losses of these companies within the group can be set-off against one another in the financial year.

- Changes to future tax rates – The financial statements carry the temporary differences between our taxable profits and our accounting profits as a deferred tax balance on the statement of financial position. Changes to the future rate of corporation tax revise the carrying value of these differences.

Our tax charge is reduced by our large capital expenditure programme and the interest we are charged on borrowings. The benefit of this is passed to our customers through reduced bills. There is no corporation tax allowance within our customer bills for the regulatory period from April 2015 to March 2020.

Details of our tax charge for the current financial year are disclosed in note 10 to the financial statements and the current year charge to the Income Statement is also explained further on page 90.

Our other tax contributions

Our other contributions to the Exchequer amounted to £72.0 million. These are explained below:

- Business rates of £27.2 million paid to local authorities (2018: £26.8 million) and payments to the Environment Agency of £9.0 million (2018: £8.5 million) for abstraction licences and discharge consents, which reduce profits chargeable to corporation tax.
- Employment taxes of £33.6 million (2018: £31.3 million) paid to the Exchequer under PAYE (Pay As You Earn) and National Insurance contributions.
- Carbon Reduction Commitment of £2.2 million (2018: £3.1 million) levied on our power costs, which reduces profits chargeable to corporation tax.

Payments have also been made to other group companies of £8.2 million for tax losses surrendered to the company. These were paid to SWSG allowing SWSG to make interest payments back to Southern Water. Overall, Southern Water pays 9.3 pence in the pound for losses surrendered from group companies. As a result of capital allowances and interest charges, no corporation tax was paid by the company to HMRC in 2018–19.

Financial KPIs

Within our financial debt structure is a comprehensive set of covenanted financial ratios. Of these, there are two key ratios, namely the ratio of net debt to Regulatory Capital Value (RCV) and the ratio of adjusted net cash income to net interest cost.

The net debt to RCV ratio is calculated as short and long-term senior borrowings, less cash and short-term deposits to the RCV (all values taken from our Regulatory Accounts). The RCV is set by Ofwat at each five-year periodic review and reflects our initial market value plus subsequent capital investment and inflation. The RCV is adjusted at each periodic review for relevant changes to the level of expenditure or performance during the five-year period.

Senior adjusted cash interest cover (measured as the ratio of net cash inflow from operating activities less RCV depreciation to senior debt interest) is targeted to be maintained above 1.1 times to meet covenanted levels.

Net debt/RCV	%
2015–16 performance	79
2016–17 performance	77
2017–18 performance	77
2018–19 performance	66
Covenanted lock-up level (to 2017–18)	<85
Covenanted lock-up level (to 2018–19)	<75

Senior adjusted cash interest cover	Times
2015–16 performance	1.9
2016–17 performance	1.9
2017–18 performance	1.8
2018–19 performance	1.5
Minimum target trigger level (to 2017–18)	1.1
Minimum target trigger level (to 2018–19)	1.3

The covenanted lock-up level/trigger level refers to debt covenants where payment of dividends by Southern Water are not permitted. These are structural buffers to protect against a default covenant e.g. the covenanted default net debt to RCV level is at 95%.

Credit rating as at 31 March 2019	
Standard & Poor's	Class A debt: BBB+
Fitch	Class A debt: BBB+
Moody's	Class A debt: Baa2

During the year we repaid our Class B debt out of the proceeds of a capital injection to Southern Water (see pages 96 to 97). Following the announcement by Ofwat of the outcome of its investigation into our wastewater performance, the credit rating agencies each reviewed their assessment of the credit ratings for Southern Water. The credit ratings are shown in the table above and the outlooks of Standard and Poor's is Negative Outlook, Fitch have a Stable Outlook and the credit ratings for Moody's are on a review for a downgrade.

Capital structure

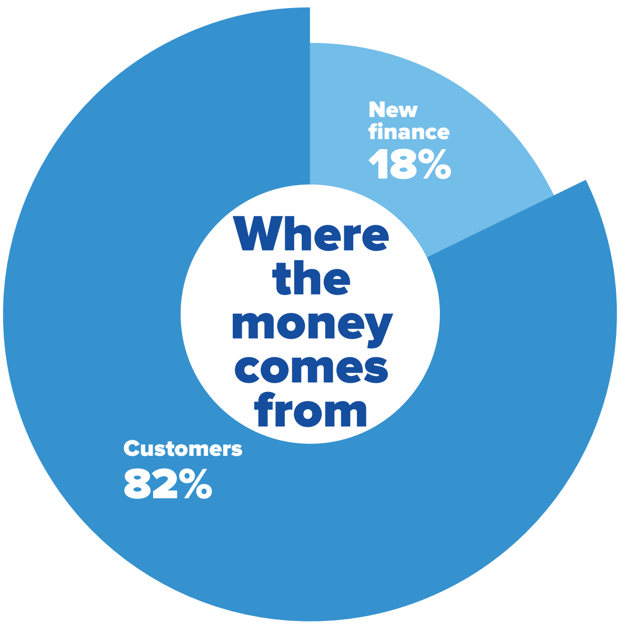
Why Southern Water raises finance

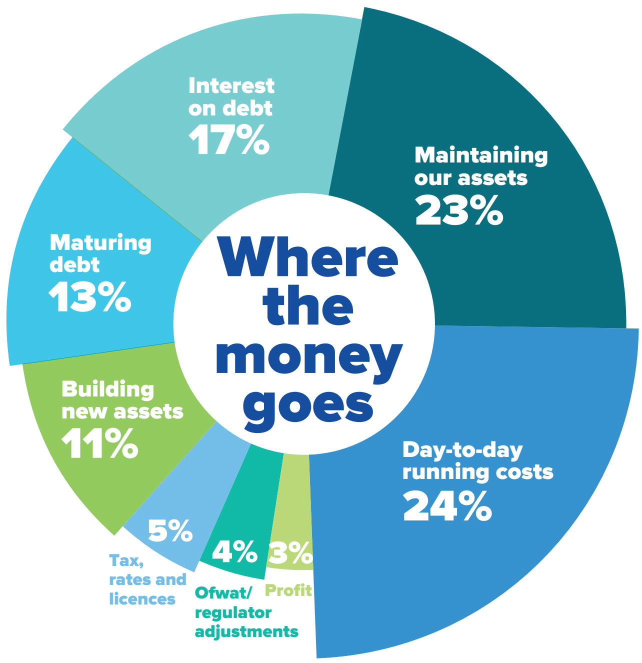
Significant capital investment has been a feature of our business since privatisation in 1989. We have invested in both maintaining our existing asset base and constructing new assets in order to improve the environmental quality of wastewater, improve the quality of drinking water and accommodate population growth in our area of operation. As an example, before privatisation, 350,000 cubic metres of wastewater per day was discharged into our coastal waters untreated, but the completion of our £300 million Cleaner Seas for Sussex scheme in 2013 marked the conclusion of a programme of capital investment to fully treat wastewater of the coastal towns and cities from Kent to Hampshire and the Isle of Wight. A further example is a current £93 million construction project at Woolston which will improve the quality of effluent discharged into the River Itchen as well as reduce odours.

We raise finance to pay for the construction of new assets and to repay loans taken out in previous years. In addition we are partly financed by shareholder equity, sufficient in size to absorb financial risk and to contribute to the financing of the construction of new assets.

The level of customer bills is calculated to cover our operating expenditure, our annual financing costs (including any equity return to our shareholders) and the amount required to invest in and maintain our assets, such as water pipes, sewers, pumping stations and treatment works.

The charts below illustrate the sources and uses of expected cash flows for the current Business Plan 2015–20, and demonstrate our requirement to raise finance to fund our capital investment programme. The data is based upon the regulatory price determination for 2015–20, which sets out both our performance obligations and the limits on customer bills for this current five-year price period.





Day-to-day running costs includes wages, power, chemicals, materials and bad debt* costs.

*Bad debt = the cost of providing for unpaid customer charges.

Maintaining our existing assets includes our pipe network, treatment works and capitalised employee costs.

Interest on debt interest on money we have borrowed to finance improvements to the business over the long term.

Building new assets contributes to projects to enhance treatment standards and cater for growth.

Profit is the residual return earned on shareholders' investment in the business.

Tax, rates and licences includes corporate taxes, business rates on buildings, wastewater treatment and water supply works and Environment Agency licences.

Ofwat/regulator adjustments applied by Ofwat for the period 2010–15, relating to customer satisfaction, cost-savings and revenue collection.

How we are structured

Southern Water Services Limited (SWS) is a privately owned company and is the principal subsidiary of Greensands Holdings Limited (GSH). All companies in the group are UK tax resident and liable for tax in the UK.

Ownership

GSH is owned by a consortium of long-term investors representing infrastructure investment funds, pension funds and private equity and no single shareholder has majority control (see below).

GSH Board

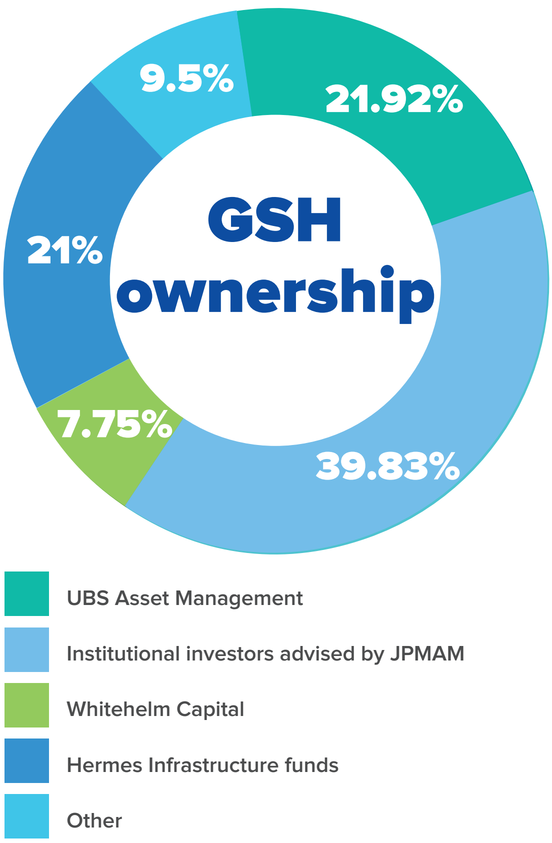
The GSH Board comprises five directors. Three of those members, including the Chair, are appointed by institutional investors advised by JP Morgan Asset Management; one director is appointed by shareholders represented by UBS Asset Management; and one is appointed by shareholders represented by Hermes. Another shareholder is entitled to appoint an observer to attend and take part, but not vote, at GSH Board meetings. No independent members of the Southern Water Board sit on the Board of GSH.

The purpose of GSH is to act as a single-purpose entity as the ultimate holding company for Southern Water and the other companies within the group. The GSH Board complements and supports the aims of Southern Water for its long-term success. Whilst certain matters are reserved to the GSH Board and/or shareholders, these matters do not impact the day-to-day operations of Southern Water and nor do they materially affect Southern Water's ability to function as an independent company in providing an essential public service.

Group structure

In September 2007, the Greensands group of companies was established for the purpose of the acquisition of 100% of the share capital of Southern Water Capital Limited, the then ultimate parent company of Southern Water, from the Royal Bank of Scotland (investing £1.9 billion of equity and debt to finance the acquisition).

During 2018–19 additional Greensands financing companies were added to the group structure as part of a financing plan to improve financial resilience of Southern Water ahead of the PR19 price review period starting April 2020. These new companies form the 'Midco' financing companies in the holding company structure diagram on page 97.



UBS Asset Management a large-scale global asset manager, offering investment capabilities across all major traditional and alternative asset classes

JP Morgan Asset Managment (JPMAM) a large-scale global asset manager advising institutional investors

Whitehelm Capital Shareholding managed by Whitehelm Capital on behalf of Motor Trades Association of Australia and Prime superannuation funds

Hermes Infrastructure funds Hermes Infrastructure is part of Hermes Investment Management and is a specialist infrastructure manager operating a diversified, well-established, UK-focused shared investment platform. With £4.1 billion of assets under management, Hermes Infrastructure is one of the UK's largest direct investors

Other minor shareholdings held by infrastructure investment companies

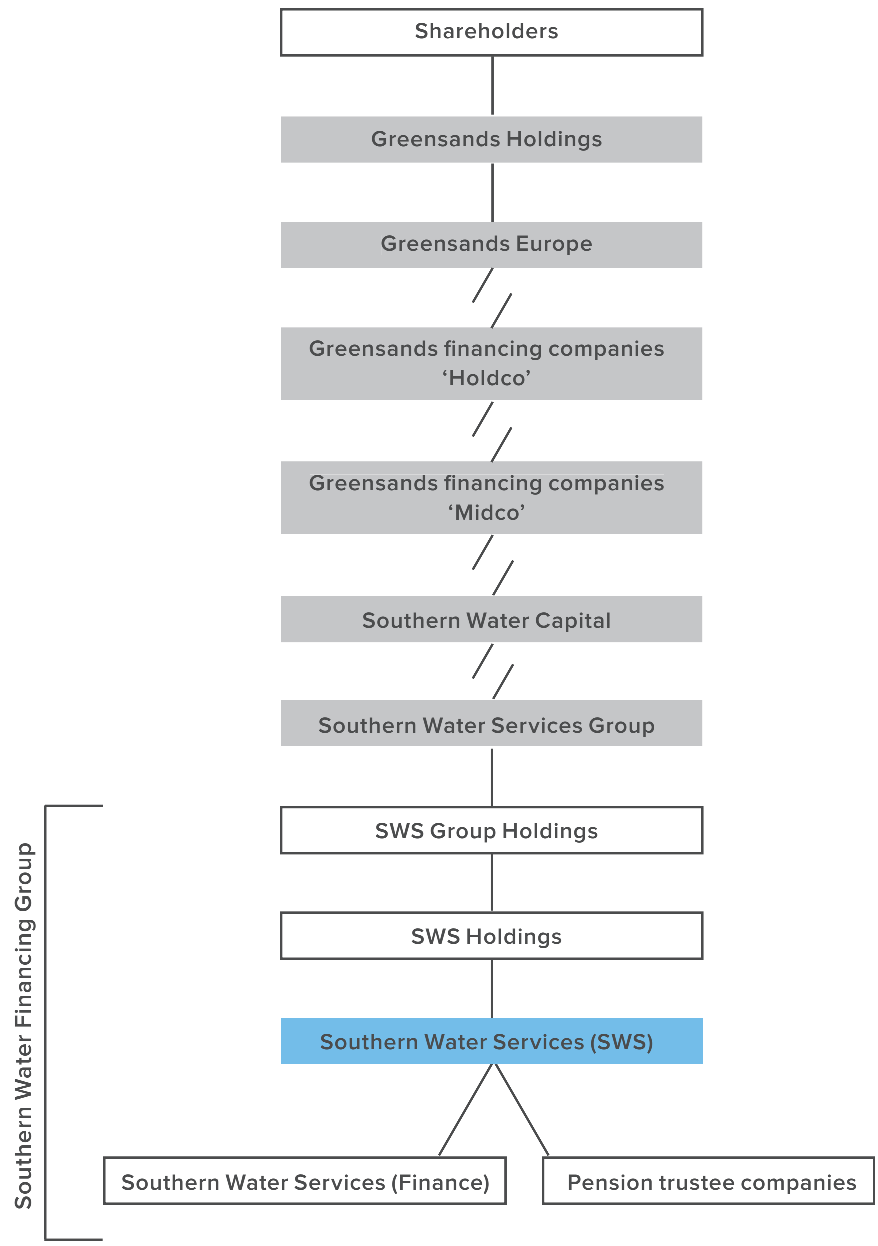
The financial restructure was completed in March 2019 and comprised:

- £450 million new borrowings raised by new Greensands financing companies formed as a 'Midco' financing structure
- £250 million new borrowing raised by existing Greensands financing companies ('Holdco' financing structure)
- £700 million of new finance was invested into Southern Water, net of £12 million costs, by a repayment of inter-company liabilities totalling £687.3 million
- These proceeds were used by Southern Water to repay £400 million of outstanding Class B debt, provide £150 million towards repayment of the £300 million Class A bond repaid 1 April 2019, £113.6 million was used toward reducing the interest cost of our inflation linked derivatives for the period 2021 to 2031, and the remaining £37.0 million was used to pay costs associated with repaying the Class B debt and terminating a derivative associated with the Class B debt.

The Greensands financing companies also maintain liquidity facilities which can provide a short-term source of finance.

The holding company structure for SWS is shown in the diagram below and this is followed by an explanation of the principal companies in the structure.

Southern Water ownership structure summary



Greensands Holdings (GSH) – The ultimate parent company within the group. GSH was established in 2007 for the acquisition of the Southern Water Capital group, from RBS, by the shareholders. The company is Jersey registered, but it is UK tax resident and, as such, is liable for tax in the UK. The company was incorporated in Jersey because Jersey law allows greater choice than the UK as to the way distributions can be made to shareholders. GSH holds 100% of the share capital of Greensands Europe and has no direct holdings in any other entities.

Further details can be found in the GSH Annual Report and Financial Statements which are published at **southernwater.co.uk/greensands-ownership-of-southern-water**.

Greensands Europe (GSE) – A subsidiary of GSH incorporated in England and Wales and resident for tax in the UK. GSE was established to issue bonds as part of the financing for the acquisition of the Southern Water Capital group in 2007. GSE has issued debt, Eurobonds, which are held by our shareholders in proportion to their respective shareholdings. This bond debt meets the eligibility requirements of the 'quoted Eurobond exemption' for tax purposes. The Eurobonds are listed on the International Stock Exchange in the Channel Islands which is a recognised stock exchange for the purposes of the quoted Eurobond exemption by HMRC. The bonds were issued on this stock exchange for ease of administration, as they are issued to the shareholders of the group and are not traded.

Greensands financing companies 'Holdco'– A number of companies, all incorporated in England and Wales and resident for tax in the UK, were established to provide additional external financing for the acquisition of the Southern Water Capital group in 2007. Security granted to the lenders of this financing is limited to the share capital of Greensands Holdings Ltd. There are no debt guarantees in place between the Greensands financing companies and the Southern Water Financing Group, with the result that SWS is fully protected, and fully isolated, from a default at any Greensands company.

Greensands financing companies 'Midco'– The Greensands Midco group of financing companies was incorporated in 2018 as part of a financial restructuring exercise to improve financial resilience of Southern Water. The objective of the restructure was to reduce the total leverage within the Southern Water Financing Group and to reduce interest payments at Southern Water to help manage financial covenants. The debt issued by Midco companies is senior to that issued by the Greensands Holdco group of financing companies.

Southern Water Capital (SWC) – Was the previous holding company for the Southern Water group established as part of the sale of Southern Water by ScottishPower in 2002. SWC is incorporated in England and Wales and resident in the UK for tax. It does not trade and holds preference shares in SWS from which it receives dividends.

Southern Water Services Group (SWSG) – The immediate parent company of the securitised group which acts as a holding company for this group following the financial restructuring in 2003. SWSG is incorporated in England and Wales and resident in the UK for tax.

Southern Water Financing Group – Southern Water established a financing structure, known as a Whole Business Securitisation (WBS), in 2003 following its sale by ScottishPower. The WBS sets strict rules which demonstrate to investors that Southern Water is a safe and reliable business in which to invest. This structure helps to reduce our financing costs and improves access to long-term and secure sources of finance. Reducing financing costs ultimately benefits customers in the form of lower bills.

The WBS works by creating a ring-fence around the Southern Water business in the form of a financing group. The financing group, whose immediate parent is SWSG, provides security to finance providers in the form of a charge over the share capital of SWS Group Holdings (SWSGH). No security is provided over our individual regulated operating assets. This structure ensures that, in the unlikely event that either Southern Water or SWSF were to default on their debt obligations, Southern Water would continue to operate as usual. Debt providers are not permitted to either break up or interrupt the business and can therefore only look to a new owner of the financing group to recover their debt in the unlikely event of serious default.

In 2003, a Common Terms Agreement (CTA) between the members of the financing group and its debt investors was established. The CTA sets out arrangements for the ongoing management of the debt issuance programme as well as a number of operating arrangements in order to minimise our financial risk and adhere to good industry practice.

One of the CTA arrangements is a limit on the indebtedness of Southern Water and SWSF. This includes precautionary 'early warning' limits which prevent the payment of dividends if a limit is breached. We ensure that we operate with sufficient financial headroom against these limits and have not breached a limit at any time since the implementation of the financing framework in 2003.

SWS Group Holdings – An intermediate holding company forming part of the securitised group. The company is incorporated in England and Wales and resident for tax in the UK.

SWS Holdings – The immediate holding company for Southern Water, forming part of the securitised group. The company is incorporated in England and Wales and resident for tax in the UK.

Southern Water Services – This is the only operating company within the group, providing water and wastewater services to customers across Kent, Sussex, Hampshire and the Isle of Wight. Southern Water is incorporated in England and Wales and resident for tax in the UK. It is the company that this Annual Report and Financial Statements relates to.

Southern Water Services (Finance) (SWSF) – Our financing subsidiary, SWSF, was established for the express purpose of raising debt finance on our behalf under the securitisation in 2003.

Due to administrative reasons applicable at the time of the WBS it was necessary for SWSF to be registered in the Cayman Islands in order to raise debt listed on bond markets. This original requirement for it to be registered in the Cayman Islands is no longer necessary and we are in the process of closing this company.

SWSF is wholly and exclusively resident for tax in the UK and files tax returns only with HMRC. This means that any profit or loss made by this company is subject only to UK tax.

How we finance the business

In note 20 to the financial statements, we provide an analysis of our outstanding debt at 31 March 2019 and 31 March 2018. Our loans comprise sterling bonds, issued by our financing subsidiary SWSF, and listed on the UK Stock Exchange, other loans including loans from US insurance companies, bank loans, and a loan from the European Investment Bank.

The regulatory framework, under which revenues and the RCV are indexed, exposes us to inflation risk. This risk is managed through the use of inflation-linked loans and derivatives within the overall debt portfolio. We do not intend to access future inflation-linked debt through the use of derivatives but will instead seek such debt from natural sources, such as public and private bond markets. As a consequence, we expect the proportion of the RCV and debt that is currently linked to inflation through the use of derivatives will decrease over time.

We are not restricted to issuing only sterling debt but will ensure any other currency loans are fully hedged back to sterling. We also hedge our exposure to interest rate volatility by ensuring that at least 85% of our outstanding debt liabilities (in respect of Class A and Class B debt) is either inflation-linked or fixed rate for the current five-year regulatory period and at least 70% in the next period (on a rolling basis).

We also consider refinancing risk by ensuring that loan maturities are not concentrated in any single year or regulatory period. When issuing new loans, we test that refinancing obligations are less than 20% of RCV in any two consecutive years and 40% of RCV within any five-year regulatory period. The maturity profile of loans extends to March 2056, which ensures we comfortably meet this test. Although not formally required, we ensure that inflation-linked swap accretion payments are included within our maturity analysis.

We ensure that sufficient liquidity (cash and committed bank facilities) is in place to fund the business for at least the next 12 months (including loan and inflation-linked swap accretion maturities), an important consideration given that we have negative cash flow generation in the majority of years as a result of our continuing capital investment programme.

As a result of our prudent liquidity policy, we can at times have large cash balances. We reduce the risk of losing cash on deposit, from bank or fund failure, by setting maximum limits on cash deposits and minimum credit ratings for each bank or fund. Banks must have, as a minimum, a credit rating of P1 (Moody's), A1 (Standard & Poor's) or F1 (Fitch). Funds must have the most secure rating of AAA rated.

In addition to our loans as analysed in note 20, we have in issue a loan with SWSG which was put in place as part of the refinancing in 2003 (note 14). The original value of this loan was £812.3 million and as part of the financial restructuring undertaken during the year £682.3 million was repaid, reducing the balance to £130.0 million.

We received £43.0 million interest on this loan from SWSG during 2018–19. In order to enable SWSG to make this payment, it received dividend and tax payments from us. For the year ended 31 March 2019, the dividend was £34.8 million and the tax payment, in respect of the taxable losses incurred by SWSG, amounted to £8.2 million. This loan provides no tax benefit to either us or the Greensands Group, with the tax payment we make to SWSG simply negating any tax effect of this loan. This is illustrated in figure 1 of the diagram on page 100.

The Greensands companies also have their own loans: a UK-listed bond which was repaid in April 2019 and loans issued by Southern Water (Greensands) Financing Plc (SWGF) represented in the diagram below as part of the 'Holdco' financing companies, loans issued by Greensands Finance Limited and Greensands Financing Plc represented in the diagram below as part of the 'Midco' financing companies and Eurobonds issued by Greensands Europe.

The Greensands financing companies also maintain liquidity facilities (£100 million at Greensands Midco financing companies and £40 million at Greensands Holdco financing companies) which can provide a source of finance to pay interest on loans.

Interest and dividend payments 2018–19

Fig. 1

£130.0m loan from SWS to SWSG

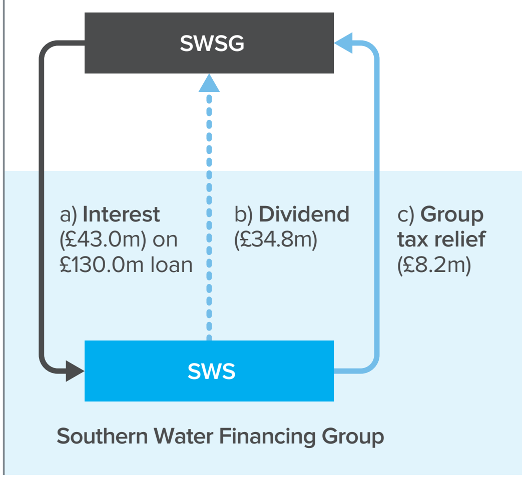
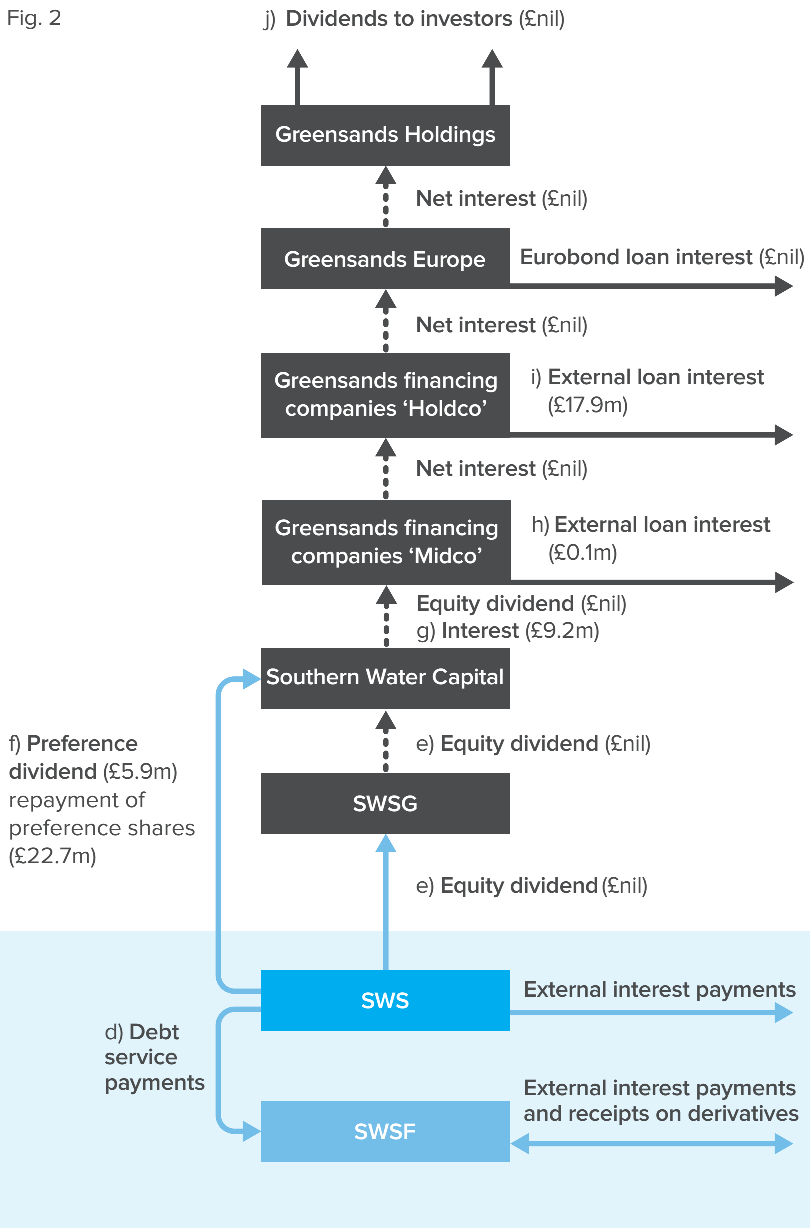


Fig. 2



In summary, SWS has paid £5.9m to internal companies. Greensands companies have paid external loan interest payments of £18.0m. No interest or dividends have been paid to investors.

Footnote:

a) During the year SWSG repaid £682.3m of its loan with SWS, reducing the balance from £812.3m to £130.0m. Interest paid on this loan amounted to £43.0m in the year.

b) Dividend paid by SWS to SWSG to facilitate the interest payment on the £130.0m loan.

c) Payment of group tax relief by SWS for the taxable losses at SWSG.

d) Interest payments from SWS to SWSF on the loans taken out by SWSF on behalf of SWS. This is then used by SWSF to pay the interest on these external loans.

e) There were no ordinary dividends paid in the year.

f) Dividend payments on the preference shares issued by SWS and repayment of preference share capital.

g) Interest payable on inter-company loans from Southern Water Capital to Greensands Investments.

h) External interest paid by GSF Ltd, funded from interest receivable and cash held in the 'Midco'.

i) External interest paid by SWGF, funded from interest receivable and cash held in the 'Holdco'.

j) Dividends paid to investors.

The Greensands financing companies comprise:

Holdco:
Greensands UK Limited (GSUK)
Greensands Junior Finance Limited (GSJF)
Southern Water (Greensands) Finance Plc (SWGF)
Greensands Senior Finance Limited (GSSF)
Greensands Investments Limited (GSI)

Midco:
Greensands Finance Holdings Limited (GSFH)
Greensands Finance Limited (GSF Ltd)
Greensands Financing Plc (GSF plc)

Viability statement

Details of the Southern Water Code of Board leadership, transparency and governance are set out in the 'Corporate governance' section of the Annual Report on page 120. In developing our code we drew on the appropriate principles of the UK Corporate Governance Code (UK Code). In accordance with provision C.2.2 of the UK Code and Ofwat's Information Notice IN 19/07, the Board has assessed the prospects of the company over a longer period than the 12 months required by the 'Going Concern' provision. The Board has selected to conduct this review to March 2030 for the following reasons:

i. The company benefits from a rolling 25-year operating licence which it is assumed will not be revoked.

ii. The wholesale and retail price controls set by Ofwat provide a high degree of certainty over cash flows through to the end of the current regulatory period, March 2020.

iii. We have also prepared our next Business Plan for the period through to 2025 which we shared with Ofwat in April 2019 and we expect to have this plan finalised in December 2019.

iv. Our Business Plan submission in 2018 and the subsequent resubmission following Ofwat's Initial Assessment of our Plan in 2019 was subject to a range of assurance which provided directors with sufficient confidence that our plans are deliverable and financeable.

v. As part of our business planning process, we prepared a high-level plan to 2030 in addition to our detailed plan to 2025. This was also submitted to Ofwat but is not subject to the same level of challenge or scrutiny from them.

vi. We considered the long-term financing of the business, including the maturity profile of existing debt, bearing in mind foreseeability of revenues reflecting the five-year price review, including the refinancing activity we carried out during 2018–19 in order to support long-term financial viability.

vii. Additional protection is afforded between price controls by Ofwat's primary legal duty to ensure that water and wastewater companies can finance their functions.

viii. Under the Water Act 2014 Ofwat has a further primary duty to ensure that water and wastewater companies have the long-term resilience to meet the needs of customers.

In assessing the viability of Southern Water over the period to March 2030, the directors have taken into account current performance and the financial and operational impacts, in severe but plausible and reasonable scenarios, of the principal risks documented in the Strategic Report on page 103. These include the impacts of:

- incidents, for example severe weather, cyber security or a major operational event, resulting in additional operating costs and/or remedial capital investment
- exceptional items, for example regulatory fines or legal claims based on historical instances in the sector
- potential Outcome Delivery Incentive (ODI) penalties associated with our current business plan performance commitments
- activities of any other group companies
- the funding position of the defined benefit pension scheme.

The principal risks have been monetised with reference to our risk weighting of likelihood and financial impact.

We have also tested specific business risk scenarios across the period to 2030 relating to higher or lower inflation than assumed in our forecasts, higher interest rates, higher expenditure and additional regulatory penalties. We have tested these scenarios separately and in combination against our business planning period to 2030. We have also considered measures to mitigate financial risk.

We have assessed a range of financial risk equivalent to at least 7% of total expenditure over the period to 2025 and at least 5% of total expenditure over the remaining period to 2030. We have also considered the opportunity to mitigate financial risk by measures such as restricting non-contractual payments and any further opportunities to support financial resilience by use of financial instruments. In addition we have assessed scenarios where interest rates are higher than our expectations for each year of the period to 2030 and inflation is either higher or lower for each year to 2030. We have recently agreed a funding plan for the defined benefit pension scheme and this is included within our Business Plan assumptions.

The result of the unmitigated financial risk scenarios is an increase in leverage of Southern Water and pressure on credit rating agency financial metrics during the period to 2025. Southern Water does not, however, breach any of its debt covenant ratios, including the 'early warning' distribution lock-up ratios and credit rating agency financial metrics are in line with an investment grade credit rating. All financial metrics recover by 2030.

Credit ratings are also affected by operational performance and the regulatory environment. For operational performance we have tested a level of ODI penalty consistent with that forecast for the current regulatory period (excluding the Ofwat regulatory settlement) and we have assumed a stable regulatory environment.

The other companies in the wider Greensands group are principally in place to support the overall financing of the group. None of these companies trade. In assessing the viability of Southern Water the Board has taken into consideration the activities of the other group companies, as described on page 98 to 99, and the overall group structure.

The directors concluded the viability of Southern Water was not compromised by the individual or combined scenarios over the assessment period. When arriving at this conclusion the directors anticipate the ability to efficiently raise new finance and a stable and supportive regulatory environment.

In making their assessment, the directors have made the following key assumptions:

- Funding for the significant ongoing capital investment programme will continue to be available in all plausible market conditions.
- There is no material unforeseen change to our plan for the period to 2025, there are no more changes to the regulatory parameters already announced for the period to 2025, and that the weighted average cost of capital (WACC) for the Business Plan period commencing April 2025, will be sufficient to enable us to finance our functions.
- Capital markets will be available for the refinancing of debt, credit facilities and financial derivative maturities when they fall due (see note 20 for details of our borrowings), given our sector and historical performance.

Based on this assessment the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period to March 2030.

In arriving at their opinion the directors have taken into account the following:

- The certainty of wholesale and household retail price controls to March 2020 provided by the 2014 Final Determination by Ofwat.
- The financial strength of the company at the balance sheet date and the fact that it has arranged £330 million of five-year committed bank facilities as back-up liquidity (maturing in 2024).
- The company's annual budget and business plan projections, including stress testing reflecting plausible but severe combinations of the principal risks of the business.
- The company's formal risk and governance arrangements which are monitored by the Risk Committee, Audit Committee and Board.
- The company's ability to manage the timing of capital programme and associated expenditure.
- The company's track record in being able to raise new forms of finance in most market conditions, see above.
- Ofwat's Initial Assessment of our Plan for 2020–25 which was published on 31 January 2019.

The results of the review were assessed by the Audit Committee in June 2019 as part of the process of recommending the accounts for approval. In addition, to support the Board in its assessment, third-party assurance was obtained over the supporting calculations and sensitivities applied to the financial projections for the 'Viability statement'.

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.

The most significant risks facing us are referred to as 'principal risks'. The principal risks are the greatest risks to the company's business objectives, both those inherent to the nature of its operations and company-specific circumstances. We therefore consider principal risks to be those with the capacity to have the greatest impact on our business, which arise as a result of our core activities operating as a water and wastewater treatment company. Risk assessments are based on outputs from 'top down' and 'bottom up' risk reviews and ongoing monitoring processes.

As part of delivering better outcomes for our customers and regulators, and becoming a more resilient organisation, we are undergoing a transformation programme. We have recognised where we have fallen short of meeting standards required by our regulators and ourselves – for example, asset compliance, or data reporting and assurance – we are working to materially improve processes and systems to ensure the mistakes of the past are not revisited.

Details of the Ofwat investigation into historic issues relating to wastewater compliance from 2010–17 and the proposed regulatory settlement can be found in the 'Ofwat investigation' section of this report on page 26 and at **southernwater.co.uk/ofwat-investigation**. We are also under investigation by the Environment Agency regarding the historic performance of certain wastewater treatment sites and the reporting of relevant compliance information. We are seeking to work proactively with them to resolve these investigations which are still evolving. At this time, there is no clarity of the findings of these investigations or further action or associated financial impact, if any.

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. In particular we have created a specific Risk Committee of our Board, a new Risk and Compliance Directorate and are implementing 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 will be extensively reviewing our current processes. The aim will be to identify key areas where we can learn from our past failures, deliver improvements and work towards embedding Enterprise Risk Management, in order to enable a more resilient service for our customers and stakeholders.

Changes to principal risks

Principal risk in 2017–18	Principal risk in 2018–19	Rationale for change
Price Review (PR19) and regulatory reform	Political and regulatory reform, and Price Review (PR19)	The scope of the Price Review (PR19) and regulatory reform risk has been expanded to include the potential impacts from 'political reform'. This has been done to capture the risks relating to political matters that may impact us, such as Brexit, renationalisation of the water sector, increased political focus, and legitimacy.
Information security and governance	Information security and governance, and information technology systems	As our services are considered 'Critical National Infrastructure', our ongoing ability to continue to provide those services is of utmost importance, and hence those systems directly supporting them. Therefore the resilience of our operational and enterprise IT systems is now included within the scope of this principal risk.
(Not applicable – new risk in 2018–19)	Transformation and organisational change	We have established this as a Principal risk, due to: • the scale of work we wish to undertake to improve our organisation over the short time window to 2020, and further to 2025 • the commitment we are dedicating to undertake this, and • our recognition that failure to mitigate this risk effectively may impact our wider strategic objectives.

Changes to principal risks

Throughout the year, we make an assessment of how the regulatory and physical environment has changed, and what impact it has had on our principal risks. This year we have made the following changes to the principal risks from 2017–18 – see table on page 103.

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.

Our strategy for risk management is that all principal risks are identified, assessed and managed to within acceptable levels. To achieve this, the Board and senior management seek to promote a culture that encourages a routine consideration of principal risks in decision making and supports the integration of risk management within our critical processes and ways of working.

Corporate risk management is monitored by a dedicated Risk Committee on behalf of our Board, though the Board retains ultimate responsibility for risk management, and for approving the overall report. Duties of the Risk Committee cover the review of our current risk exposure against the overall corporate risk appetite, tolerance and strategy, and advising the Board on the current risk exposures of the company and future risk strategy. These duties were transferred from the Audit and Risk Review Committee to the new Risk Committee, which was formed in February 2019. The new Risk Committee was formed to further improve our corporate risk management, and enable more in depth risk oversight and challenge.

The purpose of our approach to risk management is to support better decisions through an improved understanding of risk.

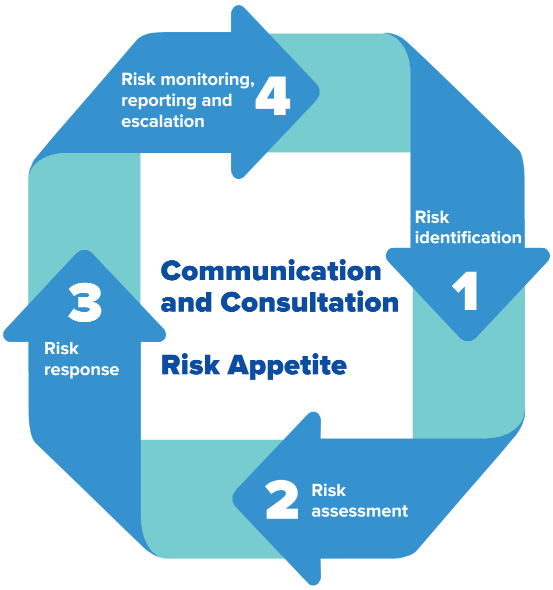


Figure 1: Southern Water Risk management process

The objectives of our risk management strategy are to:

- identify and understand all the principal risks that we face
- select and proactively adopt those risks that deliver the right returns, and understand their potential impact on the company
- take action to manage the risks we do not want to be exposed to, ensuring our resources are effectively and efficiently prioritised and used
- monitor and report the risks we are taking against our desired strategic objectives.

Every employee is responsible for helping us to effectively manage our exposure to these risks and for making us a more resilient organisation, able to successfully respond to our changing environment.

We seek to ensure controls are in place so we can reduce the likelihood of risks occurring, or take action to minimise their impact. To do this, risks are managed through a central database where they are ranked and assigned to senior managers who are responsible for implementing mitigation plans. Risks are reviewed each month and those considered most critical are escalated to our Executive Leadership Team, the Board and the Risk Committee. Any new risks added to the database with a high score are passed to an Executive Leadership Team member and the Chief Executive Officer for immediate review. We recognise there have been past failures in our control framework, which have led to the materialisation of risks that had not been identified. Our transformation project will review and improve how we monitor our control framework, how it impacts our risks and how we respond.

Risk appetite

The amount of risk the Board is willing to take to achieve our strategic objectives is referred to as the risk appetite. 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 annually by the Board.

We operate a complex infrastructure of water and wastewater assets, from pipelines to processing sites, over a broad geographical area and we recognise that extreme weather conditions and failure of our assets can have a negative impact on our customers. As a result we have clearly defined operating processes, procedures and control frameworks, including incident management, to mitigate our compliance and operating risks. In doing so we acknowledge that we also have to prepare for the unexpected and, where some risk emerges that was not anticipated, deal with it accordingly.

Our aim is to employ 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.

Principal risks and uncertainties

Strategy and regulation

Industry and Southern Water specific risk:

Compliance with regulations and legislation

Outcomes affected:	Risk change in year:
Responsive customer service A constant supply of high-quality drinking water Looking after the environment Removing wastewater effectively Having a firm financial footing	Risk is high as a result of certain regulatory compliance issues, which have been raised by our regulators.

Description:

We are a highly regulated business with three main regulators: Ofwat, the Drinking Water Inspectorate (DWI) and the Environment Agency (EA) and high standards of compliance are expected.

Risk: Inadequate culture, structure, capability, governance and assurance could result in failure to meet these high standards consistently. The consequences can be regulatory enforcement, fines, legal action and, in the worst case, the loss of our appointment as a water and wastewater company. As with all companies we are also required to comply with legislation for example Competition Law and the Bribery Act.

As reported last year, this risk remains high as a result of certain regulatory compliance issues, which have been raised by our regulators. We have recognised that we need to improve our culture, capability and performance in this area and improvement programmes are in place.

We have two DWI enforcement orders in place, which are referred to in the Risk and Compliance section of our Annual Performance Report 2018–19 which is available on our website **southernwater.co.uk/our-reports**.

We are currently assisting the Environment Agency with its investigations into legacy issues relating to wastewater compliance. Further detail on these and the recent Ofwat investigation can be found on page 26 and in our Annual Performance Report.

Cross reference:

Our commitments to customers (page 40)

A constant supply of high-quality drinking water (pages 62 to 69)

Removing wastewater effectively (pages 70 to 73)

Looking after our environment (pages 74 to 83)

ODIs (pages 41 to 42)

Further information on our improvement programmes can be found in our Final Assurance Plan 2019, which is available at **southernwater.co.uk/our-reports**.

Mitigation activities:

- A compliance framework, and internal monitoring and assurance is undertaken.
- Dedicated Risk and Compliance function.
- Subject matter experts and compliance related training.
- Values and ethical business practices being rolled out and develop a behavioural competency framework for our employees – three-year programme started this year.
- Enhancements have been made to our regulatory reporting.
- Annual reporting is externally verified by financial and technical auditors to provide assurance on our compliance with our obligations.
- Internal assurance capabilities around reporting processes to our regulators, in particular: Ofwat, the Environment Agency and the Drinking Water Inspectorate.
- Code of Ethics is being refreshed.

Additionally we have:

- Reinforced the ‘three lines of defence’ framework for our reporting governance and assurance activity.
- Internal controls and processes to mitigate the risk of supplying incorrect or inaccurate regulatory information.
- Awareness training is provided throughout our company for non-technical compliance issues, such as the Bribery Act and Competition Law.
- Compliance with company procedures is reviewed through self-assessment every six months.
- Transformation programmes to improve compliance and performance.
- Projects to develop an ethical compliance framework.

Strategy and regulation

Southern Water specific risk:

Delivery of our capital investment programme

Outcomes affected:

Responsive customer service

A constant supply of high-quality drinking water

Looking after the environment

Removing wastewater effectively

Having a firm financial footing

Risk change in year:

We accelerated our programme in the final years of the 2015–20 period to recover an initial accrued shortfall.

Description:

We have a capital investment programme of £1.8 billion between 2015 and 2020. We have plans in place to ensure we will deliver this and we are working hard to ensure our focus is maintained to complete all works on time.

Risk: If we are unable to deliver significant parts of the programme on schedule, our ability to provide an excellent service to our customers could be compromised. Any failure to deliver would also prevent us from fulfilling the promises that we have made in our Business Plan and lead to possible action by the Environment Agency, Drinking Water Inspectorate or Ofwat.

Mitigation activities:

We are bringing significant investment capability in house (over the course of the current capital investment programme) including:

- an in-house engineering function.
- a specialist programme management function.
- asset planning systems, processes and capabilities.

Additionally we have:

- An Investment Committee which oversees progress in our capital programme.
- Our monthly reporting procedures ensure the delivery of the business plan is given the greatest level of focus within the company.
- We work closely with our regulators and other interested parties to resolve issues as they arise.

Cross reference:

A constant supply of high-quality drinking water (pages 62 to 69)

Removing wastewater effectively (pages 70 to 73)

Looking after our environment (pages 74 to 83)

ODIs (pages 41 to 42)

Strategy and regulation

Southern Water specific risk:

Transformation and business change

Outcomes affected:

- Responsive customer service
- A constant supply of high-quality drinking water
- Affordable bills
- Removing wastewater effectively
- Better information and advice
- Looking after the environment
- Having a firm financial footing
- Looking after our assets

Risk change in year:

Risk increasing due to scale of changes required in readiness for the 2020–25 period.

Description:

Through a comprehensive, and ongoing transformation programme, 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 risks and significant opportunities, which we will closely monitor.

Risk: The business might be unable to deliver the significant volume of change required to transform the business in readiness for the 2020–25 period whilst maintaining focus on delivery of performance objectives and deliver shareholder value in the final year of this regulatory period. This could be due to restraints in capacity or capability to effectively coordinate the required changes, which might result in the possible failure to deliver some Customer Promises including financial targets and ODI's.

Cross reference:

Link to how we're achieving our strategy pages 19 to 25.

Link to our values (page 27).

Mitigation activities:

- Programme to improve our approach to risk and resilience management.
- Extensive review of our current processes in 2019–20 to identify key improvement areas and develop enterprise risk management.
- Programme to address both the organisational capability needs and to improve our resilience baseline understanding of financial, corporate and operational activities.
- All initiatives are developed using standard processes and business cases, ranked in order of priority, resources and wider BAU business impact.

Additionally we have:

- Transformation portfolio, office, and governance forums established.
- Ongoing monitoring and review occurring monthly / quarterly from ELT and Board sub-committee. Scope includes initiatives in the transformation portfolio and portfolio dashboard, risk registers, benefit monitoring framework, resources, capacity and capability to mitigate the risk.
- External partner support to provide capacity and capability where required.
- Programmes to reduce our underlying internal costs and the costs of delivering service improvements.
- Programmes to improve our water and waste treatment operational processes and performance (Water First, and Environment+).

Strategy and regulation

Industry risk:

Political and regulatory reform and Price Review (PR19)

Outcomes affected:

- Responsive customer service
- A constant supply of high-quality drinking water
- Affordable bills
- Removing wastewater effectively
- Better information and advice
- Looking after the environment
- Having a firm financial footing
- Looking after our assets

Risk change in year:

Risk increased due to Ofwat response to our Business Plan 2020–25, classified 'as needing significant scrutiny'. Also increased due to the level of political focus on the sector.

Description:

During recent years, there has been a significant focus on the water industry at a political and regulatory level. This has included a greater use of market mechanisms to promote innovation and efficiency, and the introduction of competition, (with the potential to extend retail competition to all residential customers), as well as the ongoing debate around renationalisation.

Risk: Failure to effectively monitor and adapt to any changes in our regulatory frameworks (Ofwat, Environment Agency or Drinking Water Inspectorate) may lead to potential un-forecasted increases in administrative costs, reduced revenue, and ultimately non-compliance.

Risk: Changes in the political landscape (e.g. Brexit, or change in government) may cause costly consequential impacts on the water sector to which we will have to adapt. Renationalisation in particular, could lead to the organisation being reacquired for less than the market value, and lead to significant changes in how we are governed, and consequently, how we operate.

Risk: Our current Business Plan and approved pricing structure runs until 2020. The next period runs from 2020–25 and Ofwat will deliver their Final Determination on our Business Plan this year.

An unfavourable Final Determination of our new business plan would lead to challenging financial circumstances and encumber delivery of our customer promises and our strategic objectives.

Cross reference:

ODIs (pages 41 to 42)

Mitigation activities:

- Programme for the Business Plan 2020–25 established to ensure we deliver a high quality response to Ofwat determinations, by their deadline.
- We respond to all Ofwat's consultations on price review methodology.
- We also provide information to the government, regulators, customers and the public as appropriate to help them to make informed decisions.
- To anticipate the impacts of Brexit, we have established contingency plans adapted to different scenarios, such as the availability of chemicals and critical spares, so we can continue services to the customer uninterrupted.

Additionally:

- We closely monitor developments in the requirements from our regulators, Ofwat, The Drinking Water Inspectorate and the Environment Agency.
- To anticipate changes we have proactively initiated programmes of investment in our infrastructure that will help us to be prepared and resilient to changes.
- We maintain close dialogue with Government, Ofwat and other regulators on key issues.

Customer

Industry risk:

Customer Service

Outcomes affected:

Responsive customer service

Better information and advice

Risk change in year:

Description:

Providing an excellent customer experience is a key objective for us. We recognise the importance of prioritising our customers, and that accomplishing our strategic goals is contingent on providing the level of service expected by our customers and our regulators.

Risk: We may not be able to provide the desired standard of service to our customers if there is inadequate capability in our people, process or systems. Our targets include identifying then reducing our unwanted call volumes for our customers, as well as improving our performance relative to our peers.

Ofwat has performance-based rewards and penalties, for which we may incur financial penalties if we do not continuously improve our Customer Service performance, relative to our peers and our own targets. These are due to be replaced with new metrics from April 2020, the scope of which will expand to include the trust and confidence of the customer, the impact of which is uncertain at this stage.

Mitigation activities:

- Organisational restructure to deliver improved strategy for customer service.
- Redesigned range of tailored services for our customers.
- Improved training for our employees.
- New single outsourced partner appointed to improve customer journey.

Additionally we have:

- Active engagement with our customers and stakeholders to strengthen our links with local organisations such as councils and community groups.
- Enhanced online facilities.
- Convenient opening hours of our contact centre.
- Software to identify dissatisfied customers after speaking to us.

Cross reference:

Our commitments to customers (page 40)

Better information and advice (page 54 to 61)

ODIs (pages 41 to 42)

Customer

Industry risk:

Bad debt

Outcomes affected:

Responsive customer service

Affordable bills

Having a firm financial footing

Risk change in year:

Bad debts charged for year decreased to £10.7m (2018: £21.8m)

Description:

We understand that some customers may experience financial difficulties and we aim to support our customers to help reduce the level of customer debt.

Risk: Bad debt is a significant issue for the water industry in the current economic climate, and there is a risk that the number of customers who are unable to pay their bills will increase leading to lost revenue.

Although we only operate in the south east of England, we note that the ongoing Brexit process may have an adverse economic effect on our customers and their ability to pay for our services. While there are no signs that this has affected our bad debt position to date it is a risk that we continue to monitor and review.

Mitigation activities:

For customers in difficulty we have:

- A range of flexible instalment plans and tariffs for setting an affordable payment plan they can sustain.
- A dedicated Affordability and Vulnerability team to support them.
- Partnered with debt agencies, to provide specialist customer advice and assistance.

Where internal contact strategies fail:

- We may refer customer accounts to a panel of debt collection agencies.
- We are responsive to individual customers' circumstances, focusing on positive customer outcomes and improving longer term behaviour patterns.
- As a final course of action, litigation is used.

Cross reference:

Affordable bills (page 50 to 53)

ODIs (pages 41 to 42)

Financial

Southern Water specific risk:

Financial resilience

Outcomes affected:

Having a firm financial footing

Looking after our assets

Risk change in year:

Risk increased due to anticipated challenges of financing our transition to the next business plan period.

Description:

Risk: A reduction in the availability of credit to the water industry, a reduction in our credit rating or a significant increase in interest rates, could put our ability to finance our capital investment programme, or refinance our existing debt maturities, at risk in the future. Maintenance of specified credit ratings is required as a condition of our regulatory licence and our borrowing covenants.

Risk: A failure to maintain certain credit ratings could lead to a restriction in dividend payments. As a minimum, we intend to maintain our current risk profile. We only enter into treasury transactions to manage inherent risk and support prudent funding, not to speculate.

During the year each of the rating agencies downgraded the credit ratings of Southern Water:

- Moody's and Fitch tightened their credit rating guidance ratios in response to a weakened assessment of the water regulatory framework.
- Standard and Poor's downgraded the credit rating in response to the announcement by Ofwat of the outcome of its investigation into wastewater performance.
- There was a general concern regarding their perceived challenges facing Southern Water in delivering the Business Plan 2020–25.

Our current credit ratings are provided on page 94.

Mitigation activities:

- We maintain sufficient cash reserves and liquidity facilities to finance our operations for at least 12 months.
- We ensure the aggregate nominal value of debt maturities does not exceed 40% of RCV in any single regulatory period (and 20% of RCV in any 24 months).
- New schedule of payments negotiated with Trustees to fund our defined benefit pension scheme and meet the April 2019 valuation deficit.
- Successful completion of a capital restructure resulted in Southern Water leverage reducing to less than 70% and a reduction to interest costs for the period 2020 to 2030.

Additionally:

- Our exposure to interest rate rises on our current borrowings is hedged by a subsidiary company, Southern Water Services (Finance) Limited.
- Current borrowings are 'fixed rates' or 'index-linked'.
- We ensure sufficient funds are available for our operational and capital investment programme.
- We ensure our financial position is robust and are reviewing this in light of the Ofwat regulatory penalty and the uncertain outcome of the price review process.

Cross reference:

Financial performance (pages 88 to 94)

Climate

Industry and Southern Water specific risk:

Resilience to drought

Outcomes affected:

Looking after the environment

A constant supply of high-quality drinking water

Risk change in year:

Risk increased due to more stringent revised abstraction licences in Hampshire.

Description:

We are committed to providing our customers with a sustainable supply of excellent quality drinking water. Some areas of the South East are classified as areas of 'severe water stress'. Given that we supply drinking water to a growing population of more than 2.5 million people across Kent, Sussex, Hampshire and the Isle of Wight, it is critical that we are able to continue to ensure access to adequate water resources for our customers.

Risk: Climate change and more variable weather patterns will pose an increasing challenge for all water companies in future years, both in terms of the volume of water available and resilience to extreme weather. Protecting local environmental needs can result in a reduction in the amount of water that can be abstracted for water supply.

Mitigation activities:

We have a long-term investment plan for additional measures to ensure we have a secure supply of water.

We are investing over £40 million on our water network during 2015–20 including:

- Replacing over 70km of water mains.
- Installation of the Hardham winter transfer.
- Reconfiguration of Hardham well field.
- Development of aquifer storage reuse in Sussex.
- Gaters Mill (Moorhill – Otterbourne transfer from Portsmouth Water, Hampshire).

Additionally we have:

- A Drought Plan developed to introduce measures to conserve water, operate our sources and secure additional resources (via drought permits/orders).
- A Water Resources Management Plan, adapted to operate under different drought severities.
- Campaigns to increase customer awareness about water availability.
- An investment planning process to identify and develop schemes to meet demands for water over the next 25 years.
- Initiatives working regionally and nationally to identify potential strategic water resources for the South East, including desalination, new pipelines from neighbouring water companies, reducing leakage and improving water efficiency.

Cross reference:

A constant supply of high-quality drinking water (pages 62 to 69)

Looking after our environment (pages 74 to 83)

ODIs (pages 41 to 42)

Climate

Industry risk:

Resilience to flooding

Outcomes affected:

Looking after the environment

Removing wastewater effectively

Risk change in year:

Description:

A key priority to the company is the protection of our customers' properties from flooding. Flooding can be caused by intense rainfall, and/or blockages due to inappropriate disposal by customers.

Risk: Changing rainfall patterns, more frequent and intense storms and rising sea levels, could all lead to an increased risk of flooding if volumes overwhelm our assets. Excessive rainfall can result in high groundwater levels which are not possible to control. This leads to flooding of private land and property, possible contamination of water supply, and infiltration/inundation of sewers. Serious floods seen historically have highlighted the need to protect our water and wastewater treatment works and pumping stations from being affected during a flood.

Mitigation activities:

Investing over £400 million on our wastewater service during 2015–20 including:

- Maintenance on 39,500km of sewers and 3,321 wastewater pumping stations.
- Replacing/refurbishing 100km of sewers.
- Investing £268 million to reduce the number of blockages in our sewer network, including:
  - Targeted surveys of our sewers using cameras.
  - Performing regular sewer cleaning work.
  - Keeping our drainage plans up to date.

Additionally we have:

- Part of national research via UKWIR (UK Water Industry Research) on the drainage project on the national headroom capacity and flood risk.
- Developing drainage water management plans.
- Identifying properties and areas at risk of flooding in severe weather, to assist in building our five-year Business Plan from a resilience perspective.
- Building an extensive onwards customer behavioural programme to reduce blockages further.

Cross reference:

Removing wastewater effectively (pages 70 to 73)

Looking after our environment (pages 74 to 83)

ODIs (pages 41 to 42)

Operational

Industry risk:

Resilient supply of good quality water

Outcomes affected:

Looking after the environment

A constant supply of high-quality drinking water

Risk change in year:

Missed annual targets for:

- Customer minutes without supply customers; and
- Leakage.

Description:

We must ensure we can supply enough good quality drinking water to cater for a growing population of more than 2.5 million people.

Risk: Should operational water treatment processes fail, the water supply become contaminated, or our water distribution network fail:

- there is a risk that water could be supplied to customers that is unfit for consumption, and would require a widespread notice in order to protect public health
- large numbers of customers could find their water supply becomes cut off.
- harmful chemicals could be released to the environment.

This could lead to a risk to our customers, and consumer confidence, and lead to prosecution and fines by the Environment Agency or the Drinking Water Inspectorate (DWI).

Cross reference:

A constant supply of high-quality drinking water (pages 62 to 69)

Looking after our environment (pages 74 to 83)

ODIs (pages 41 to 42)

Mitigation activities:

We are investing over £150 million on our production works during 2015–20, including:

- Improvement schemes at Testwood, Burham and Otterbourne (with additional investment planned to 2025).
- General resilience improvement schemes, such as; the ability to run to waste, UV disinfection replacement and borehole headworks upgrades.
- Nitrate management improvement.
- Advanced filters at water treatment works in high risk areas (e.g. Hastings), to improve the taste and smell of water.
- Upgrading wells, service reservoirs, flushing mains, and cleaning service reservoirs.
- Leakage reduction plan.

Additionally we have:

- A transformation programme – Water First to embed change in processes and performance.
- A culture transformation programme to develop a behavioural competency framework for our employees.
- Drinking Water Safety Plans are in place to evaluate risks with our drinking water quality. These cover the entire supply system.
- Catchment Risk Management team has been formed with responsibility for understanding and managing catchment risks to drinking water quality.
- Employees are trained appropriately to perform their roles well.
- Emergency plans developed to continue water supply during an interruption.
- Prioritised maintenance of critical assets and technology.

Operational

Southern Water specific risk:

Information security and governance, and information technology systems

Outcomes affected:

- Responsive customer service
- A constant supply of high-quality drinking water
- Better information and advice
- Removing wastewater effectively
- Having a firm financial footing
- Looking after our assets

Risk change in year:

Following an NIS review in the year, a number of planned actions have been extended in scope, and additional actions have been identified.

Description:

We provide water and wastewater services to customers across our regional infrastructure, considered to be critical national infrastructure.

Risk: If we do not maintain the resilience of our operational and enterprise IT systems, their failure could have a significant impact on our business reputation, ability to operate, and the resilience of our operational assets.

Additionally we hold and process personal and payment data about our customers and employees so it is important that we treat this information with respect and in accordance with the requirements of information governance.

Risk: Failure to properly protect the data we hold could lead to reputational damage and loss of confidence from our customers, as well as significant fines under Data Protection (GDPR) and the Network and Information Systems (NIS) Directive. Our main objective is to be able to manage these risks and issues holistically across the organisation (information governance incorporates physical security as part of its scope).

Mitigation activities:

- IT security policies, standards and ongoing monitoring and incident management of our IT infrastructure to identify risks and threats.
- We continue to invest in cyber threat mitigation strategies in response to the ever-changing risk landscape.
- Regular testing to assure our security measures during the year.
- Security and data protection training (mandatory for all our staff).
- Insourcing our IT management and data centre services and improving their resilience.
- Construction of a new improved data centre.

Additionally we have:

- An Information Governance Council with responsibilities for the oversight and governance of our GDPR and NIS compliance.

During 2018–19 we continued to develop our Infrastructure resilience to protect the systems and information we hold, as well as actively focusing on improving our company's position with regard to GDPR and the NIS Directive which came into effect from May 2018.

Cross reference:

Our commitments to customers (page 40)

ODIs (pages 41 to 42)

Operational

Industry and Southern Water specific risk:

Wastewater treatment works failures and pollution incidents

Outcomes affected:	Risk change in year:
Looking after the environment; Removing wastewater effectively	Due to under performance in 2018 and concerns over our asset base.

Description:

Our region benefits from a high quality environment, both inland and coastal. We are fortunate to have some extremely rare habitats, as well as some of the best quality river fishing and coastline in the UK. Reliable wastewater services are essential to maintain public health and protect the environment.

Risk: Should operational wastewater treatment processes fail, or our sewers and pumping stations become blocked or fail, our assets may discharge sewage, which is not of the required standard, to the environment. This may cause risks to the environment or public health from pollution and/or sewer flooding. There is also the potential to cause damage to the environment or distress to customers. This could lead to prosecution and fines by the Environment Agency and a reduction in stakeholder and customer confidence.

Mitigation activities:

In 2018–19 we invested:

- £144.7 million at our wastewater treatment works and pumping stations to reduce risks at critical sites.
- £46.3 million in our sewer networks.

We monitor function and performance of our assets on a continuous basis through a central control room.

- Data analytics and reporting team proactively monitor asset performance.
- We also monitor when our combined sewer overflows are used, to proactively identify infrastructure under stress.
- Monitor long-term asset risk and deterioration to target investment.
- Complete extensive planned and proactive maintenance to drive reliability.

Additionally we have:

- A transformation programme – Environment + to embed change in processes and performance and improve confidence in our data around pollution incidents.
- Pollution reduction programme.
- Have tested deployable contingency plans when incidents occur.
- Customer awareness/education programmes on avoiding blocked drains, targeted at catchments with blockage hotspots.
- A culture transformation programme to develop a behavioural competency framework for our employees.

Cross reference:

Removing wastewater effectively (pages 70 to 73)

Looking after our environment (pages 74 to 83)

ODIs (pages 41 to 42)

Operational

Southern Water specific risk:

Health and safety

Outcomes affected:

Having great people

Working in partnership

Risk change in year:

We are improving our existing processes for mechanical and electrical safety.

Description:

The health and safety of our employees and the public while we are providing our services is of the highest priority. The nature of our work requires that our employees and contractors undertake activities or use equipment which, if uncontrolled, have the potential to cause significant harm.

Risk: Failure to comply with our Health and Safety Management System and associated procedures could result in death, serious injury or adverse health effects. We could be liable for prosecution under the Health and Safety at Work and Corporate Manslaughter Acts, civil claims and employers' liability and professional liability. Finally, emotional and physical wellbeing is an important part of caring about health and safety and the company recognises that wellbeing has a major impact on all aspects of our work.

Cross reference:

Our people (pages 28 to 35)

ODIs (pages 41 to 42)

Mitigation activities:

- A clearly defined strategy, safety protocols and standards are set.
- Health and safety performance and compliance is monitored and reported monthly to the Board and to the tri-annual Board Health and Safety Committee.
- The Executive Leadership Team monitors health and safety performance monthly.
- Our processes and procedures are continuously reviewed.
- Employees receive suitable health and safety training.

Additionally we have:

- Training for employees to report 'near misses'.
- Access to a copy of the corporate policy statement and health and safety processes and procedures for all employees.
- Comprehensive health and safety processes and procedures help prevent injury and occupational ill-health to our employees and contractors.
- Committed to the 'Time to Change' programme to raise awareness and understanding of mental health issues, and established a wellbeing and mental health road map.

This Strategic Report was approved by the Board of Directors on 12 July 2019.

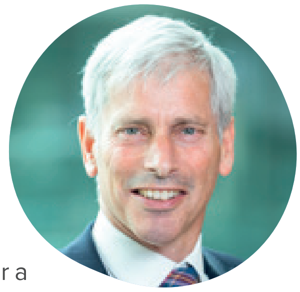
Richard Manning
Company Secretary

12 July 2019

Corporate governance

Acting Chairman's overview

Introduction



Southern Water is a provider of an essential public service to its customers and communities in the South East. As directors, we are under a duty to promote the success of the company for the benefits of its members, but also to take into the account the interests of wider stakeholders, such as our customers, employees, suppliers, local communities and the environment. This section of our Annual Report describes Southern Water's governance, including the role of the Board and its committees and how the directors meet their obligations to the company's customers, local communities, the environment and shareholders.

The Board is responsible for setting the company's purpose and values. During the year we launched our revised vision, purpose and values. Due to the nature of our business and to fulfil our vision of creating a resilient water future for customers in the South East, the Board considers the long-term implication of its decisions and the impact on the environment and on stakeholders such as our employees and customers, in line with the company's purpose and values as well as the directors' statutory duty under section 172 of the Companies Act 2006.

The year has, again, been a time of change and this has also extended to the Board and the Executive. We have had a number of changes in the composition of the Board, including the announcement of Bill Tame's resignation as Chairman with effect from 31 March 2019, new independent non-executive directors and an interim Chief Financial Officer, following the departure of William Lambe in December 2018. As a result of Bill's departure, I have been serving as acting Chairman and am leading the search for a replacement as part of my role as senior independent non-executive director and we hope that an appointment can be made very soon.

The structure of the company's senior leadership, the Executive Leadership Team, has also been revised to improve the functioning of executive decision-making and to make more efficient use of the abilities, knowledge and time of the executive team.

Similarly, the Board has reviewed and revised its operations and committees as a result of Ofwat's publication of its revised Board leadership, transparency and governance principles together with the publication of the 2018 UK Corporate Governance Code to reflect best practice in the field of corporate governance. The outcome of this review was to create separate Audit and Risk committees, subsume the Health and Safety Committee into the new Risk Committee and to revise the terms of reference and membership of all of the Board's committees, including the Nomination and Remuneration committees. The new Risk Committee ensures that the Board focuses on risk management and reporting, throughout the year, separate to its Audit Committee functions. The Board, in including Health and Safety in the newly established Risk Committee, acknowledges the importance of Health and Safety throughout the organisation.

During the year, the Board has been heavily focused on the preparation and development of the company's Business Plan for 2020–25. The Board met frequently at both meetings and wider engagement sessions during the period up to the submission of the company's plan. Furthermore, after Ofwat's Initial Assessment of our Plan (IAP) announced on 31 January 2019, the Board was again heavily engaged in considering and contributing to the company's response to Ofwat. The Board will continue to engage with management and stakeholders more widely throughout 2019 in respect of Ofwat's further draft and final determinations in respect of our plan.

The Board has also been intensely involved in assisting with the Ofwat investigation into wastewater compliance, and has been working to strengthen its processes and governance to improve ongoing compliance.

Following the UK's decision to leave the European Union, the Board has received regular updates on the company's plans to ensure the continuance of its operations, particularly in the event of a 'no deal' Brexit, which could have taken place at the end of March. The company's senior leaders have also participated in national and regional bodies (including with the UK Government) to co-ordinate ongoing planning for Brexit.

The Board has also concentrated on monitoring and contributing to the company's turnaround and transformation programmes to ensure that the company can create a resilient water future for customers in the South East.

Southern Water's Governance

In July 2018, Ofwat consulted on changes to its Board leadership, transparency and governance principles (the 'Ofwat Principles') and published revised principles in January 2019. Throughout both the consultation and subsequently, the company and the Board engaged with Ofwat in the development of the new principles and the introduction of a licence obligation to comply with the Ofwat Principles. The Board and company confirmed that it endorses the principles introduced by Ofwat to improve governance in the water sector.

In addition, the Financial Reporting Council published its revised UK Corporate Governance Code ('UK Code') in July 2018. The new UK Code introduced a number of significant changes, including emphasis on the Board's role in establishing the company's purpose, values and strategy and ensuring that the company's culture is aligned with these. The introduction of a new ambition, values and purpose in Southern Water demonstrates the Board's commitment and leadership in this area and, in particular, the need to address historical concerns where the company did not perform to the standards expected in terms of both performance and the way of doing business.

Having considered the UK Code, together with the new Ofwat Principles and the output from the Wates Report, the Board agreed a number of changes to the structure and roles of its committees. These included a wholesale review and refresh of the committees' terms of reference and the separation of the Audit and Risk Review Committee into separate Audit and Risk committees. The Board agreed to incorporate the work of the Health and Safety Committee into the new Risk Committee.

The Board also considered the impact of the Companies (Miscellaneous Reporting) Regulations 2018 on future reporting requirements.

Southern Water Code of Board leadership, transparency and governance

The new Ofwat Principles, detailed above, became effective from 1 April 2019 and, as such the company, at time of writing, operates in accordance with those principles.

During the reporting period 2018–19, the company complied with the applicable Ofwat Principles through the Southern Water Code. We continued to comply with both the letter and spirit of the Ofwat Principles and the commitments in the Southern Water Code and the board of our parent company, Greensands Holdings Limited (GSH) assisted us in doing so.

We envisage that we will continue to operate with a Southern Water Code notwithstanding that there is no specific reference to such a code in the new Ofwat Principles. Accordingly, the Southern Water Code is currently under review to ensure that it is appropriate and effective in meeting the objectives set out in the Ofwat Principles.

The Southern Water Code is published at **southernwater.co.uk/southern-water-code**.

Business Plan 2020–25

The company's development and submission of its Business Plan for 2020–25 and the subsequent response from Ofwat has been a key area of focus for the Board during the year. The Board attended engagement days, dealing with aspects of the plan and submission process in the period up to submission of the plan in September 2018. In addition, individual Board members sat on Board sub-groups, which addressed particular areas of the plan in more detail.

During July and August 2018, the Board held three additional Board meetings to review and sign off the submission of the plan to Ofwat. Throughout this process the Board challenged management's assumptions and proposals. Furthermore, in its consideration of the plan, the Board kept in mind its duty under section 172 of the Companies Act 2006 to promote the success of the company for the benefit of its members as a whole.

In producing the plan, particular consideration was given to the evidence of customer engagement and insight in developing the plan and this is reported in more detail on page 36. The Board also considered the company's impact on the environment and the challenges of providing a resilient water and wastewater service in the context of the rapidly expanding population of the South East.

Following Ofwat's IAP, the Board again convened sub-groups to both challenge and facilitate management's response to the points raised by Ofwat. The Board approved the response to the IAP in March 2019. The Board will continue to focus on the Business Plan throughout the coming year and, in particular, ensure that the company's transformation programmes proceed at pace to enable the company to deliver on its ambitions for the future in an efficient and effective way.

Legacy, turnaround and transformation

As has been extensively reported elsewhere in this annual report, the company has a number of legacy matters, which have required significant Board attention during the year. These issues range from internal organisational structures in need of reform, to behaviours that are not reflective of the high standards of integrity expected of the company.

In addressing these issues, the company has strengthened the effectiveness of its three lines of defence risk management and internal controls and the new structure of its Board committees will enable the Board to provide additional focus through its Audit and Risk committees.

As part of its role in establishing the company's purpose and values and in order that the culture reflects the needs of all those the company serves, the Board identified a need to take action to improve the company's culture in some areas and, therefore, approved the development and launch of a new company purpose and values during the year. This included supporting materials such as a new Code of Ethics to set out the expectations of the Board and to aid ethical decision-making. The Audit Committee will continue to monitor the progress of the company's culture transformation programme.

The Board is also responsible for setting the company's strategy and holding the executive to account for the delivery of that strategy. As such, the Board has continued to play an active role in monitoring the company's turnaround and transformation programmes to ensure that the company is able to not only deliver a resilient water future for the South East, but that it does so in a manner that is both cost-effective and delivers the right outcomes for its customers, the environment and local communities. The Board has had to make some hard decisions during the year, including making changes to our Customer Services department. In doing so, the Board considered the impact on the company's employees and ensured that support was in place for those impacted.

Conclusions

The Board and I remain committed to the company applying and acting in accordance with good corporate governance practices to underpin the company's business strategies and plans. The Board is also committed to ensuring that the company's culture aligns with the company's purpose and values and to identifying any areas where this is not the case and taking appropriate action.

Ensuring that the company's purpose, strategy and values are aligned with its culture is key to enabling the company to act in the interests of its stakeholders and in particular those of its customers.

Paul Sheffield
Acting Chairman

The Board

The Board's role is to:

- establish the company's purpose, strategy and values,
- develop and promote the company's purpose in consultation with a wide range of stakeholders,
- determine overall strategic aims and direction consistent with the company's purpose,
- monitor and assess the company's values and culture to ensure that behaviour throughout the business is aligned with the company's purpose,
- have full responsibility for all aspects of the company's regulated business in the long term,
- ensure that the company's obligations to, and interests of, all its stakeholders, including customers, employees, key partners, contractors and regulators, are known and met appropriately,
- provide effective leadership and collective responsibility for the long-term success of the company for the benefit of its members, taking into account the interests of a wide range of stakeholders, including customers, local communities, employees, suppliers and the company's impact on the environment,
- ensure that sufficient resources are available to the Chief Executive Officer and his team to operate, manage and develop the business appropriately to provide an essential public service to our customers, and
- ensure that appropriate and effective processes and controls are in place to assess and manage risk.

Board membership

There have been a number of significant changes to the Board during 2018–19. In late 2018, Bill Tame expressed his intention to resign from the Board with effect from 31 March 2019. Bill had been a Board member since January 2015 and had served as Audit and Risk Review Committee Chair until 2017 when he became the company's non-executive Chairman on 1 March 2017. Following this announcement to the Board, it was agreed that Paul Sheffield, as senior independent non-executive director, would assume the role of acting Chairman and would lead the search for Bill's replacement; it is hoped that an appointment can be made very soon. The Board is cognisant of the need to carefully monitor Paul's independence during this period.

In the year, we appointed two new independent non-executive directors – Ian Francis as Chair of Audit and Risk, and Gillian Guy. Regrettably, Ian decided to resign in February 2019, as he was unable to commit the significant additional time required to the role given the particular circumstances of the company. Rosemary Boot agreed to step in as Interim Audit Chair. The Nomination Committee, having reviewed the Board's skills and experience and the company's strategy, commenced the search for two further independent non-executive directors in addition to an independent Chair. It is intended that a further independent non-executive director will be appointed to the Board in July 2019 who will bring with them skills and experience in transformation and turnaround of organisations. The search for an independent non-executive director to take on the Audit Chair role is ongoing.

In addition, in December 2018, William Lambe resigned as the company's Chief Financial Officer. We were pleased to appoint Sebastiaan Boelen as Interim Chief Financial Officer in December 2018.

The Board also appointed Richard Manning as the company's General Counsel and Company Secretary in July 2018, replacing Joanne Statton as Company Secretary. Joanne remains the company's Head of Company Secretariat.

During 2018–19, the Board comprised an independent non-executive Chairman, two executive directors (the Chief Executive Officer and Chief Financial Officer (from December 2018, Interim Chief Financial Officer)) and non-executive directors. Throughout the year the majority of non-executive directors have been independent and independent non-executive directors were the largest single group on the Board in accordance with both the Southern Water Code and the Ofwat Principles (both previous and new principles).

The Board as a whole has an appropriate balance of skills, experience, independence and knowledge of the company and the Board provides independent support and advice as well as new ideas and healthy challenge. The members of the Board, their biographies and descriptions of their complementary skills and extensive experience are on pages 131 to 134.

As at 31 March 2019, women made up 44% of the Board (four out of nine directors). The company is committed to having a diverse workforce that reflects the communities in which it operates. The company published its Gender Pay Gap Report which showed the median gender pay gap at Southern Water is below the national average median (9.6%). Our report at April 2018 showed a mean gap in favour of male employees of 7.3% and median gap in favour of male employees of 7.5%, compared with 9.5% and 9.0% respectively in 2017. In terms of bonus recipients, 84.3% of female employees and 87.2% of male employees received a bonus, compared with 84.0% and 87.4% respectively in 2017. We are committed to supporting the aspirations of our talented female workforce and are implementing plans to address the gender pay gap. Read the full report at **southernwater.co.uk/gender-pay-gap.**

In accordance with good governance practice, the roles of the Chairman and Chief Executive Officer are separate.

Chairman

The role of the Chairman is to lead the Board in its shared responsibilities, to encourage and facilitate the contributions of its members and to ensure adherence to the governance principles and processes of the Board. Bill Tame served as the company's Chairman until 31 March 2019. As reported above, it was agreed that Paul Sheffield would act as the company's Chairman during the period between Bill's departure and a replacement being appointed. In order to ensure that Paul remains independent, the Board carefully monitors the duties expected of and carried out by Paul in this capacity.

The Chairman discusses and agrees Board meeting agendas with the Chief Executive Officer and Company Secretary, although any director may sponsor an item to be included on the agenda. The Chairman has authority to act and speak for the Board between its meetings, which includes engaging with the Chief Executive Officer. The Chairman reports to the Board, chairs of its committees and individual directors as appropriate on decisions and actions taken between Board meetings. The Chairman also meets with the non-executive directors, without the executive directors present, to consider the performance of the executive directors and to provide feedback.

The Chairman is not a member of the Greensands Holdings Limited (the company's ultimate parent company) board, although he and others from the company are regular attendees to report on the company's progress.

Investor representation

The membership of Southern Water's investors is explained on page 96 and at **southernwater.co.uk/greensands-ownership-of-southern-water**.

One non-executive director represents an investor and another non-executive director represents Greensands Holdings Limited. The Chairman (and acting Chairman) ensures that the views of all investors can be communicated to the Board.

Senior independent non-executive director

Paul Sheffield is the senior independent non-executive director. In this capacity he is leading the search for a replacement of Bill Tame as the company's Chairman and is acting Chairman for the period until a permanent replacement is appointed. Paul chairs the Remuneration Committee and is also a member of the Nomination Committee. Paul also chaired the Health and Safety Committee, prior to the creation of the Risk Committee.

As senior independent non-executive director, ordinarily, Paul would chair Board meetings in the event that the Chairman was unable to do so for any reason. In the capacity of senior independent non-executive director, he is available to discuss matters or concerns with investors as required. Paul has been a non-executive director of the company for five years and brings with him considerable experience in construction and engineering as well as in corporate governance.

Independent non-executive directors

The largest single group on the Board are the independent non-executive directors in accordance with the Ofwat Principles, as a matter of good governance practice, and the number of independent non-executive directors is also in accordance with the company's licence conditions, which require at least three independent non-executive directors on the Board.

They provide independent advice and perspectives and review and challenge decisions and reporting on behalf of all stakeholders, including customers. The independent non-executive directors have been appointed for their individual external expertise and experience in specific areas, such as customer service, the environment, operations, procurement, capital project delivery, regulation, transformation and for the range of their experience of general corporate management. The Board further strengthened its customer service and consumer knowledge and experience in the reporting year with the appointment of Gillian Guy in November 2018, who is the CEO of Citizens Advice. In addition, as reported above, the Board intends to appoint, as soon as practicable, two further independent non-executive directors, further strengthening the Board's expertise in transformation, utilities and regulatory finance.

In accordance with best practice, the Board takes into account those matters listed in Provision 10 of the new UK Corporate Governance Code as well as any other relevant circumstances or considerations in forming its assessment of the independence of directors.

The Board considers that the independent non-executive directors were throughout the year, and to continue to be, independent in character and judgment and persons of standing with relevant experience, collectively having connections with, and knowledge of, the company's area and understanding of the interests of our customers and how these can be respected and protected.

The independent non-executive directors also appraise the Chairman's performance.

The standard terms and conditions of the appointments of independent non-executive directors are published at **southernwater.co.uk/corporate-governance**.

Shareholder representative non-executive directors

Sara Sulaiman joined the Board in 2017 and was nominated by one of the company's three major investors. She brings the extensive knowledge, skills and resources of her nominating investor and employer as well as her own personal skills, experience and knowledge of businesses and business sectors similar to our own. She does not receive any remuneration from Southern Water.

Wendy Barnes also joined the Board in 2017 and was appointed as a representative of the Greensands Holdings Limited board. She brings with her experience of the water sector, cyber security and customer.

As members of the Board, Sara and Wendy have all the duties, obligations and rights of a director of Southern Water and as such act in accordance with the directors' duties set out in the Companies Act 2006, including that set out in section 172 to promote the success of the company for the benefit of its members as a whole, having regard to the long-term and the interests of the company's stakeholders.

Chief Executive Officer

The Chief Executive Officer, Ian McAulay, is a member of the Board and has all the responsibilities of a director of the company. In his executive role, responsibility has been delegated to him to deliver the company's strategy. He is empowered to take all decisions and actions that further the company's strategy and which, in his judgment, are reasonable within the Chief Executive Officer's limits set out in the company's internal controls and matters reserved to the Board. The non-executive directors, led by the Chairman, appraise his performance annually.

Chief Financial Officer

The Chief Financial Officer is a member of the Board with all the responsibilities of a director of the company. Following William Lambe's resignation on 14 December 2018, Sebastiaan Boelen was appointed as the company's Interim Chief Financial Officer and member of the Board. In his executive role and reporting to Ian McAulay, he has the responsibility for managing the company's financial affairs and assisting the Chief Executive Officer in the delivery of the company's strategy. His performance is reviewed annually by the Chief Executive Officer.

Executive Leadership Team

Reporting to Ian McAulay, the Executive Leadership Team supports him in driving the implementation of strategy in the company. The team is committed to do this in a responsible way that takes account of our commitment to our customers, the environment, the communities in which we live and work and all our other stakeholders, with a view towards the long-term responsible stewardship of the business.

During the year the structure of the Executive Leadership Team was reviewed and amended to improve both the effectiveness and efficiency of the company's executive leaders. In addition, the Executive Leadership Team saw a number of changes during the year with the appointment of the company's General Counsel and Company Secretary to the team and the creation of the role of Managing Director, responsible for overseeing the company's transformation programmes and the necessary preparatory work prior to the commencement of the company's Business Plan 2020–25. Furthermore, it was agreed to create a wider executive leadership team from the company's senior management team, which would attend appropriate meetings of the Executive Leadership Team and be responsible for key areas under the supervision of the relevant Executive Leadership Team member.

As such the Executive Leadership Team is now structured into four key groupings, which meet regularly:

- The Chief Executive Officer, Chief Financial Officer, Managing Director and General Counsel and Company Secretary meet as the Executive Committee (Excom) to discuss and make decisions on areas of strategy and other matters critical to the company.
- The Executive Leadership Team and, where appropriate, the wider executive leadership team meet as:
  - the Operating Committee (Opcom), chaired by the Chief Executive Officer, to consider performance and make decisions on operational matters,
  - the Transformation Committee (Transcom), to oversee the company's transformation programme, and
  - the Risk and Compliance Committee, to consider health and safety, risk and compliance.

Role of the Company Secretary

All directors have access to the advice and services of the Company Secretary, Richard Manning, and the Company Secretariat team. The Company Secretary is responsible for ensuring that the Board operates in accordance with the adopted governance framework and that there are good information flows to the Board and its committees and between senior executives and the non-executive directors. The appointment and removal of the Company Secretary is a matter reserved to the Board.

Director induction, training, development and information

On appointment to the Board, induction coverage is agreed with each director and then an appropriate comprehensive and individualised induction is provided, which will include information on the company structure, the regulatory framework of our business, customer service and the operation of assets, strategic plans, financial reports, business plans and our governance framework and holding group structure.

In addition, meetings with members of the Executive Leadership Team and with external advisers are arranged as well as visits to operational and office sites.

The Board also has access to professional development provided by external bodies and our specialist advisers, which this year included presentations on directors duties, cyber and information security, ethical business practice and unconscious bias. The Board also received regular updates on regulatory matters and matters raised by Ofwat, the Drinking Water Inspectorate and the Environment Agency in particular.

Directors have access to the advice and services of the Company Secretary and are able to obtain appropriate independent professional advice in connection with the performance of their duties.

Engaging with stakeholders

During the year, the Board has actively engaged with the company's regulators and other stakeholders. In particular, the company's Chairman and Chief Executive Officer regularly attended meetings and other events with Ofwat, the Department for Environment, Food and Rural Affairs, Environment Agency, Drinking Water Inspectorate and the Consumer Council for Water.

The Chair of our Customer Challenge Group (CCG), currently Anna Bradley, has an open invitation to attend our Board meetings, and attended two meetings during 2018–19, to provide challenge and feedback on the company's development of its Business Plan for 2020–25, as well as the company's delivery against its business plan promises for 2015–20. Furthermore, the company's Chairman and the Chair of the Customer Challenge Group held regular calls and meetings during the year outside of formal Board meetings. There is an open invitation for Board members to attend meetings of the CCG, and directors have attended throughout the year, hearing in detail how customer insight has informed the company's Business Plan 2020–25. The work of the CCG is reported in their annual report at **southernwater.co.uk/ccg-annual-report**.

In addition, in late 2018, the company's executive directors and Executive Leadership Team members held a series of roadshows across the company's sites to inform the company's employees about the company's priorities based on the new Business Plan 2020–25, including the pathway to the new five-year period. The new Water for Life brand and new values were tested with employees through this participation and the results of this engagement were communicated to the Board to inform their decision-making.

Board evaluation

In view of the changes on the Board during the year and given that the last externally facilitated evaluation of the Board was held in 2017, Paul Sheffield, as the senior independent non-executive director, led an internal evaluation of the Board during the year.

As reported in last year's annual report, Ffion Hague of Independent Board Evaluation facilitated an evaluation of the Board in 2017.

Board operation

There is good understanding of the principles and processes in place regarding the tasks and activities of the Board, the authority delegated to the Chief Executive Officer and the relationship between the Board and the executive.

The following matters are routinely determined by the Board:

- Business strategy
- Financing strategy
- Business plans
- Approval of annual budgets
- Fixing of principal charges and charges schemes
- Approval of financial statements
- Key regulatory submissions (including, but not limited to, market reform, price review submissions to Ofwat, Interim Determination of K applications, Risk and Compliance Statement and Regulatory Financial Statements)
- Key customer and stakeholder publications (including, but not limited to, the Annual Report)
- Entering into significant contracts or commitments (including capital schemes over £15 million and disposals over £1 million)
- Approval of dividends
- Commencing new businesses
- Appointment or removal of auditor
- Appointment and remuneration of independent non-executive directors
- Appointment or removal of the Company Secretary
- Amendment, qualification, addition to or removal from the above.

During the year, the Board's agenda also included:

- the company's response to the Freeze/Thaw event in early 2018 and the company's improvement plans
- regulatory changes and developments such as the Directive on security of network and information systems (NIS Directive)
- the company's water resources position, particularly in view of the exceptionally hot and dry summer experienced in 2018
- the company's Business Plan 2020–25 and Ofwat's Initial Assessment of Plan
- the company's transformation programmes including the company's retail strategy
- the company's re-financing programme and the removal of the Cayman entity
- reporting from the Audit and Risk Review Committee about progress on the improvement programmes in place to resolve legacy and historical matters of concern
- the ongoing Ofwat investigation, the company's own internal findings, its wastewater action plan and the proposed regulatory settlement
- other ongoing investigations by the Environment Agency and Drinking Water Inspectorate
- changes to the role and structure of Board committees
- consideration and response to Ofwat's Board leadership, transparency and governance consultation and other consultations.

The Shareholders' Agreement of our parent company, Greensands Holdings Limited, reserves certain matters by exception to the Board and shareholders of that company. A schedule of those matters reserved to Greensands Holdings Limited is published at **southernwater.co.uk/greensands-ownership-of-southern-water.**

During the year 2018–19 a number of matters required shareholder approval under the terms of the Shareholders' Agreement. These included appointments of the new independent non-executive directors and Interim Chief Financial Officer and the re-financing activities detailed on page 96 to 97 as well as requests for material capital expenditure on projects not originally included in the scope of the company's 2015–20 Business Plan. In addition, our shareholders approved the Business Plan 2020–25, the proposed regulatory settlement, material contracts and the revised dividend policy.

A statement of these responsibilities is published at **southernwater.co.uk/greensands-ownership-of-southern-water**.

Board meetings

Ten Board meetings were scheduled to take place during the year. In February 2019, as part of the review of the company's corporate governance, which included comparison with peers, it was agreed that the Board would meet six times from 2019–20, in order to give the Board the opportunity to focus on longer-term strategy and progress by the company against its transformation objectives. This new structure is supported by the changes to the Board's committees.

The agenda and papers are sent to Board members in advance of each meeting. The monthly financial and performance reports are also distributed for the months when there is no scheduled meeting.

The Board holds its meetings at its principal office in Worthing and in London and the Board also held a meeting at Peacehaven Wastewater Treatment Works in May 2018. Furthermore, the Board also held an off-site strategy day in October 2018 at Ricardo's site in Shoreham-by-Sea to discuss the company's future strategy and plans.

In addition to the scheduled Board meetings, the Board met once in July and twice in August 2018 to review and challenge and then approve the submission of the company's Business Plan 2020–25. Prior to these meetings, the Board, Executive Leadership Team and shareholders met regularly up to the submission of the Business Plan to discuss and review particular aspects of the plan as part of organised workshops. This included a two-day workshop in July 2018 to review and challenge the proposed plan. As mentioned previously, the Board members also met as sub-groups to consider specific areas of the plan.

Following the publication of Ofwat's Initial Assessment of Plan in February 2019, the Board met once in addition to the scheduled meetings to discuss, review and approve the company's response to the IAP, which was submitted to Ofwat in March 2019. It is anticipated that the Board will continue to hold meetings in addition to the quarterly Board meetings to consider matters relating to the company's Business Plan 2020–25 over the course of 2019.

Furthermore, the Board has regularly held calls to discuss and receive updates on the ongoing investigations as detailed on page 26.

Where a director has a concern over any unresolved matter, he/she is entitled to require the Company Secretary to record that concern in the minutes of a meeting. Should the director later resign over the issue, the Chairman would bring it to the attention of the Board.

Although this has again been a full year, all members of the Board were and are able to allocate the necessary time to the company and its areas of business to discharge their responsibilities effectively.

Board committees

Standing committees of the Board have been established with specific responsibilities. They assist by monitoring and reviewing performance and issues in the areas within their respective scopes and by advising and making recommendations to the Board. Specific responsibilities have been delegated to those committees.

The standing committees of the Board for the majority of the reporting year were:

- Audit and Risk Review
- Health and Safety
- Remuneration
- Nomination.

Following a review of the Board's committees, which took into account both the new Ofwat Principles and the publication of the new UK Corporate Governance Code by the FRC and best practice in corporate governance, in February 2019 the Board agreed to amend its standing committees as follows:

- The company's Audit and Risk Review committee was separated into an Audit Committee and a Risk Committee
- The company's Health and Safety Committee's duties and roles were included within the scope of the Risk Committee's terms of reference
- The membership of all of the committees was reviewed and revised.

Accordingly, the company's standing committees are now:

- Audit
- Risk
- Remuneration
- Nomination.

As part of the review, the Board also agreed to establish an Information Security Committee for an initial 12-month period in order to be able to focus on, among other matters, the company's steps to implement the requirements of the NIS Directive, the company's GDPR compliance programme and information security risk more generally.

Each committee has written terms of reference to exercise oversight on behalf of the Board and provide advice on its remit. These terms of reference are published at **southernwater.co.uk/board-committee-terms-of-reference**.

Other committees are constituted if and when required for specific matters.

Attendance at Board and committee meetings

Attendance at scheduled meetings in 2018–19	Board meetings	To February 2019				From February 2019	
		Audit and Risk Review Committee	Health and Safety Committee	Remuneration Committee[2]	Nomination Committee[3]	Audit Committee	Risk Committee
Bill Tame[1] (resigned 31 March 2019)	13/14	2/3	–	4/4	4/4	–	–
Ian McAulay	14/14	–	1/2	–	–	–	–
Sebastiaan Boelen (appointed 14 December 2018)	4/4	–	–	–	–	–	–
William Lambe (resigned 14 December 2018)	10/10	–	–	–	–	–	–
Paul Sheffield	14/14	3/3	2/2	5/5	3/4	–	–
Rosemary Boot	14/14	3/3	2/2	5/5	4/4	1/1	1/1
Mike Putnam	14/14	3/3	–	4/4	3/4	1/1	1/1
Ian Francis (appointed 12 September 2018; resigned 12 February 2019)	2/4	2/2	–	–	–	–	–
Gillian Guy (appointed 12 November 2018)	4/5	–	–	–	–	–	1/1
Wendy Barnes	13/14	3/3	–	4/4	3/4	–	1/1
Sara Sulaiman	14/14	3/3	2/2	4/5	4/4	1/1	–

Note – Attendance includes attendance in person and by phone.

[1] Although not a member of the ARRC, the Chairman attended by invitation.

[2] From February 2019, the members of the Remuneration Committee were: Paul Sheffield (Chair), Rosemary Boot and Sara Sulaiman.

[3] From February 2019, the members of the Nomination Committee were: Bill Tame (Chair), Paul Sheffield and Sara Sulaiman.

Remuneration

The Directors' Remuneration Report is set out on pages 144 to 157.

Interests

No director declared a material interest at any time during the year in any contract of significance with the company.

Conflicts of interests

Conflicts or potential conflicts are governed by the Companies Act 2006. The Board does not have power to authorise conflicts under the company's Articles of Association. If a conflict should arise, the conflicted director takes no part in discussions and may not vote on that issue.

Annual General Meeting

Southern Water Services Limited is a private company with single corporate ownership and is not required to hold an Annual General Meeting.

Board of directors

The day-to-day running of Southern Water is led by Ian McAulay, Chief Executive Officer, and the Executive Leadership Team, which reports to our Board of Directors.

Paul Sheffield

Senior independent non-executive director and Acting Chairman

Paul Sheffield joined the Board in June 2014 and was appointed as Senior Independent Director in July 2015. Since 1 April 2019, Paul has been acting Chairman following Bill Tame's departure. He is a Fellow and Senior Vice President of the Institution of Civil Engineers and is also a member of the Supervisory Board of BAM Group in the Netherlands. Paul is also a specialist adviser to the Board of Manchester Airport Group, working on their £2 billion capital programme at Manchester and Stansted Airports.

In his executive career, he spent over 32 years with Kier Group plc — the construction, services and property group. Graduating as a Civil Engineer in 1983, Paul spent 15 years working on major capital projects around the world, before taking responsibility for a number of business units within the Group. Paul was on the Group Board for 10 years and served as its chief executive officer between 2010 and 2014. Between 2014 and 2017 he headed up the construction operations for the European and Middle Eastern business for Laing O'Rourke Services, delivering some of the biggest capital projects, such as Crossrail, Hinkley Point C Nuclear Power Station and major capital projects in the water industry.

Through his various roles in business leadership, Paul has gained significant experience of strategy, productivity innovation and efficiency and the vital role that ethics plays in determining the long term success of an organisation.

Ian McAulay

Chief Executive Officer

Ian joined Southern Water as CEO in January 2017 and was appointed to the Board from 1 February. Ian has more than 30 years of global water and environmental experience and a significant record of achievement operating in both publicly quoted FTSE 100/250 companies and privately held enterprises.

Ian holds an honours degree in Civil and Environmental Engineering and is a Chartered Member of the ICE and CIWEM.

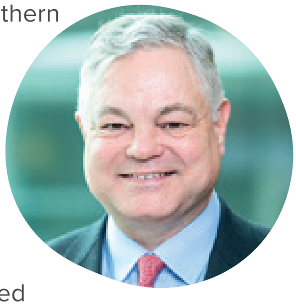
Throughout his career he has managed major utility, construction and consulting businesses in the UK, Belgium, India and the USA. He has enhanced this practical experience with professional executive education, most notably at Harvard Business School.

He has extensive experience in the UK regulated utility, construction and environmental services sectors, holding board positions across a broad range of commercial and statutory organisations. In his previous role he served as an executive director of the Pennon Group plc and chief executive of its subsidiary company, Viridor, one of the largest renewable energy and recycling companies in the UK.

In a non-executive capacity, he serves on the CBI Infrastructure Board and the Greater Brighton Economic Board. Ian currently chairs the Greater Brighton Economic Board and Infrastructure Panel and is a member of the CBI Infrastructure Board. He has also provided expert input to Government Review Groups and Industry Partnerships with particular emphasis on the UK skills agenda and development of future smarter regulation and environmental policy.

Sebastiaan Boelen

Interim Chief Financial Officer



Sebastiaan joined Southern Water as CFO in December 2018 and was appointed to the Board in the same month.

He started his career with more than 10 years in the Royal Navy where he attended the Dutch Royal Naval Academy, and the University of Technology Delft specialising in Operations (Air defence) and Information Technology. After completing an MBA at the INSEAD business school he worked in management consulting (McKinsey, Coopers & Lybrand), followed by a number of senior finance roles in telecoms, consumer goods, business services and financial services. He has worked for listed companies as well as private and private equity portfolio companies (such as Electricity NorthWest, previously a division of United Utilities). He has lived and worked in the Netherlands, France, Switzerland, Belgium, Luxembourg and the UK.

Rosemary Boot

Independent non-executive director

Rosemary Boot joined the Board in March 2015. She was appointed Interim Chair of the Audit and Risk Review Committee on the resignation of Ian Francis in February 2019. She had previously served as Chair of the Audit and Risk Review Committee from July 2017 to September 2018 and as Interim Chair from March 2017.

Rosemary is a non-executive director of Impact Healthcare REIT plc, a UK care home real estate investment trust that is listed on the London Stock Exchange. In May 2019, she was appointed as a non-executive director of Urban&Civic plc, a London Stock Exchange listed master developer. She is also a Trustee of Green Alliance, the environmental think tank.

Previously Rosemary was the chief financial officer of Future Cities Catapult, one of a network of technology and innovation centres established by the UK Government. She has also worked at Circle Housing Group and was involved in setting up the government-owned Low Carbon Contracts Company and Electricity Settlements Company.

From 2001 to 2011 she was group finance director of the Carbon Trust, the independent company set up in 2001 to work with business and the public sector to accelerate the move to a sustainable, low carbon economy. Prior to that, she worked for 16 years as an investment banker, primarily advising large listed UK companies on mergers and aquisitions.

Mike Putnam

Independent non-executive director

Mike Putnam joined the Board in September 2017.

A Chartered Engineer and a Fellow of both the Institution of Civil Engineers and Royal Institution of Chartered Surveyors, Mike has over 25 years' experience leading and managing multiple businesses across development and construction. He is known for his values-based approach to leadership. Mike has since successfully transitioned to a plural career with a portfolio of Non-Executive Directorships, including currently serving on the boards of Network Rail, Arcadis NV and Bazalgette (Tideway) Tunnel Ltd.

Mike was President and CEO of Skanska UK between 2009 and 2017, responsible for a business with circa £1.8 billion revenues and 6,000 employees. Prior to this, he was Executive Vice President and main Board Director from 2001, as well working across the group as a non-executive director on some of the international boards. Throughout Mike's career he has been closely involved with the successful delivery of many high-profile projects and programmes.

Externally, Mike has been very active on the built environment change agenda, working with government and industry as a member of the Construction Leadership Council on the Industrial Strategy & Sector Deal. He has also been chair of the Green Construction Board; a member of the CBI Construction Council, influencing the future direction of the industry and linking into Government; and a non-executive director of the Association of Consulting Engineers.

With proven all-round business and operations capability, Mike has particular strengths in: strategy development and deployment; results delivery; inclusive people and values-based leadership and transformational change.

Gillian Guy CBE

Independent non-executive director

Gillian joined the Board in November 2018. Since July 2010, she has been Chief Executive Officer of the independent charity Citizens Advice. She is also currently Chair of the UK Finance Consumer Advisory Group and a member of the Banking Standards Board.

Gillian is a lawyer and spent 11 years as Chief Executive Officer of the London Borough of Ealing, before becoming Chief Executive Officer of Victim Support. She served as a non-executive board member and Chair of the Audit Committee of the National Audit Office and a non-judicial member of the Sentencing Council for England and Wales. Gillian was awarded a CBE in the New Year's Honours list in 2015.

Wendy Barnes

Non-executive director

Appointed to Southern Water in September 2017, Wendy, a portfolio non-executive and an independent consultant in cyber security, has wide experience in utilities, security and defence sectors. Having started her career as a statistician with British Nuclear Fuels, Wendy went on to have an executive career in customer service and business development with United Utilities.

In recent years, Wendy has been a non-executive director in the Ministry of Defence, government security departments, Met Office, Ofwat and the National Crime Agency. She is currently a non-executive director at OCS Group, BMT Group and Scottish Power Networks and an Associate Director of Templar Executives. Wendy has chaired, and been a member of, several audit and remuneration committees and has a particular focus on developing risk management and good governance, as well as helping organisations take on change in challenging environments.

In 2011–12, Wendy was a Director General in the Department of Energy and Climate Change (DECC) where she was responsible for Corporate Services and legacy nuclear policies.

Wendy runs a consultancy business with her husband, and is also a non-executive director of Chester Cathedral Enterprise Board and Finance Committee.

Sara Sulaiman

Non-executive director

Appointed in September 2017, Sara Sulaiman is an Executive Director of JP Morgan Asset Management.

Before joining JP Morgan, Sara was an investment director at Arle Capital Partners, a London based mid-market private equity firm. Prior to that she worked on corporate finance transactions both within Simmons & Company International, a specialist energy investment bank, and KPMG's Global Infrastructure and Projects Group (within the Energy & Natural Resources team).

Sara started her career in industry working as a finance analyst in Petroleum Development Oman and Shell Chemicals in London. She holds a Bachelor of Arts in Economics from Yale University, an MPhil in Economics from the University of Cambridge, and is an Associate of the Chartered Institute of Management Accountants.

In addition to her board role on Southern Water, Sara currently serves as a non-executive director on the holding companies of Nortegas, a Spanish gas distribution business and North Sea Midstream Partners, a gas transport and processing business in the UK.

Richard Manning

General Counsel and Company Secretary

Richard joined Southern Water in July 2018 as General Counsel and Company Secretary.

Over the past thirty years, he has held similar roles in a number of listed and private companies and brings extensive experience of legal, company secretarial and governance matters. He holds a law degree and an MBA and is a qualified solicitor.

Other Board members who served in 2018–19 were:

Bill Tame – Chairman

Bill Tame joined the Board in January 2015 and was appointed as the company's Chairman on 1 March 2017 until his resignation as a director on 31 March 2019.

William Lambe – Chief Financial Officer

William Lambe joined the Board in May 2016 as Chief Financial Officer. He served on the Board until his resignation as a director on 14 December 2018.

Ian Francis – Independent Non-Executive Director and Chair of the Audit and Risk Review Committee

Ian Francis joined the Board in September 2018 and resigned in February 2019. During this period Ian was Chair of the Audit and Risk Review Committee.

Executive Leadership Team

As of 31 March 2019, the Executive Leadership Team consisted of:

Ian McAulay	Chief Executive Officer, Member of Excom
Sebastiaan Boelen	Interim Chief Financial Officer (appointed 14 December 2018) , Member of Excom
Rob Barnett	Managing Director, Member of Excom
Richard Manning	General Counsel and Company Secretary (appointed 24 July 2018), Member of Excom
Simon Oates	Director of Corporate Strategy and Regulatory Affairs
Craig Lonie	Director of Strategy and Regulation
Alison Hoyle	Director of Risk and Compliance
Helen Simonian	Director of Wholesale Water Services
Simon Parker	Director of Wholesale Wastewater Services
Jamie Ford	Director of Customer and Commercial Services
Neil Colman	Director of Engineering and Construction

Audit and Risk Committee and the Audit Committee

Message from the Interim Chair

As detailed earlier in the report, towards the end of the financial year the Board agreed to split the responsibilities of the Audit and Risk Review Committee into separate Audit and Risk committees in order to give enough time to their respective oversight roles as we head into the next business plan period 2020–25.

As the Interim Chair of the Audit Committee, I am a member of the Risk Committee.

During the year, Ian Francis took over as Chair of the Audit and Risk Review Committee before stepping down when it became clear that the ongoing time commitment was incompatible with his other roles and requirements. I am currently Interim Chair of the Audit Committee, pending the recruitment of a new independent non-executive director as Audit Committee Chair.

It was again a busy year for the Audit Committee and its predecessor, the Audit and Risk Committee. Following the oversight by the committee last year on the changes to improve our non-financial information and reporting, the committee has focused on the regular monitoring of the ongoing improvements being made to the processes and systems. We are making good progress towards having the confidence that we and all our stakeholders need in the quality of our non-financial reporting. The committee has also overseen and approved the Data Assurance summary which details our assurance processes and actions, together with our Final Assurance plan, which both respond directly to Ofwat's status assessment of the company as 'prescribed' in the Company Monitoring Framework. We were pleased to hear, in March 2019, from the company's non-financial assurers that significant progress has been made against the improvement plan for non-financial reporting.

Recognising the challenges faced by the company, we have received updates on progress of specific transformation programmes, including water and wastewater, culture and the implementation of the modern compliance and resilience framework. We have been updated on the company's action plans and the Ofwat investigation findings along with the accounting for the reparation package disclosed on page 26 as well as the Environment Agency investigation and the associated accounting considerations. We will monitor progress and performance against these in the coming year.

Looking forward, the Audit Committee will continue to focus on the company's transformation programmes and action plans, including the refresh of the company's Speak Up process, as well as internal controls, financial and non-financial reporting, compliance and internal and external audit.

Rosemary Boot
Interim Chair of the Audit and Risk Review Committee

Introduction

This report describes the role of the Audit and Risk Review Committee (ARRC) and, from February 2019, the Audit Committee, and the work undertaken during the year.

As reported earlier, the Board agreed to amend the structure of its Board committees and as part of this decision, the Audit and Risk Review Committee was split into a separate Audit Committee and Risk Committee. The principal changes are detailed below:

- Removal of the responsibility for oversight of the company's risk appetite, risk monitoring and reporting
- Explicit inclusion of the role of the oversight of the effectiveness of internal controls around non-financial reporting
- Explicit inclusion of the associated external assurance processes of internal controls around non-financial reporting
- Monitoring the Speak Up reporting.

Following his appointment in September 2018, Ian Francis served as the Chair of the ARRC, replacing Rosemary Boot, who had been serving as the Chair since July 2017. After Ian Francis' resignation in February 2019, Rosemary was appointed as the Interim Chair. The other members of the ARRC were all non-executive directors. The number of meetings and attendance of the ARRC is shown on page 129.

In addition, it was agreed that the following would be members of the Audit Committee, and their attendance at meetings held during the year is also shown below.

Attendance at scheduled meetings of the Audit Committee:

Audit Committee attendance in 2018–19	
Rosemary Boot (Interim Chair)	1 / 1
Mike Putnam	1 / 1
Sara Sulaiman	1 / 1

Note – Attendance includes attendance in person and by phone.

Under the terms of reference of the Audit Committee, all members must be non-executive directors and a majority must be independent non-executive directors. At least one member must also be a member of the Risk Committee.

The terms of reference of the Audit Committee are published at **southernwater.co.uk/about-us/about-southern-water/our-business/our-governance.asp**.

Work of the ARRC and Audit Committee during 2018–19

Throughout the year, the committee received regular updates on financial reporting, risk, internal audit and the company's regulatory framework. The committee also focused on non-financial reporting process improvements, receiving regular updates on the development of, and performance against, the improvement plan.

The Chairman of the Board, Chief Executive Officer, Chief Financial Officer, Director of Compliance and Asset Resilience (now Director of Risk and Compliance) and the Head of Audit and Risk (now Head of Audit) were invited to all meetings of the ARRC and were usually in attendance. In addition, key members of the finance team and the external auditor were invited to the ARRC meetings, excluding the annual risk review. Other members of senior management were also invited to attend when necessary or appropriate. Following the creation of the separate Audit Committee, it is anticipated that the Chief Executive Officer, Chief Financial Officer, Director of Risk and Compliance and Head of Internal Audit will be regular attendees at committee meetings, in addition to the external auditor and the non-financial information assurance providers.

The ARRC had and the Audit Committee has access to the services of the Head of Audit, the Company Secretary and external professional advisers to assist it in performing its duties.

During the year the work of the ARRC and Audit Committee focused on the following key areas:

- The company's annual and interim financial statements and going concern and viability statements
- The impact of the implementation of IFRS 15 and IFRS 9
- Non-financial regulatory reporting and improvements in processes and controls, including oversight of external assurance
- Internal controls
- Corporate governance matters

- Internal audit reports and plans
- Areas of risk, risk management and risk appetite (ARRC – now within the remit of the Risk Committee)
- Oversight of internal and external audit
- Compliance with the company's legal and regulatory obligations, including payment practices reporting and the Criminal Finance Act 2018
- Water and wastewater regulatory compliance
- Speak Up
- Transformation programmes
- Ongoing Ofwat investigation as well as the Environment Agency investigations and the associated accounting considerations
- The company's information governance, including GDPR and the NIS Directive (now Information Security Committee)
- The level of non-audit fees paid to the external audit firm.

Due to the amount of data held by the company on its customers in particular, the governance of information by the company and the security of that information was a key area of focus for the committee during the year. As such the committee reviewed both the company's compliance with the requirements of the EU General Data Protection Regulation and the NIS Directive and cyber and IT controls more generally. This oversight is now provided by the Information Security Committee.

The committee has spent significant time considering the company's plans to address those matters that have contributed to the legacy issues. The committee has received regular updates on the transformation programmes driving the required change, with particular updates on water and wastewater compliance, culture and the implementation of the modern compliance framework and new code of conduct. The company's non-financial assurers have reported regularly to the committee on the company's improving performance, having previously reported on matters that needed to be addressed.

The Chair of the ARRC reported to the Board those matters reviewed and discussed by the committee at its previous meeting.

Financial statements

The Audit Committee received and reviewed the financial statements, including the key areas of judgment and estimation uncertainty set out in note 2 and the external audit report from Deloitte regarding the year-end financial statements, considering any items of significant judgment that have been made and comments on the control environment, including general IT controls, and contingent liabilities, before making a recommendation to the Board to approve the annual results. There were no significant issues to be addressed.

Our Ofwat performance commitments

We appoint an external non-financial assurer to independently confirm our non-financial reporting to Ofwat and that we have a robust system of internal controls in place for non-financial regulatory reporting, such that information in the Annual Report fairly represents the company's progress and delivery of its promises. The assurer attends the Audit Committee and reports formally its results of its assurance. Following the assurer's report last year, management has implemented a number of changes to people, process and systems to strengthen our regulatory reporting. As recognised earlier in this annual report, significant improvements have been made to our regulatory reporting and will continue to be made in the coming year.

Internal controls

The ARRC received and the Audit Committee receives regular reports from Internal Audit in respect of its work on internal controls and reviews any internal control findings identified by the external auditor. The committee keeps under review the company's internal financial controls systems that identify, assess, manage and monitor financial risks along with other internal control and risk management systems.

The committee also receives a regular report of any incidents of fraud or bribery, including the actions taken to investigate and respond to the incidents and information on potential incidents of wrongdoing under investigation.

The committee also receives updates on matters identified via the company's Speak Up policy. The Audit Committee has reviewed the adequacy of the company's procedures for its employees and contractors to raise concerns in confidence about possible wrongdoing and as a result a number of improvements will be made to the company's arrangements in line with best practice informed in part by involvement with the Institute of Business Ethics. The company's Speak Up process is being refreshed in 2019–20.

There were no material incidents reported via Speak Up during the year.

Throughout the year, the committee has received progress reports and independent assurance of the improvement programmes in respect of the company's non-financial reporting. This has included details of end to end reviews of the company's key reporting processes and maturity of management controls across all three lines of defence. Further details of our internal control framework, including the main features of our internal control and risk management systems, can be found in the Annual Report on page 103.

Oversight of internal audit and external audit

The ARRC was and the Audit Committee is responsible for overseeing both the work of the Internal Audit function and for the management of the relationship with the external auditor and external non-financial assurer. The committee reviews the performance of both the internal and external auditors on an annual basis to ensure that they remain effective. The ARRC/ Audit Committee also provides the Board with its recommendation on whether the external auditor should be reappointed.

The ARRC held discussions with both the internal and external auditors and the external non-financial assurers in the absence of management and the Audit Committee will continue this practice.

Internal audit

The Head of Internal Audit and the team report on a day-to-day basis to management on the effectiveness of the company's systems of internal controls and the adequacy of these systems to manage business risk and to safeguard the company's assets and resources.

The work of Internal Audit was reported to the ARRC on a regular basis throughout the year and will continue to be reported to the Audit Committee. The reports from Internal Audit are a key element of the assurance received by the committee on the company's risks and controls. If changes are required to internal audit action dates for medium and high actions, the action owners are required to attend the committee and explain why such changes are required and to seek the Committee's approval.

The committee reviews, at least annually, the level of resources and the budget of the Internal Audit function. The Head of Internal Audit is free to raise any issues with the committee or its Chair at any time during the year.

Risk and Compliance

The company's Risk and Compliance function, previously Compliance and Asset Resilience function, provided regular reports to the committee throughout the year in respect of the company's processes and controls and its work on assurance of the company's non-financial data as part of an overall improvement plan.

Risk

Whilst the Board is ultimately accountable for ensuring that risks are managed effectively across the company and for maintaining robust systems of risk management and internal control, the ARRC was also responsible for the robust assessment of the principal risks facing the company, monitoring its risk management and internal control systems and testing of effectiveness.

During the year the ARRC considered and recommended to the Board, the approval of the company's risk appetite statements.

The ARRC undertook and the Audit Committee undertakes, on behalf of the Board, ongoing performance monitoring of the systems of internal control to ensure they are effective and performing as expected.

The ARRC received and reviewed a risk update report three times in the year. In addition, the committee held one meeting, which focused extensively on risk. This meeting was held on 24 September 2018 and included a review of the company's risks and a deep-dive into wastewater regulatory compliance. The meeting also received a report on the company's information governance (including GDPR and NIS Directive compliance) and a report on IT business continuity.

Following the committee changes agreed in February 2019, the Risk Committee took over responsibility for advising on risk appetite, tolerance and strategy and keeping under review the company's risk assessment processes, parameters and monitoring. The Risk Committee report can be found on page 141.

The Audit Committee is responsible for supporting the Risk Committee's work in overseeing and challenging the effectiveness of Southern Water's approach to risk management. Key responsibilities of the two committees include:

- The Risk Committee ensures the Board receives appropriate assurance that the systems of risk management are operating effectively, and that all significant failings and weaknesses and principal risks have suitable management activities in place to rectify and/or remain within defined risk appetite
- The Audit Committee has responsibility for monitoring the effectiveness of the company's systems of internal controls and for endorsing an internal audit plan that is informed by principal risk exposures, including overseeing targeted reviews of key risk and control areas
- The Audit Committee is responsible for maintaining an assurance landscape that has integrity, independence and reliability.

External auditor

Deloitte LLP was appointed as the company's auditor for the year ended 31 March 2012, following a tendering process carried out in 2011.

The ARRC considered and the Audit Committee continues to review the auditor's effectiveness each year and would report to the Board any concerns over the auditor's continuing appointment.

The current audit partner, Anthony Matthews, rotated onto the audit for the 2016–17 Annual Report.

An annual review of the external auditor's independence and objectivity within the context of the applicable regulatory requirements and professional standards is undertaken. This includes an assessment of the impact of any non-audit work carried out by the audit firm on the auditor's independence and objectivity. The committee monitors the ratio of audit fees to non-audit fees and approved non-audit services and fees paid to Deloitte during 2018–19. Under the Southern Water Code of Board leadership, transparency and governance, the external audit contract will be put to tender at least every 10 years. A tender process would also be initiated if there were any concerns about the quality of the audit or the independence and objectivity of the auditor. There are no contractual obligations that act to restrict the Board's choice of external auditor, although the Board is mindful of non-audit services currently being undertaken by other potential external audit providers. The next tendering exercise is expected to take place in respect of the year ending March 2022.

Details of the amounts paid to Deloitte for these services are provided in note 6 to the financial statements.

Health and Safety Committee

Message from the Chair

The health and safety of the company's workforce, its contractors and all who come into contact with our activities is a priority for the company. This extends not only to 'traditional' workplace activities and interventions to minimise and, where possible, remove risk of accidents, but also includes a commitment by the company to improving the mental and non-physical wellbeing of its workforce. We welcomed the company's new Head of Health, Safety, Security and Wellbeing, who is bringing his knowledge and perspective into the organisation, and invited him to provide his observations and any feedback during his initial months in the business. The committee met throughout the year to review the strategic approach to safety, health and wellbeing and I have been pleased to see that our performance remains in the upper quartile when compared with our peer group. We decided during the year to subsume this committee into the wider Risk Committee but the importance of health and safety will continue to be an area of key focus for the company.

Paul Sheffield
Chair of the Health and Safety Committee

Prior to the committee changes agreed in February 2019, the Health and Safety Committee was responsible for reviewing and advising on the company's health and safety policy and the implementation of, and compliance with, agreed policies, applicable guidance and standards. The Health and Safety Committee reviewed incident and accident prevention performance and policies and any other matters assigned by the Board.

The Health and Safety Committee's role was included in the remit of the Risk Committee following the establishment of the Risk Committee in February 2019.

During the year, the committee received reports on the company's health and safety performance including significant near misses, lost time and non-lost time injuries and accidents and incidents. New reporting metrics were adopted by the company, with the Head of Health, Safety and Wellbeing introducing an injury-weighted-index and assurance strategy to further strengthen the company's monitoring of risk and performance. The committee received updates on safety improvements introduced following serious incidents as a result of lifting operations. Furthermore, the committee discussed plans for improvement of the management of health and safety as well as employee physical and mental wellbeing.

The members of the Health and Safety Committee were Paul Sheffield (Chair of the Committee), Ian McAulay, Rosemary Boot and Sara Sulaiman.

The Health and Safety Committee met on two occasions in 2018–19 and details of attendance are provided on page 129.

Risk Committee

Message from the Chair

I am pleased to have been appointed as the Chair of the newly constituted Risk Committee following the review of the company's corporate governance arrangements in early 2019. It is intended that this new committee will review both the external and internal environment to ascertain what should be viewed as a risk following which the committee will then make recommendations to the Board in terms of risk appetite, tolerance and strategy. It is important to have such a dedicated forum to enable appropriate focus to be given to the risks faced by the company, particularly given the complex regulatory, legal, economic and political environment in which Southern Water operates. In addition, the committee continues the work of the Health and Safety Committee with its focus on health and safety. The committee will also monitor the company's developing resilience action plan.

Mike Putnam
Chair of the Risk Committee

With the separation of the Audit and Risk Review Committee, the Risk Committee was established in February 2019. This followed a review of the company's corporate governance arrangements and structures, which took into account the changes in the UK Corporate Governance Code, Ofwat's Principles and practice in the water sector and other industries.

It was agreed that the Risk Committee would, primarily, be responsible for considering what in the external or internal environment could impact the company's activities and should therefore be viewed as a risk. Once identified the committee will make a recommendation to the Board concerning the Board's appetite, tolerance and strategy in terms of the risk. The role of the Risk Committee is to ensure that the internal controls act as appropriate mitigation for the relevant risk(s). Due to the inevitable overlap in some areas, the Audit and Risk committees work together to ensure that all matters are addressed properly. To reinforce this collaboration, the terms of reference of the Risk Committee require at least one member of the committee to also be a member of the Audit Committee and the Audit Committee's terms of reference have an equivalent provision.

Due to the importance of health and safety and the interplay with risk, it was considered appropriate to also include oversight of health and safety within the committee's terms of reference. The separate Information Security Committee was established to monitor and advise on NIS, GDPR, cyber risk and information security more generally.

The role of the Risk Committee is to:

- advise the Board on the company's overall risk appetite, tolerance and strategy
- oversee and advise the Board on current risk exposures
- keep under review the company's risk assessment procedures, the parameters used and reporting
- review the company's capability to identify and manage new risks
- review reports on material breaches of risk limits
- review and monitor developments in environmental standards, law and regulation and make appropriate recommendations to the Board
- review and advise on the company's health and safety policy, guidance, standards and culture
- review the company's risk management processes and controls.

In addition, it was agreed that the following would be members of the Risk Committee, and their attendance at meetings held during the year is also shown below.

Attendance at scheduled meetings:

Risk Committee attendance in 2018–19	
Mike Putnam	1 / 1
Rosemary Boot	1 / 1
Gillian Guy	1 / 1
Wendy Barnes	1 / 1

Note – Attendance includes attendance in person and by phone.

Under the terms of reference of the Risk Committee, all members must be non-executive directors and a majority must be independent non-executive directors. At least one member must also be a member of the Audit Committee.

The terms of reference of the Risk Committee are published at **southernwater.co.uk/board-committee-terms-of-reference**

During the year, the committee met once following its establishment in February 2019. The committee received reports on health, safety, security and wellbeing as well as an update on the company's risk management and risk governance. The committee also approved the company's risk plan for 2019–20.

Nomination Committee

Message from the Chair

There have been significant changes in the composition of the Board during the year and, accordingly, the Nomination Committee has been busy in the search for new non-executive directors. This included an assessment of the skills and experience present on the Board and additional areas of expertise that would be desirable in a new non-executive director appointment. In addition, the search for a replacement Chairman following the resignation of Bill Tame has and continues to occupy the committee's agenda.

Paul Sheffield
Chair of the Nomination Committee

The Nomination Committee is responsible for reviewing the structure, size and composition of the Board and evaluating the balance of independence, skills, experience, knowledge and diversity. It prepares descriptions of roles, specifies the capabilities required and leads the process for identifying and nominating candidates for the approval of the Board.

In February 2019, the Nomination Committee adopted new terms of reference following a review of its previous terms of reference against best practice and the UK Corporate Governance Code. It was also agreed to amend the membership of the committee to be Bill Tame (Chair) (until 31 March 2019), Paul Sheffield (senior independent non-executive director, Acting Chair from 1 April 2019) and Sara Sulaiman. Previously, the committee was chaired by Bill Tame and the senior independent non-executive director and all non-executive directors were members.

The committee's terms of reference require all members to be non-executive directors, a majority of whom must be independent non-executive directors.

There were a number of changes in the Board's composition during the year. The Nomination Committee led the search for the non-executive directors recruited during the year, supported by Russell Reynolds Associates and Ridgeway Partners. This process involved the assessment of the skills and experience required by the Board, the importance of diversity on the Board and the preparation of a candidate specification, followed by meetings between candidates and the Board members, key executives and the company's shareholders. The candidates also meet with Ofwat prior to appointment.

Following the departure of Bill Tame on 31 March 2019, taking account of the fact that the Nomination Committee had only two members, Paul Sheffield has led the search for a replacement on behalf of the full Board.

The Nomination Committee met on four occasions in 2018–19 and details of attendance are provided on page 129.

The terms of reference of the Nomination Committee are published at **southernwater.co.uk/board-committee-terms-of-reference**.

Directors' Remuneration Report

This report details the activities of the Remuneration Committee for the period to 31 March 2019. It sets out the remuneration policy and remuneration details for the executive and non-executive directors of the company.

It has been prepared in accordance with our Code, the guidance issued by Ofwat in Regulatory Accounting Guidance (RAG) 3.11 and, where relevant for a non-listed company, has taken into account the requirements of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

Chairman's annual statement

I am pleased to present the Remuneration Committee's report for the year to 31 March 2019.

The key purpose of the Remuneration Committee is to develop and implement incentive and retention structures that allow Southern Water to drive performance improvement, align our employees to deliver the outcomes and expectations of our customers and create value for our shareholders.

Summary of the year

During the year, Ofwat consulted on executive remuneration and we have committed to fully comply with their requirements.

We have committed to adopt the expectations on performance related pay for 2020–25 as set out in Ofwat's 'Putting the sector in balance' to include:

- visibility and evidence of substantial linkage of executive remuneration to delivery to customers
- clear explanation of stretching targets and how they will be applied
- clearer explanation of how the policy will be rigorously applied and monitored
- commitment to report how changes, including the underlying reasons, are signalled to customers
- commitment to publish the executive pay policy for 2020–25 once it has been finalised.

In addition, the terms of reference were fully reviewed and updated to ensure that they remain appropriate. Remuneration Committee membership was also reviewed and the committee maintains a majority of independent non-executive directors.

Remuneration outcomes for the year 2018–19

2018–19 has been a watershed year for the company – one in which we have addressed various legacy issues of the past whilst putting together a challenging business plan for the future. The executive team in place for the year under review has been dealing with both of these issues, whilst also focusing on improving the day-to-day performance of the business. Whilst the significant penalties that the company is now facing to remedy past performance is a reality, the executive and leadership team have been chosen and tasked with identifying and remedying the past whilst setting a new course for the future. They have all been selected for these roles since the start of 2017 and have not been involved in the historic performance issues reported on elsewhere in this document. The Remuneration Committee has been very mindful of ensuring their performance is assessed and measured against this background and the performance metrics used for both 2018–19 and 2019–20 reflect this.

As such, the performance of the executive in leading this change measured against the key targets set at the outset of the year has resulted in a contribution of 66.3% of maximum available target for in-year performance and 54% of maximum available target for the long-term performance metrics. Under the incentive scheme, the bonus is paid into the deferred Incentive and Retention Plan pool for distribution in accordance with the methodology explained on page 152 of this report.

Remuneration for 2019–20

For the next financial year, our response and commitment to Ofwat's executive remuneration consultation will be put into practice. This will be achieved by setting even more stretching targets that deliver quality outcomes for customers. We have reviewed base pay for the Executive team which will be in line with the inflationary increase awarded for other staff although it is worthy of note that the CEO has proposed not to accept this increase and the committee has decided to accept his decision.

The Remuneration Committee of Southern Water takes the views of customers, shareholders and regulators seriously and is committed to listening to the opinions of all of our stakeholders. I would like to take this opportunity to thank those of you who have taken the time to provide valuable input for the committee.

Paul Sheffield
12 July 2019

The Remuneration Committee of Southern Water

The Remuneration Committee has the responsibility for setting the remuneration policy and structure of the executive directors and senior management.

It is also responsible for setting the remuneration of the Chairman. The Committee has defined terms of reference, which are published at **southernwater.co.uk/board-committee-terms-of-reference**.

We recognise that the independent non-executive directors have an important role to play in determining and challenging remuneration policy and practice. In order to reflect this, the independent non-executive directors represent a majority on the committee.

Only committee members are entitled to attend meetings, with the Managing Director (accountable for People) and the Chief Executive Officer attending by invitation. The Company Secretariat acts as secretary to the committee.

No attendee participates in discussions regarding their own remuneration.

Committee activities and membership for the year

The table below sets out the members of the committee for the year, attendance at meetings and the key activities undertaken at each meeting.

As part of the Board's review of its corporate governance arrangements, the Remuneration Committee carried out a review of its terms of reference and membership. In particular, the committee considered the publication of the revised UK Code in July 2018 and Ofwat's revised Board leadership, transparency and governance principles as well as other best practice and guidance in the area of executive remuneration. Accordingly, in February 2019, it was agreed to implement the revised terms of reference and membership based on the output of the review of corporate governance. As such the members of the committee from February 2019 are Paul Sheffield (Chair), Rosemary Boot and Sara Sulaiman.

Members	Meeting 1 24 April 2018	Meeting 2 24 May 2018	Meeting 3 25 September 2018	Meeting 4 28 November 2018	Meeting 5 26 February 2019
Paul Sheffield (Chair)	●	●	●	●	●
Bill Tame	●	●	●	●	n/a
Rosemary Boot	●	●	●	●	●
Mike Putnam	●	●	●	●	n/a
Sara Sulaiman	●	●	●	Apologies	●
Wendy Barnes	●	●	●	●	n/a
Key activities undertaken:	• 2017–18 Management corporate objectives outturn • 2018–19 Management corporate incentive targets	• 2017–18 Management corporate objectives outturn • CEO and Executive Team remuneration review • 2018–19 Management corporate objectives	• Non-executive director fees	• 2019–20 Executive Bonus targets	• Remuneration strategy • 2018 Gender Pay Gap Report • 2019–20 Bonus KPIs

Remuneration policy (unaudited)

Purpose

The remuneration policy of SWS applies to all its employees. The Board of Directors has adopted the remuneration policy at the recommendation of the Remuneration Committee. The policy applies to remuneration earned from 1 April 2018.

Providing transparent alignment between performance-related pay and quality customer outcomes

The policy reflects the Board's commitment to being open and transparent in respect of executive pay. In line with the expectations set out in Ofwat's 'Putting the sector back in balance' the Board has also committed during the year to ensuring that performance related executive pay has a clearer alignment to delivering in the interests of customers as well as providing sustained and long-term value creation for shareholders by:

- setting stretching performance targets that are based on the performance ambitions set out in our business plan
- ensuring that targets and metrics have a substantial and demonstrable link to stretching performance delivery and quality outcomes that align with the interests of customers
- transparently reporting how performance related executive pay is linked to the underlying performance of the company
- embedding behavioural competence built around company values to underpin the cultural change and instil a way of working that will increase employee engagement and therefore productivity
- ensuring employees feel encouraged to create sustainable results and that a clear link exists between customers, shareholders and employees' interests
- aligning pay to the market-median position, recognising the need, from time to time, to implement specific arrangements for certain individuals
- ensuring employees are offered a competitive and market median-aligned remuneration package, which balances the fixed and variable remuneration components according to job role
- ensuring that SWS is able to attract, develop and retain high-performing and motivated employees in a competitive market.

The table on page 149 summarises the elements of our executive directors' remuneration package and our policy for each item.

Governance, risk management and rigorous application

The Board applies sound and effective risk management principles to ensure that the policy is rigorously monitored and applied through:

- the application of good corporate governance by taking into account regulatory requirements and, among others, the UK Corporate Governance Code and any corporate governance principles issued by its regulator, Ofwat, from time to time, as well as compliance with the Southern Water Code
- a stringent governance structure for setting relevant and stretching goals, which are aligned to customer outcomes, and communicating these goals to employees
- clear alignment with our business strategy, company values, key priorities and long-term goals
- the Remuneration Committee consists of two independent non-executive directors and one non-executive director, which avoids any conflicts of interest and aligns the principle of protection of customers and investors
- a commitment to the transparent reporting of executive pay within our Annual Report and Accounts, and any other channels as appropriate
- a commitment to transparently report any changes to the policy, including the underlying reasons, within the Annual Report and Accounts, and any other channels as appropriate
- an annual review of the constitution and terms of reference of the Remuneration Committee to maintain its operational effectiveness and publishing these on our website for transparency
- ensuring the ongoing effectiveness of Board and its committees through regular external and independent evaluation.

Applying stretching targets linked to customer outcomes

The Board is committed to setting bonus targets that are linked to outcomes for customers that require stretching performance. For 2019–20, in-year targets include customer experience delivery, efficient customer service delivery, Totex performance and delivering customer commitments. These metrics will also be used throughout the organisation so that all company employees are incentivised to achieve stretching levels of customer service. Of the short-term incentives for 2019–20, 75% are closely aligned with customer expectations and needs. More detail can be found on page 154 of this report.

Executive remuneration components

Executive remuneration comprises both fixed and variable elements with the four remuneration components detailed as follows:

- Fixed remuneration (including fixed supplements)
- Performance-based remuneration (variable percentage of salary)
- Pension schemes, where applicable
- Other benefits in kind (e.g. car allowance and private medical cover).

The fixed remuneration is determined on the basis of the role and position of the individual employee, including professional experience, responsibility, job complexity and local market conditions and is frequently benchmarked against industry peer groups.

The performance-based remuneration motivates and rewards those employees who significantly contribute to sustainable results, perform according to set expectations for the individual in question, strengthen long-term delivery of quality outcomes for customers and generate income and shareholder value.

The Board of Directors has determined a maximum percentage of performance-based remuneration relative to the fixed salary remuneration for the executive management positions. The table below shows the maximum limit on variable remuneration (excluding any pension allowance) for the CEO and CFO for 2018–19. The maximum percentages are made up of short-term and long-term elements as follows:

	CEO	CFO
Short-term range and maximum:	0% – 100%	0% – 80%
Long-term range and maximum:	0% – 120%	0% – 75%
Total maximum variable remuneration:	0% – 220%	0% – 155%

Performance-based remuneration is disbursed as a cash bonus. Each year, the total of any executive bonus earned is added to the individual's bonus pool carried over from prior years. Each year, 50% of the pool is paid in cash, with the remaining 50% deferred. Rules of the scheme include bonus recovery provisions, which allow for the possibility of a reduction or clawback of bonuses already earned, or those deferred, to incentivise sustained executive performance over the longer term.

Executive directors are covered by an insured four times salary 'death in service' lump sum benefit and a contribution to a personal pension arrangement. The CEO receives an 18% contribution rate and the CFO receives 15%. Where retirement savings have exceeded the Lifetime Allowance (as defined by HMRC for their circumstances) the employer contribution may instead be taken as a pay supplement, subject to the relevant tax and National Insurance deductions.

The policy is that remuneration should be market-competitive relative to other comparable companies, with a significant proportion being performance-related. The performance-related element is only paid out if stretching short-term and long-term targets are achieved that benefit both customers and shareholders. In setting the remuneration policy for executive directors, the committee takes into account the remuneration practices found in other UK companies of a similar size or operating in the same sector. It also ensures that the remuneration arrangements for the executive directors are appropriate when compared with those for other senior executives and the wider workforce. Attracting and retaining first class leadership is vital to the long-term success of the company.

In particular, the committee is kept informed on a regular basis of the following, which it uses to set executive remuneration policy:

- the level of salary increase for the general employee population
- company-wide benefit provision and any proposed changes
- overall spend on management bonus arrangements.

An investor representative non-executive director sits on the committee and is closely involved in setting remuneration levels, monitoring the performance of the executive directors, agreeing payments and approving any changes to executive reward packages. This involvement ensures that shareholders play a key part in shaping remuneration policy and decisions. Along with the independent non-executive directors they ensure that the link between pay and performance is closely managed.

To ensure that our remuneration practices remain competitive, the committee periodically calls upon experienced specialist consultants. During the year, the committee also received some guidance and market practice information from external, independent advisors, PwC.

Remuneration components

Element of remuneration	Purpose and link to strategy	Policy and approach	Maximum opportunity 2018–19
Base salary	Takes into account experience and personal contribution to our strategy and performance. Attracts and retains executives of the quality required to deliver our strategy.	• Reviewed annually with changes effective from 1 July if applicable. • Consideration given to individual and company performance. • General pay increases to all employees taken into consideration. • Aim to pay within a mid-market range, but may pay higher salaries to attract and retain executives of the right calibre or for out-performance by the individual or company. • Referenced against UK companies of a similar size, utility companies and other water companies.	Base salary increases are applied in line with the annual review.
Incentive and Retention Plan	Drives and rewards performance against stretching financial, customer and operational KPIs, which are directly linked to business strategy. It is also structured to provide retention incentives to executives.	• Details of the operation of the plan are shown on page 152. • Performance metrics and targets are established annually by the committee, making sure they are sufficiently stretching while also recognising the nature and risk profile of the company. • Where applicable, between 0% – 80% of the opportunity available for each measure is created for achieving a threshold target. 60% – 100% is awarded for achieving the actual target, with stretch targets creating between 100% – 120% for achieving outstanding performance. • The committee has discretion to amend or withdraw payments based on the consideration of other factors which could significantly affect business performance. • Awards made under the plan are disclosed on page 155.	220% of salary for the CEO 155% of salary for the CFO
Pension	Defined contribution scheme minimises the risk to the company associated with defined benefit pension plans.	• A company contribution into a defined contribution scheme, and/or • A cash allowance in lieu of pension.	Contribution of: CEO 18% of salary CFO 15% of salary
Other benefits	Provides market competitive benefits.	May consist of: • Car allowance • Health cover • Disturbance or relocation allowances.	Based on individual circumstances.

Notes to the policy table

Directors' pay

Executive directors who served during the 2018–19 year are shown below:

Ian McAulay Chief Executive Officer

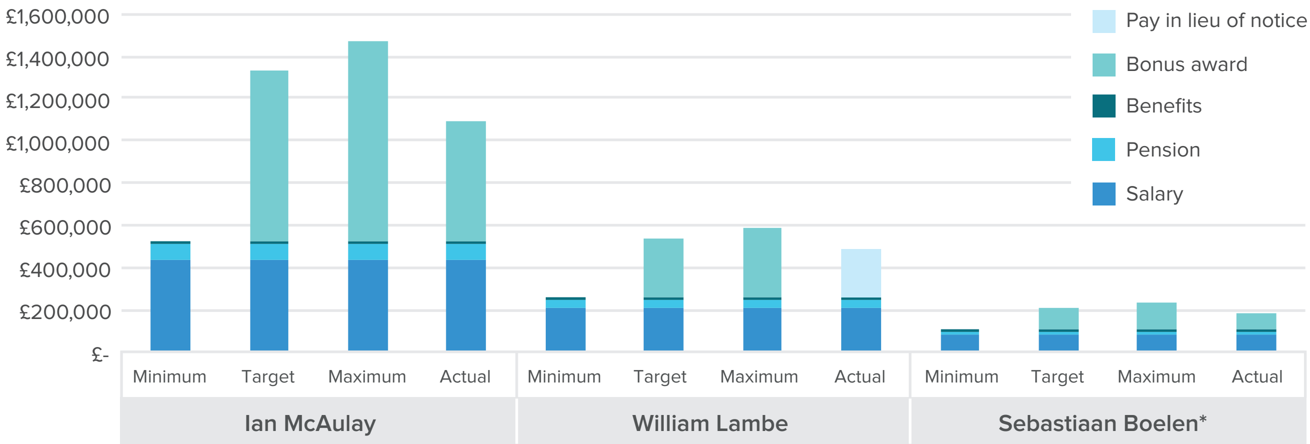
Sebastiaan Boelen Interim Chief Financial Officer (appointed 14 December 2018)

William Lambe Chief Financial Officer (resigned as a director of the Board on 14 December 2018 and continued working on specific projects and to ensure effective handover until 4 May 2019)

Details are given on page 153 of the amounts paid to them in the year ended 31 March 2019.

The following chart sets out the remuneration scenarios payable to the executive directors for various levels of performance as well as the actual remuneration for 2018–19.

Remuneration scenarios and actual for 2018–19



*The amounts reported for Sebastiaan Boelen represent his service from 14 December 2018 to 31 March 2019

Executive director benchmarking

Our stated pay policy is to aim to pay within a mid-market range.

In March 2019, the Remuneration Committee commissioned PwC remuneration advisors to undertake an executive director benchmarking exercise. Comparisons were made within sector and also against FTSE 250 small cap and private equivalents (excluding Financial Services). The data is based on the most recent information available to PwC through its Executive and Management Reward Survey.

The conclusion of this benchmarking exercise is that both the CEO and CFO roles are currently being remunerated within the lower quartile range, significantly below our stated pay policy position.

Despite this, as noted in the Chairman’s introductory statement, the CEO requested that no pay rise should be made for 2019–20 and for 2019–20 onwards, the long-term element of bonus potential be reduced from 120% to 100%. The Remuneration Committee accepted these requests.

CEO benchmarking

FTSE 250 size group	Revenue (£m)	Base salary (£000)	Single figure salary (£000)
Upper quartile	1,727	666	2,175
Median	895	560	1,625
Lower quartile	424	486	1,233
Southern Water	**830**	**435**	**1,088**

Water and sewerage companies size group	Base salary (£000)	Single figure salary (£000)
Median	491	1,309
Southern Water	**435**	**1,088**

CFO benchmarking

FTSE 250 size group	Revenue (£m)	Base salary (£000)	Single figure salary (£000)
Upper quartile	1,915	424	1,320
Median	937	375	1,034
Lower quartile	454	329	864
Southern Water	**830**	**275**	**572**

Water and sewerage companies size group	Base salary (£000)	Single figure salary (£000)
Median	375	840
Southern Water	**275**	**572**

Operation of the Incentive and Retention Plan

The Incentive and Retention Plan operates as follows:

1. **Annual Contribution:** Each year, participants have the opportunity to earn an annual bonus contribution based on performance against targets pre-determined by the Board. This is then added to the 'bonus pool'.
2. **Annual Pay-out:** Each year, following the Annual Contribution, 50% of the total amount in the 'bonus pool' is paid out to participants in cash.
3. **Deferred value:** Each year, the remaining 50% of the 'bonus pool' is carried forward. These deferred amounts will therefore roll over to the subsequent years.
4. **Repeat:** The following year, the process repeats, and continues for an indefinite period of time. This serves to increase the retention incentive and also give the Remuneration Committee a long-term view of sustainable outcomes for the company, customers and shareholders.

Measures used in the Incentive and Retention Plan

During the year the committee identified and operated both short-term and long-term performance measures in the Incentive and Retention Plan. Measures for the year were therefore split into two categories; short-term and long-term. Short-term performance measures for 2018–19 were focused on issues that affect customers such as:

- customer satisfaction, as measured by our SIM performance
- delivery of our business plan commitments, as measured by our ODI performance
- a number of other measures aimed at reducing our operating costs, which ultimately helps us to reduce bills for customers.

Long-term performance conditions for 2018–19 included Total Shareholder Return and Total Costs to Serve reflecting both shareholders' and customers' long-term interests.

An executive leaving the company will only be eligible for release of any deferred incentives if he/she is deemed as a 'Good Leaver' and complies with specific targets prior to departure.

An individual is usually deemed to be a 'Good Leaver' if they leave the company in the following circumstances:

- Retirement
- Redundancy
- Disability
- Death
- Other circumstances which the committee deems appropriate.

Remuneration policy for joiners and leavers

The table below sets out the contractual notice periods for the executive directors. If the notice period is worked, no termination payment is payable, otherwise a payment up to a maximum equivalent to the notice period of basic salary, pension and car allowance is payable.

	Notice period
Ian McAulay, CEO:	Twelve months by both parties
William Lambe, CFO:	Twelve months by both parties
Sebastiaan Boelen, Interim CFO:	Three months by both parties

Annual remuneration report

Single figure of remuneration for 2018–19 (unaudited)

Details of the remuneration received by the executive directors are shown below:

£'000		Base salary paid	Benefits	Relocation	Annual Bonus/ Incentive and Retention Plan	Total	Pension related benefit	Total including pension
Ian McAulay	2018–19	431.3	16.8	76.2	570.3	**1,094.6**	77.6	**1,172.2**
	2017–18	420.0	12.8	41.0	517.4	**991.2**	75.6	**1,066.8**
Sebastiaan Boelen[2]	2018–19	85.0	4.0	–	75.0	**164.0**	12.8	**176.8**
	2017–18	–	–	–	–	**–**	–	**–**
William Lambe[3]	2018–19	211.3	7.2	0.8	–	**219.3**	31.7	**251.0**
	2017–18	265.5	7.5	13.6	238.3	**524.9**	39.8	**564.7**

[1] The amount reported is 100% of the contribution into the bonus pool for the year as shown in the table under Incentive and Retention Plan on page 155. The table also provides details of payments made from the bonus pool.

[2] Sebastiaan Boelen was appointed to the board on 14 December 2018.

[3] The amounts reported relate to William Lambe's service as an executive director from 1 April 2018 to 14 December 2018. The additional table below shows payments made since that time.

£'000		Base salary paid	Benefits	Relocation	Annual Bonus/ Incentive and Retention Plan	Total	Pension related benefit	Total including pension
William Lambe[1]	15/12/18 – 04/05/19	116.9	4.0	–	–	**120.9**	17.5	**138.4**
	Pay in lieu of notice	–	–	189.3	–	**189.3**	27.9	**217.2**

[1] William Lambe resigned as a director of the Board on 14 December 2018 and continued working on specific projects and to ensure effective handover until 4 May 2019. He received a payment in lieu of notice following his departure from the business on 4 May 2019 for his contracted notice period to 14 December 2019. The payment comprised £183,065 for base salary and £6,225 for car allowance.

Notes to the single figure (unaudited)

Base salary

The base salary for Ian McAulay was increased to £435,000 on 1 July 2018 from £420,000 and the base salary for William Lambe was reviewed in January 2018 and increased to £300,000. On his appointment in December 2018, the base salary for Sebastiaan Boelen was agreed as £275,000. Salary was paid monthly via PAYE.

Incentive and Retention Plan (short and long-term targets)

The performance measures agreed by the committee for 2018–19 were:

- Cash collection – cash receipts from measured and unmeasured customers, ensures good financial performance and provides customers with an affordable service
- Operating costs (opex) – maintaining operating costs within budgeted levels and helps reduce customer bills
- Bad debt provision – reducing the cost of bad debt which minimises the impact of bad debt charges on customer bills
- Output Delivery Incentives – delivery of the operational promises made to customers as part of our business plan
- Service Incentive Mechanism – improving our customer service performance
- Capital programme – delivery of our investment plan on time, ensuring we meet our commitments to customers
- Capital expenditure (capex) – delivery of our investment plan within budget
- Total Shareholder Return – achievement of a minimum level of return for shareholders but only if underlying performance of the business supports this
- Total Cost to Serve – efficient delivery of services to customers in line with the industry.

The performance for 2018–19 was assessed by the committee in May 2019. Details of the maximum bonus achievable, targets and outturn percentage for each executive director are shown in the tables below.

CEO	Maximum bonus achievable	Outturn %	Outturn as a % of salary
Short-term targets	100%	66.3%	66.3%
Long-term targets (Total shareholder return and Total cost to serve)	120%	54.0%	64.8%
Total outturn as a percentage of salary			**131.1%**

CFO	Maximum bonus achievable	Outturn %	Outturn as a % of salary
Short-term targets	80%	66.3%	53.0%
Long-term targets (Total shareholder return and Total cost to serve)	75%	54.0%	40.5%
Total outturn as a percentage of salary			**93.5%**

The outturn as a percentage of salary is calculated by multiplying the maximum bonus achievable by the outturn percentage.

Incentive and Retention Plan 2018–19	Performance level			CEO Weighting (% of salary)	CFO Weighting (% of salary)	Bonus percentage			Performance for the year	CEO Pay-out (% of salary)	CFO Pay-out (% of salary)
	Threshold	Target	Stretch			Threshold	Target	Stretch			
Cash Collection (£m)	779.3	803.4	827.5	20%	16%	5%	60%	120%	810.4	19.2%	15.4%
OPEX (net operating costs; £m) Excluding approved one-off costs	323.1	313.1	308.1	15%	12%	10%	100%	120%	336.0	0.0%	0.0%
Bad Debt Provision (£m)	22.0	15.7	12.0	10%	8%	40%	100%	120%	10.7	12.0%	9.6%
Output Delivery Incentives (annual ODI penalty; £m)	1.0	0.5	0.0	20%	16%	30%	60%	100%	0.0	20.0%	16.0%
Service Incentive Mechanism (SIM qualitative ranking)	80.71	84.47	84.77	20%	16%	0%	80%	120%	80.14	0.0%	0.0%
Capital Programme (Regulatory Dates)	127	137	145	10%	8%	50%	100%	120%	142	11.3%	9.0%
CAPEX (Forecasting accuracy)	6%	5%	3%	5%	4%	80%	100%	120%	6.8%	3.8%	3.0%
Total Shareholder Return (TSR)	7%	10%	12%	60%	37.5%	80%	100%	120%	0.0%	0.0%	0.0%
Total Cost To Serve (£m)	63.4	60.4	57.4	60%	37.5%	80%	100%	120%	54.0%	64.8%	40.5%
Total										**131.1%**	**93.5%**

The threshold, target and stretch bonus percentages shown reflect the level of bonus award for achievement of the threshold, target and stretch performance levels for each metric.

Incentive and Retention Plan Contribution 2018–19	a) Bonus pool brought forward (£000)	b) Bonus awarded in year (£000)	c) Bonus paid out (£000)	d) Bonus pool carried forward (£000)
Ian McAulay	258.7	570.3	414.5	414.5
Sebastiaan Boelen	–	75.0	37.5	37.5
William Lambe	119.1	–	119.1	–

The amounts paid out (c) and carried forward (d) are each calculated as ((a) + (b)) ÷ 2

Sebastiaan Boelen's bonus award has been pro-rated due to his length of service being 3.5 months in 2018–19.

The bonus pool brought forward for William Lambe was paid out on cessation, following the satisfactory discharge of agreed personal targets during handover. No bonus was awarded to him for 2018–19 following his resignation from the Board on 14 December 2018.

Pension contributions

The pension contribution for the Executive Directors is set out in the table below:

Pension	Salary received (£000)	Pension contribution as a % of base salary	Cash allowance in lieu of pension (£'000)	Pension contribution to scheme (£'000)	Total Pension related benefit (£'000)
Ian McAulay	431.2	18%	67.6	10.0	77.6
Sebastiaan Boelen	85.0	15%	–	12.8	12.8
William Lambe	211.3	15%	24.6	7.1	31.7

Non-Executive Director fees for the year (audited)

The Chairman and the independent non-executive directors each receive a fee and do not participate in any performance-related incentive arrangements. The investor-nominated non-executive director does not receive any remuneration from the company.

Details of the emoluments received by the Chairman and non-executive directors are shown below:

£000	2018–19			2017–18		
	Fees	Other	Total	Fees	Other	Total
Bill Tame Chairman (resigned 31 March 2019)	250.0	68.5	**318.5**	250.0	1.5	**251.5**
Paul Sheffield Senior independent non-executive director	65.0	4.4	**69.4**	60.0	10.1	**70.1**
Rosemary Boot Independent non-executive director	52.5	1.4	**53.9**	50.0	1.5	**51.5**
Mike Putnam Independent non-executive director	50.0	6.9	**56.9**	25.7	1.3	**27.0**
Ian Francis Independent non-executive director (from 12 Sept 2018 – 12 Feb 2019)	24.8	0.1	**24.9**	–	–	**–**
Gillian Guy Independent non-executive director (from 12 Sept 2018)	19.3	–	**19.3**	–	–	**–**
Lisa Harrington Independent non-executive director	–	0.5	**0.5**	50.0	1.5	**51.5**
Wendy Barnes Non-executive director	60.0	11.7	**71.7**	30.8	13.0	**43.8**
Sara Sulaiman Investor-nominated non-executive director	–	–	**–**	–	–	**–**

The base fees for the independent non-executive directors are £50,000.

Paul Sheffield receives an additional payment of £10,000 for his role as senior independent non-executive director and a further £10,000 with effect from 1 October 2018 as Chair of the Remuneration Committee. Rosemary Boot received an additional £10,000 per annum with effect from 1 January 2019 for her role as Chair of Audit Committee. Wendy Barnes receives an additional payment of £10,000 for her liaison work with the Greensands Board.

The other amounts payable to the non-executive directors include taxable expenses incurred in the attendance at Board meetings and shareholder events. In respect of Bill Tame, the other amount includes three months' pay of £62,500 for services performed for the company other than as a director to support the handover to Paul Sheffield as Acting Chairman.

None of the directors who held office during the financial year had any disclosable interests in the shares of Southern Water or the group; there are no share options in place and no payments were made to them by any other group companies.

Gender pay (unaudited)

Gender pay is an issue which we take very seriously. We are committed to supporting the aspirations of our talented female workforce and we are implementing plans to help us close the gender pay gap. On our Board, we already have a good balance of gender diversity, with women making up 44% of our Board as at March 2019. In terms of overall equality we have already taken steps to improve gender diversity at an executive level and we continue to focus and develop our succession plans and recruitment processes to strengthen gender equality across the business. For more information see the report on our gender pay gap at **southernwater.co.uk/gender-pay-gap**.

Implementation of policy for 2019–20 (unaudited)

Base salary

A basic salary increase of 2.0% for Sebastiaan Boelen for 2019–20 was approved in May 2019, in line with the award approved for the general workforce, and will be applicable to basic salary with effect from 1 July 2019. The salary for Ian McAulay for 2019–20 remains unchanged from the previous year at £435,000 at his request.

The revised base salaries for each Executive Director are as follows:

Base salary	Base salary from July 2018 (£000)	Base salary increase (%)	Base salary 2018–19 (£000)
Ian McAulay	435.0	0.0	435.0
Sebastiaan Boelen	275.0	2.0	280.5

Incentive and Retention Plan

As set out in our remuneration policy, the incentive and retention plan is designed to ensure that the executive is focused on delivering high quality performance for our customers in terms of the service they receive and for our wider stakeholders by enabling economic growth, supporting critical industries, supporting local communities, developing skills in our region, generating renewable energy and improving our environment. Delivery of these objectives will in turn generate returns for shareholders.

Bonus potential for 2019–20

The table below shows the maximum bonus potential for the executive directors in 2019–20.

	CEO		CFO	
	2018–19	2019–20	2018–19	2019–20
Short term maximum:	100%	100%	80%	80%
Long term maximum:	120%	100%	75%	75%
Total maximum variable remuneration	220%	200%	155%	155%

We have fully committed to comply with Ofwat's code of practice for executive remuneration for 2020–25

We have already made significant steps towards compliance in our 2019–20 Remuneration policy, which sets out:

- our policy to provide transparent alignment between executive performance-related pay and stretching outcomes for all our stakeholders and, substantially, for our customers
- our policy to apply stretching targets linked to customer outcomes
- our policy to apply rigorous application of incentive scheme rules and provide independent governance of remuneration decisions, whilst taking into consideration risk management principles
- our policy to defer an element of bonus so that performance can be measured over the medium to long-term.

Our performance measures for 2019–20 focus on positive outcomes for our customers and other stakeholders

The following measures will be used to assess our performance:

- Totex performance
- Delivering customer commitments
- Efficiently delivering customer service
- Actual Customer Experience Delivery
- PR19 efficiency glidepath
- Long-term resilience.

Weightings and targets, along with actual performance, will be fully disclosed in the 2019–20 Remuneration Report.

Directors' Report for the year ended 31 March 2019

The directors of Southern Water Services Limited (registered no. 02366670) present their report and the audited financial statements for the year ended 31 March 2019.

Principal activities

The principal activities of Southern Water Services Limited, herein after referred to as 'the company', also referred to as SWS, are the provision of water supply and wastewater services in the South East of England. The company is regulated by the Water Services Regulation Authority (Ofwat) and supplies water to over 2.5 million people and provides wastewater services to over 4.7 million people.

Strategic report

The information that fulfils the requirement of the Strategic Report can be found in our Annual Report on pages 3 to 117.

Future developments

The information regarding future developments of the company can be found in our Annual Report on pages 3 to 117.

Post balance sheet events

On 28 June 2019, the company redeemed all remaining 9,863 of its Class A1 and Class A2 preference shares, and 19,340 of its Class B preference shares, at nominal value plus the premium on issue, including settlement for fixed or base value dividends due to that date. The total amount paid was £34.0 million comprising principal redemption of £29.2 million and dividends of £4.8 million of which £4.4 million was accrued at 31 March 2019.

Results and dividends

The income statement on page 164 shows the company's results and profit for the year. Further details are also available in the Annual Report on pages 88 to 94.

Interim dividends of £622.41 per ordinary share (2018: £822.52 per share), totalling £34.8 million (2018: £46.1 million) were paid during the year to Southern Water Services Group (SWSG). These dividends, along with associated group tax relief of £8.2 million, enable SWSG to pay the interest of £43.0 million due to SWS on an inter-company loan as disclosed in note 14 to the financial statements.

No ordinary interim dividends were paid during the year, (2018: £8.0 million, equivalent to £142.86 per share) were declared and paid in the year. No final dividend has been declared or paid for the year ended 31 March 2019.

Directors and their interests

The directors who held office during the year ended 31 March 2019 and up to the date of signing the financial statements, unless otherwise stated, were as follows (further details can be found on pages 131 to 134):

Bill Tame (Chairman) (resigned 31 March 2019)

Ian McAulay
(Executive director – Chief Executive Officer)

Sebastiaan Boelen
(Executive director – Interim Chief Financial Officer) (appointed 14 December 2018)

William Lambe
(Executive director – Chief Financial Officer) (resigned as a director 14 December 2018)

Paul Sheffield
(Senior independent non-executive director, Acting Chairman from 1 April 2019)

Rosemary Boot
(Independent non-executive director)

Michael Putnam
(Independent non-executive director)

Ian Francis
(Independent non-executive director) (appointed 12 September 2018, resigned 12 February 2019)

Gillian Guy CBE
(Independent non-executive director) (appointed 12 November 2018)

Wendy Barnes (Non-executive director)

Sara Sulaiman (Non-executive director)

Alternate directors for the year were as follows:

Andrew Gilbert
(Alternate non-executive director for Sara Sulaiman) (resigned 4 October 2018)

None of the directors who held office during the financial year had any disclosable interests in the shares of the company or the group.

Research and development

The improvement of existing services and processes, together with the identification and development of new technology and innovative solutions, are important aspects of the company's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure charged to the income statement for the year amounted to £1.0 million (2018: £1.1 million).

Financial risk management

The Financial Risk Management Policy is included in the Strategic Report which can be found in the Annual Report on pages 103 to 117.

Employees

Employee involvement

The company recognises the importance of its employees and is committed to effective two-way communication and consultation.

The company has established Business Involvement Groups to facilitate meaningful consultation between company management and employees through elected employee representatives. The groups meet regularly at both a functional and company-wide level.

In 2017, the company introduced the Gallup employee survey, which has continued to be undertaken six monthly, to reset its approach to employee engagement and to help develop management action plans.

The company recognises the rights of every employee to join a trade union and participate in its activities. SWS has a single union agreement with Unison.

The company publishes its own in-house newspaper, Southern Water News, on a regular basis. General information is posted on the company intranet and regular team briefing sessions are also held. The information in these publications and briefings covers a wide range of subjects that affect the business, including progress on business and capital projects, the impact of regulatory issues and wider financial and economic issues that may affect the company.

In addition, in late 2018, the company's executive directors and Executive Leadership Team members held a series of roadshows across the company's sites to inform the company's employees about the company's priorities based on the new Business Plan 2020–25, including the pathway to the new five-year period. The new Water for Life brand and new values were tested with employees through this participation and the results of this engagement were communicated to the Board to inform their decision-making.

Equal opportunity

The company's policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The company takes full account of the needs of people with disabilities and follows set policies and procedures to support reasonable adjustments in the workplace.

Health, safety and wellbeing

The company recognises its duties to make proper provision for the health, safety and welfare at work of its employees.

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety. In addition there is a Health and Safety Management Review Group which ensures that there is an adequate system for meeting the company's responsibilities for health and safety to its staff, customers and members of the public.

The company holds an annual Health and Safety Conference, which this year focused on wellbeing. It attracted people from across the company and its partners to share the latest developments within the health and safety industry. SWS is committed to the 'Time for change' programme to raise awareness and understanding of mental health issues.

SWS provides an internal occupational health service for employees, including the provision of physiotherapy. These services have been developed and are continuously reviewed to ensure they meet the needs of the business and our employees at work.

Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the abilities of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

Speak Up

Employees are actively encouraged to Speak Up if they see things that are not quite right. This helps us work better as a company and fosters a culture where we ensure that we are always doing the right thing for each other, our customers, the environment and other stakeholders.

Engagement with customers, suppliers and others

Details of the company's engagement with its customers, suppliers and other stakeholders is included in the Strategic Report and can be found on pages 10 to 14, 31 to 35 and 54 to 61.

Environmental issues

The company is committed to meeting or improving upon legislative and regulatory environmental requirements and codes of practice and aims to contain the environmental impact of its activities to a practicable minimum.

Ofwat and the Environment Agency have been conducting investigations into our historic wastewater performance and reporting. Further details of these investigations are disclosed on page 26.

The company's environmental performance for 2018–19 is reported on pages 74 to 83. The company recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

Political donations

No political donations were made.

Land and buildings

In the opinion of the directors, the market value of land is significantly more than its book value. However, it would not be practicable to quantify the difference precisely.

Going concern

The directors believe, after due and careful enquiry, that the company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the financial statements to 31 March 2019.

In forming this assessment the directors have considered the following information:

- The company's business activities, together with the factors likely to affect its future development, performance and position, which are set out in the Strategic Report on pages 3 to 117.
- The financial position of the company, its cash flows, liquidity position, covenants and borrowing facilities, which are described in the 'Financial performance review' on pages 88 to 94.
- The company has available a combination of cash and committed undrawn bank facilities totalling £577.0 million at 31 March 2019 (2018: £514.4 million). These funds are sufficient to fund the operating and capital investment activities of the company for the 12 months from the date of signing the financial statements.
- The company operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities.

As a consequence, the directors believe that the company is well placed to manage its business risks successfully.

The directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Long-term viability statement

In accordance with provision C.2.2 of the UK Code and Ofwat's Information Notice IN 19/07, the Board has assessed the prospects of the company over a longer period than the 12 months required by the 'Going Concern' provision. Details of its assessment and the associated 'Viability statement' can be found on page 101 of this report.

Qualifying third party indemnity

Following shareholder approval, the company has also provided an indemnity for its directors and the Company Secretary, which is a qualifying third party indemnity provision for the purposes of the Companies Act 2006.

Directors' responsibilities statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 101 'Reduced Disclosure Framework'. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

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

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

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company
- the management report, which is incorporated into the Strategic Report, includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that it faces.

Statement of disclosure of information to auditor

Each of the persons who is a director at the date of approval of this report confirms that:

(1) so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware

(2) he/she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

Auditor

Deloitte LLP has indicated its willingness to continue in office.

Approved by the Board of Directors and signed by order of the Board.

Richard Manning
General Counsel and Company Secretary

12 July 2019

Financial statements

Income statement

For the year ended 31 March 2019

Income statement for the year ended 31 March 2019

	Note	2019 £m	2018 Restated* £m
Continuing operations			
Revenue	5	**876.3**	857.7
Regulatory settlement	5	**(135.5)**	–
Total revenue		**740.8**	857.7
Other operating income	5	**1.2**	1.1
Operating costs			
– before depreciation, amortisation and regulatory settlement		**(349.3)**	(336.0)
– depreciation and amortisation		**(271.8)**	(259.5)
– regulatory settlement		**(3.0)**	–
Total operating costs		**(624.1)**	(595.5)
Operating profit	6	**117.9**	263.3
Operating profit before regulatory settlement		**256.4**	263.3
Regulatory settlement		**(138.5)**	–
Operating profit		**117.9**	263.3
Other income	6	**0.2**	11.2
Profit on disposal of fixed assets	6	**0.7**	0.8
Finance income	9	**53.4**	57.9
Finance costs	9	**(209.2)**	(176.6)
Fair value (losses)/gains on derivative financial instruments	21	**(216.6)**	46.3
Net finance costs	9	**(372.4)**	(72.4)
(Loss)/profit before taxation		**(253.6)**	202.9
Taxation	10	**20.7**	(32.2)
(Loss)/profit for the financial year		**(232.9)**	170.7

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

The notes on pages 169 to 213 form part of these financial statements.

Statement of other comprehensive income for the year ended 31 March 2019

Statement of other comprehensive income for the year ended 31 March 2019	Note	2019 £m	2018 Restated* £m
(Loss)/profit for the year		**(232.9)**	170.7
Other comprehensive (loss)/income:			
Items that cannot be reclassified to profit or loss:			
Actuarial (loss)/gain on pension scheme	23	**(24.2)**	9.8
Movement on deferred tax relating to retirement benefit obligations	22	**4.1**	(1.7)
Total other comprehensive (loss)/income for the year, net of tax		**(20.1)**	8.1
Total comprehensive (loss)/income for the year attributable to the owner of the company		**(253.0)**	178.8

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

Statement of financial position

as at 31 March 2019

Statement of financial position as at 31 March 2019	Note	2019 £m	2018 Restated* £m
Non-current assets			
Intangible assets	12	**45.6**	61.1
Property, plant and equipment	13	**6,051.1**	5,865.3
Investments	15	**29.2**	29.2
Derivative financial instruments	21	**46.2**	0.3
Other non-current assets	14	**130.0**	812.3
		6,302.1	6,768.2
Current assets			
Inventories	16	**4.7**	2.9
Trade and other receivables	17	**332.5**	323.1
Derivative financial instruments	21	**–**	3.9
Cash and cash equivalents	30	**372.0**	164.4
		709.2	494.3
Total assets		**7,011.3**	7,262.5
Current liabilities			
Borrowings	19	**(504.5)**	(352.4)
Trade and other payables	18	**(362.3)**	(357.6)
Regulatory settlement liability	24	**(3.0)**	–
Provision for liabilities	25	**(1.2)**	–
		(871.0)	(710.0)
Non-current liabilities			
Borrowings	20	**(3,271.7)**	(3,652.4)
Derivative financial instruments	21	**(1,428.2)**	(1,292.2)
Deferred tax liabilities	22	**(247.7)**	(280.7)
Retirement benefit obligations	23	**(186.7)**	(171.7)
Regulatory settlement liability	24	**(135.5)**	–
Provision for liabilities	25	**(5.4)**	(3.4)
Other non-current liabilities	26	**(27.4)**	(26.6)
		(5,302.6)	(5,427.0)
Total liabilities		**(6,173.6)**	(6,137.0)
Net assets		**837.7**	1,125.5
Equity			
Called up share capital	27	**0.1**	0.1
Share premium account	28	**46.3**	46.3
Non-distributable reserve	29	**53.8**	46.7
Retained earnings	30	**737.5**	1,032.4
Total equity		**837.7**	1,125.5

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements and for derivative assets previously offset against derivative liabilities (see notes 14, 17 and 21).

The financial statements of Southern Water Services Limited (Registered no. 02366670) on pages 164 to 213 were approved by the Board and authorised for issue on 12 July 2019. They were signed on its behalf by:

Sebastiaan Boelen
Interim Chief Financial Officer

Statement of changes in equity

for the year ended 31 March 2019

Statement of changes in equity for the year ended 31 March 2019	Called up share capital (Note 27) £m	Share premium account (Note 28) £m	Non-distributable reserve (Note 29) Restated* £m	Retained earnings (Note 30) Restated* £m	Total Restated* £m
Balance at 31 March 2017	**0.1**	**46.3**	**24.1**	**930.3**	**1,000.8**
Profit for the financial year	–	–	23.7	147.0	170.7
Other comprehensive income/(loss) for the year: Actuarial gain on pension scheme	–	–	–	9.8	9.8
Movement on deferred tax relating to retirement benefit obligations	–	–	–	(1.7)	(1.7)
Total comprehensive income for the year	**–**	**–**	**23.7**	**155.1**	**178.8**
Reserves transfer**	–	–	(1.1)	1.1	–
Equity dividends paid (Note 11)	–	–	–	(54.1)	(54.1)
Balance at 31 March 2018	**0.1**	**46.3**	**46.7**	**1,032.4**	**1,125.5**
Profit/(loss) for the financial year	–	–	8.5	(241.4)	(232.9)
Other comprehensive (loss)/income for the year: Actuarial loss on pension scheme	–	–	–	(24.2)	(24.2)
Movement on deferred tax relating to retirement benefit obligations	–	–	–	4.1	4.1
Total comprehensive income/(loss) for the year	–	–	**8.5**	**(261.5)**	**(253.0)**
Reserves transfer**	–	–	(1.4)	1.4	–
Equity dividends paid (Note 11)	–	–	–	(34.8)	(34.8)
Balance at 31 March 2019	**0.1**	**46.3**	**53.8**	**737.5**	**837.7**

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

** The non-distributable reserve has arisen on adoption of IFRS 15 and relates to deemed revenue on adoption of assets from customers and is being amortised to reserves in line with the depreciation of the related assets.

Statement of cash flows

for the year ended 31 March 2019

Statement of cash flows for the year ended 31 March 2019	Note	2019 £m	2018 Restated* £m
Cash from operations	31	**498.0**	470.7
Tax paid		**(8.2)**	(14.1)
Net cash from operating activities		**489.8**	456.6
Investing activities			
Interest received		**51.9**	58.0
Purchase of property, plant and equipment		**(396.5)**	(373.3)
Purchase of intangible assets		**(7.2)**	(15.9)
Receipt of grants and contributions		**2.3**	2.8
Proceeds on disposal of property, plant and equipment		**0.3**	0.4
Repayments of intercompany loan receivable		**682.3**	–
Repayments/(advances) of intercompany loan receivables		**1.1**	(103.5)
Proceeds from disposal of business		**1.8**	11.8
Net cash generated from/(used in) investing activities		**336.0**	(419.7)
Financing activities			
Equity dividends paid		**(34.8)**	(117.3)
Interest paid		**(198.7)**	(23.9)
Preference share dividends		**(6.5)**	(12.5)
Payment of derivative accretion		**(4.7)**	(3.7)
Repayment of borrowings		**(420.4)**	(150.0)
Repayments of obligations under finance leases		**(0.6)**	(0.4)
Payments on restructure of derivative instruments		**(122.5)**	–
Proceeds of new loans		**170.0**	150.0
Net cash used in financing activities		**(618.2)**	(157.8)
Net increase/(decrease) in cash and cash equivalents		**207.6**	(120.9)
Cash and cash equivalents at beginning of the year		**164.4**	285.3
Cash and cash equivalents at end of the year		**372.0**	164.4

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

Notes to the financial statements

for the year ended 31 March 2019

1 Accounting policies

The principal accounting policies, which have been applied consistently throughout the current and preceding year, are set out below.

Basis of preparation

Southern Water Services Limited is a company incorporated in the United Kingdom under the Companies Act. The company is a private company limited by shares and is registered in England and Wales. The address of the registered office is given on page 2. The nature of the company's operations and its principal activities are set out in the Strategic Report on page 3 to 117.

These financial statements have been prepared in accordance with FRS 101 incorporating the Amendments to FRS 101 issued by the FRC in July 2015 and the amendments to Company law made by The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015.

The financial statements have been prepared on a going concern basis under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments and retirement benefit obligations) at fair value through profit and loss or other comprehensive income.

Historical cost is generally based on the fair value of the consideration given in exchange for the goods and services.

Fair value is the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the company takes into account the characteristics of the asset or liability as if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement purposes in these financial statements is determined on such a basis, except leasing transactions that are within the scope of IAS 17 'Leases', and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 'Inventories' or value in use in IAS 36 'Impairment of Assets'.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly
- Level 3 inputs are unobservable inputs for the asset or liability.

The financial statements contain information about Southern Water Services Limited (SWS) as an individual company and do not contain consolidated financial information as the parent of subsidiary companies. The company is exempt under Section 401 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it and its subsidiary undertaking are included by full consolidation in the consolidated financial statements of the ultimate holding company, Greensands Holdings Limited. The group financial statements of Greensands Holdings Limited are available to the public and can be obtained at **southernwater.co.uk/greensands-ownership-of-southern-water**.

As permitted by FRS 101, the company has taken advantage of the disclosure exemptions available under that standard in relation to financial instruments, fair value measurement, revenue from contracts with customers, presentation of a statement of financial position as at the beginning of the preceding period following a retrospective accounting policy application or restatement, capital management, related party disclosures and impairment of assets. Where required, equivalent disclosures are given in the group financial statements of Greensands Holdings Limited.

The company has elected not to take advantage of the exemption regarding the requirements of IAS 7 'Statement of Cash Flows' in order to align with regulatory reporting requirements and provide additional transparency for users of the financial statements.

Adoption of new and revised accounting and financial reporting standards

This is the first set of the company's annual financial statements where IFRS 15 'Revenue from Contracts with Customers' and IFRS 9 'Financial Instruments' have been applied. Changes to significant accounting policies are described in note 3.

IFRS 16 'Leases' sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor') and will be effective for the company from 1 April 2019. The changes effected by the new lease accounting model will result in all leases (including those currently classified as operating leases) of more than 12 months (with some limited exceptions such as low value leases) being recognised on the company's statement of financial position. The impact on the results or net assets of the company of the changes to the standard is not expected to be significant because the company does not hold a significant value of operating leases. An estimation of the expected impact derived from initial assessment is given below.

The company intends to adopt the modified retrospective approach due to the number of leases and volume of work that would be required for full retrospective application. In the year to 31 March 2019 the value of operating lease expenditure charged to the income statement was £4 million (2018: £4 million). Under the new standard, operating lease expenditure will be replaced by depreciation and interest of approximately the same value, and the initial expectation is recognition of approximately £23 million of non-current assets, £20 million of lease liabilities and a reduction in prepaid rentals of £3 million.

The company notes a recent IFRIC determination on a parallel situation to the water sector and will actively consider whether this changes the lease treatment of certain items that may affect this disclosure during the course of the next few months as well as considering industry practice in this area.

Going concern

The company's business activities, together with the factors likely to affect its future development and position, are set out in the Strategic Report pages 3 to 117.

The directors have undertaken a detailed review of the company's liquidity requirements compared with the cash and facilities available, the financial covenant position including projections based on future forecasts, the current credit ratings and financial risk.

On the basis of their assessment of the company's financial position the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements. For this reason they continue to adopt the going concern basis of accounting in preparing the annual financial statements, further details can be found in the Directors' Report on page 160.

In addition and in accordance with provision C.2.2 of the UK Code and Ofwat's Information Notice IN 19/07, 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 selected to conduct this review for the period to March 2030 and full details of the assessment and the viability statement are set out within the Strategic Report on page 161.

Segmental reporting

The company's revenue arises from the provision of services within the United Kingdom. It has a large and diverse customer base and is not reliant on any single customer.

The Southern Water Board and management team review all internal management information on a single segment basis and accordingly no segmental information is provided in this report.

Revenue recognition

The company has adopted IFRS 15 'Revenue from Contracts with Customers' from 1 April 2018 and further details on the impact of this change in accounting policy is provided in note 3. The accounting treatment for the regulatory settlement shown as a deduction to revenue is explained in note 2.

Revenue represents the income receivable (net of value added tax) in the ordinary course of business for goods and services provided. In respect of unbilled charges, revenue includes an estimate of the consumption between the date of the last meter reading and the period-end. The revenue accrual is estimated using a defined methodology based upon historical billing, consumption information and the applicable tariff.

Revenue from the supply of services represents the value of services provided under contracts to the extent that there is a right to consideration and is recorded at the fair value of the consideration due.

The company recognises revenue when it transfers control over a product or service to a customer.

Revenue is recognised when the amount of revenue can be measured reliably, the performance obligation has been satisfied, and it is probable that the economic benefits associated with the transaction will flow to the company. Revenue is not recognised when it is considered probable that economic benefits will not be received. In these circumstances revenue is only recognised when collectability is reasonably certain. Payments received in advance of revenue recognition are recorded as deferred income.

For provisioning purposes, revenues and outstanding arrears are segmented based on customer characteristics. Should a group of customers attract a provision rate of 100%, i.e. assessed as not generating economic benefit, revenue would not be recognised. In 2018–19 no segment of customers met this criteria and so revenue relating to the provision of water and wastewater services has been recognised in full.

Unmetered income is based on either the rateable value of the property or on an assessed volume of water supplied. Metered income is based on actual or estimated water consumption.

Customer rebates are shown as a reduction in revenue.

Interest income is recognised on a time-proportionate basis using the effective interest method.

Provision for impairment of trade receivables

The provision for impairment of trade receivables is calculated by applying estimated recovery rates to various categories of trade receivables, reflecting past collections experience and expectations of future recovery of outstanding receivables at the date of the statement of financial position.

This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

The model considers current and forward looking macro-economic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment.

Taxation

Taxation in the income statement represents the sum of the tax currently payable and deferred tax.

Current taxation is based on the result for the year as adjusted for disallowable and non-taxable items and items of income or expense which are taxable or deductible in other years. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred taxation is tax expected to be payable on temporary differences between the treatment of certain items for taxation and accounting purposes. Deferred taxation is provided on all temporary differences that have originated, but not reversed, by the end of the reporting period. It is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted or substantively enacted at the reporting date.

Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is regarded as probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the company intends to settle its current tax assets and liabilities on a net basis.

Intangible assets

Intangible assets comprises:

i. Assets in development.
ii. Other assets – comprising software, studies and development projects.

Intangible assets are measured at cost less subsequent amortisation and any impairment. Amortisation of intangible assets is calculated on a straight-line basis over the estimated useful lives, which are primarily three to 10 years. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Capitalised development costs are for plant installed on some of our sites to test new processes for performance data and scalability. The data is used to identify innovative and efficient future assets and processes to meet new higher environmental or quality standards. Development costs capitalised are depreciated over three to five years.

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Property, plant and equipment

Property, plant and equipment comprises:

i. Freehold land and buildings – comprising land and non-operational buildings.
ii. Plant and machinery – comprising structures at sites used for water and wastewater treatment; pumping or storage, where not classed as infrastructure, along with associated fixed plant.
iii. Infrastructure assets – comprising a network of systems consisting of mains and sewers, impounding and pumped raw water storage reservoirs, sludge pipelines and sea outfalls.
iv. Assets under construction.
v. Other assets – comprising vehicles, computers, mobile plant and meters.

All property, plant and equipment is stated in the statement of financial position at cost or at deemed cost on transition to FRS 101, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

The costs of repairs to the infrastructure network are recognised in the income statement as they arise.

Expenditure which results in replacement or renewal of infrastructure or enhancements to the operating capability of the infrastructure network is capitalised.

Items of property, plant and equipment that are transferred to the company from customers or developers are initially recognised at fair value in accordance with IFRS 15 'Revenue from Contracts with Customers' (see note 3).

The corresponding credit is recorded as revenue through non-distributable reserves and released to retained earnings over the expected useful lives of the related assets.

Borrowing costs directly attributable to the construction of qualifying assets, that necessarily take a substantial period of time to get ready for their intended use, are capitalised during the period of time that is required to complete and prepare the asset for its intended use. The commencement of capitalisation begins when both finance costs and expenditures for the asset are being incurred and activities that are necessary to get the asset ready for use are in progress. Capitalisation ceases when substantially all the activities that are necessary to get the asset ready for use are complete. Other borrowing costs are expensed.

Subsequent costs are included in the asset's carrying amount or recognised as separate assets, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the company and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the income statement as incurred.

Assets are depreciated on a straight-line basis over their estimated operating lives, which are principally as follows:

	Years
Land and buildings	
Land [1]	Not depreciated
Buildings	10–60
Plant and machinery	
Operational structures[2]	15–80
Fixed plant	10–40
Infrastructure assets	
Water mains	100–120
Sewers	80–200
Reservoirs	200
Ancillary structures	10–70
Assets under construction[1]	Not depreciated
Other	
Vehicles, computers and mobile plant	3–10

The estimated useful lives and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis.

Impairment of tangible and intangible assets

At the end of each reporting period, the company reviews the carrying amounts of its tangible and intangible assets, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

[1] Freehold land is not depreciated, nor are assets in the course of construction until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor, following completion of performance and take-over tests.

[2] Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

Grants and contributions

Grants and contributions received are treated as either revenue or deferred income in line with IFRS 15 as defined by the nature of the receipt.

Infrastructure receipts associated with new connections are recognised as revenue when they are receivable.

Deemed contributions from the transfer of non-current assets from customers are recognised as revenue through non-distributable reserves and released to retained earnings over the life of the asset.

Grants and contributions receivable in respect of other non-current assets are treated as deferred income and released to other operating income over the useful economic life of those fixed assets.

Grants and contributions received in respect of new connections to the water and sewerage networks are treated as deferred income and released to revenue in line with the expected expenditure they are intended to compensate.

Grants and contributions received in respect of diversions of water mains and sewers are treated as deferred income and recognised as revenue upon completion of the diversion.

Grants and contributions which are given in compensation for expenses incurred with no future-related costs are recognised in revenue in the period that they become receivable.

Leased assets

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The company as lessee

Where the company enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a ‘finance lease’. Assets held under finance leases are recognised as assets of the company at their fair value or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. The asset is recorded in the statement of financial position as a non-current asset and is depreciated over its estimated useful life or the term of the lease, whichever is shorter. Future liabilities to the lessor under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the income statement, and the capital element which reduces the outstanding obligation for future instalments.

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases. Rentals payable under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Sale and leaseback transactions occur when an asset is sold but use is immediately re-acquired by entering into a lease with the buyer. Where the new lease is an operating lease, the transaction is treated as the disposal of an asset and the operating lease accounted for in accordance with existing policies.

The company as lessor

The sale of income rights relating to aerial masts and sites owned by the company to third parties is treated as an operating lease. Income received from such sales is received entirely in advance and is therefore taken to deferred revenue and credited to the income statement over the life of the lease.

Non-current asset investments

Investments held as non-current assets, including investments in subsidiaries, are stated at cost, less where appropriate, provision for any impairment in value. The carrying values of non-current asset investments are reviewed for impairment in periods, if events or changes in circumstances indicate the carrying value may not be recoverable.

Cash and cash equivalents

Cash and cash equivalents comprise cash and short-term bank deposits.

Inventories

Inventory is held for use in the production of water supply and treatment of wastewater. Raw materials and work in progress are valued at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. Net realisable value is the estimated selling price, less further costs expected to be incurred to completion and costs to be incurred in marketing, selling and distribution.

Deferred revenue

Deferred revenue includes monies received from customers where the related service has not yet been provided.

Amounts are deferred to the statement of financial position and released to the income statement in line with the period of the service provided.

Provisions

Provisions are recognised when the company has a present obligation (legal or constructive) as a result of a past event, it is probable that the company will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

An environmental provision is made for the costs relating to decommissioned or dormant assets which have been identified as having an environmental impact.

Retirement benefits

SWS operates a defined benefit pension scheme, the assets of which are held separately from those of the company in independently administered funds. An independent actuary conducts a valuation of this pension scheme every three years.

The liability recognised in the statement of financial position in respect of the defined benefit pension scheme is the present value of the defined benefit obligation at the end of the period less the fair value of plan assets. The current service cost, which is the increase in the present value of the liabilities of the company's defined benefit pension scheme expected to arise from employee service in the period, is charged to operating costs. The net interest on the scheme's net assets/(liabilities) is included in other finance charges. Actuarial gains and losses are recognised in the statement of other comprehensive income.

The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 23.

Profit before taxation and net assets are affected by the actuarial assumptions used. The key assumptions include: discount rates, pay growth, mortality and increases to pensions in payment and deferred pensions, and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants.

The company also operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the company in an independently administered fund. Company contributions to the scheme are charged to the income statement in the period to which they relate. Differences between contributions actually paid are shown as either accruals or prepayments in the statement of financial position.

Financial instruments

The company has adopted IFRS 9 'Financial Instruments' from 1 April 2018.

IFRS 9 introduces new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) impairment for financial assets and 3) general hedge accounting. There was no material impact resulting from the application of this standard.

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires companies to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

Financial assets and financial liabilities are recognised in the company's statement of financial position when the company becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss (FVTPL)) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVTPL are recognised immediately in the income statement.

Financial assets

(i) Loans receivable

Loans receivable that have fixed or determinable payments that are not quoted in an active market are classified as 'held to collect'. Loans receivable are measured at fair value on initial recognition and subsequently measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

(ii) Trade receivables and accrued income

Trade receivables and accrued income are classified as 'held to collect' and measured at fair value on initial recognition. If there is objective evidence that the amount receivable is impaired it is written down to its recoverable amount, with the irrecoverable amount being recognised as an expense in operating costs.

The company applies an approach permitted by IFRS 9 for estimating expected credit losses on trade receivables. For trade receivables that are assessed not to be impaired individually, expected credit losses are estimated based on company's historical experience of trade receivable write-offs, and forward-looking macro-economic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment.

The provision for impairment of trade receivables is calculated by applying estimated recovery rates to various categories of debt, reflecting past collections experience and expectations of future recovery of outstanding receivables at the date of the statement of financial position.

This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred or are expected to occur after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account.

Derecognition of financial assets

The company derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. On derecognition of a financial asset the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

Financial liabilities

Fixed rate interest-bearing borrowings are initially measured at fair value, net of transaction costs and are subsequently measured at amortised cost using the effective interest method, with the interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Issue costs in relation to index-linked and variable rate bonds are separately disclosed within creditors.

The carrying value of index-linked debt instruments is adjusted for the annual movement in the retail price index. The change in value arising from indexation is charged or credited to the income statement in the year in which it arises.

Premiums and proceeds such as those from gilt lock agreements received on issue of debt instruments are credited to the income statement over the term of the debt at a constant rate on the carrying amount.

Derecognition of financial liabilities

The company derecognises financial liabilities when, and only when, the company's obligations are discharged, cancelled or they expire.

Derivative financial instruments

The company enters into a variety of derivative financial instruments to manage its exposure to inflation and interest rate risk in line with the company's risk management policy and no speculative trading in financial instruments is undertaken. Further details of derivative financial instruments are disclosed in note 21.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at the end of each reporting period. The resulting gain or loss is recognised in the income statement immediately.

Certain derivative instruments, principally index-linked swaps, do not qualify for hedge accounting and, as such, the company does not currently apply hedge accounting.

A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

Embedded derivatives

In accordance with IFRS 9 the company has reviewed all contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value through profit and loss.

An embedded derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the hybrid instrument to which the embedded derivative relates is more than 12 months and is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

2 Critical accounting judgments and key sources of estimation uncertainty

In the application of the company's accounting policies, which are described in note 1 above, the directors are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgments

Critical judgments, apart from those involving estimations, that are applied in the preparation of the financial statements are discussed below:

Revenue recognition
The company recognises revenue generally at the time of delivery and when collection of the resulting receivable is reasonably assured. When the company considers that the criteria for revenue recognition are not met for a transaction, revenue recognition is delayed until such time as collectability is reasonably assured.

Payments received in advance of revenue recognition are recorded as deferred income. Under IFRS 15, revenue is recognised when a customer obtains control of the goods or services and the performance obligation is complete.

Particular challenges exist within the water industry as formal written contracts do not exist for most transactions with customers. Contracts are instead implied through statute and regulation. Judgment is therefore required in identifying the services contained within the contract and the customer with whom the contract is entered into, which in turn impacts on how the performance obligations are considered and therefore revenue recognised.

Regulatory settlement
The treatment of the regulatory settlement has been actively considered in the light of the specific circumstances of the approach agreed with Ofwat as noted on page 26. Reflecting that

this relates to past performance and matters outside the normal regulatory framework for agreeing amounts for future billing to customers it has been considered appropriate to accrue for this settlement in the 2019 financial statements when it became possible to quantify the financial impact.

There is no clear accounting standard guidance for the income statement treatment of this regulatory settlement. It was considered whether the settlement should be recognised as an expense; however, given that this is an agreed reduction in customer bills in the future, with a requirement to show this separately on invoicing as required by Ofwat, the most appropriate treatment has been concluded to be to treat the invoice reductions as a reduction in revenue in the period. This will be separately identified and unwound on the face of the income statement in future periods. The £3 million penalty payable to Ofwat has been treated as an operating expense.

Property, plant and equipment
The company recognises property, plant and equipment (PPE) on its water and wastewater infrastructure assets where such expenditure enhances a significant length of the network or increases the capacity of the network, whereas any expenditure classed as maintenance is expensed in the period it is incurred. Determining enhancement from maintenance expenditure is a subjective area, particularly when assessing whether the length of network replaced enhances the network. In addition, management capitalise time and resources incurred by the company's support functions on capital programmes based on judgments made in respect of the proportion of capital work performed by these functions.

Sources of estimation uncertainty

The key assumptions about the future and other key sources of estimation uncertainty at the reporting period end that may have a risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are discussed below:

Measured income accrual
The measured income accrual is an estimation of the amount of water and wastewater unbilled at the period end. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff. The calculation is sensitive to estimated consumption for measured customers. Actual consumption may differ from the estimate made which could impact future operating results positively or negatively.

The value of household billings raised in the year ended 31 March 2019 for consumption in prior years was £129.4 million, £1.2 million (0.9%) more than the accrual made at 31 March 2018. This difference is well within our view of acceptable tolerances for accounting estimates.

Impairment of trade receivables
The impairment of trade receivables at each reporting date is calculated by segmenting customer debt based on historic debt collection and payment performance, demographic information and the age of debt outstanding. For each segment, forecast cash collection rates are determined which result in a corresponding provision percentage. This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

The model considers current and forward looking macro-economic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment.

The value of the provision for doubtful debts as at 31 March 2019 was £188.7 million (2018: £180.0 million). The actual level of receivables collected may differ from the estimated levels of recovery, which could impact future operating results positively or negatively.

Our sensitivity analysis suggests that the impairment provision would vary by £1.8m and £5.4m if cash collections estimates were between 1% and 3% above or below those predicted.

Impairment provision sensitivity analysis

	31 March 2019	Sensitivity			
		1%	3%	-1%	-3%
Impairment provision estimate (£m)	**188.7**	1.8	5.4	-1.8	-5.4

Retirement benefit obligations
The company operates a defined benefit scheme as well as a defined contribution scheme. Under IAS 19 'Employee Benefits' the company has recognised an actuarial loss of £24.2 million (2018: gain of £9.8 million).

The pension cost and liabilities under IAS 19 are assessed in accordance with directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on CMI 2018 actuarial tables with a smoothing factor of 7.5 and a 1.25% pa allowance for future longevity improvement.

The major assumptions used to measure schemes' liabilities, along with sensitivities to changes in those assumptions and future funding obligations are set out in note 23 of the financial statements.

Provisions and contingent liabilities
The company evaluates its exposures to contingent liabilities relating to pending litigation or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation. A provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made after careful analysis of the individual matter. Analysis includes assessing the likelihood that a pending claim will succeed, or a liability will arise, and the point of recognition for the associated liability.

Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed as contingent liabilities in note 32, unless the possibility of transferring economic benefits is remote. In particular there is a contingent liability associated with an Environment Agency investigation set out on page 26 which it has not been possible to estimate. Accordingly an associated sensitivity analysis cannot be disclosed.

Provisions determined may change in the future due to new developments and as additional information becomes available. Reflecting the inherent uncertainty in this evaluation process actual costs may be different from the estimated provision. Details of provisions are disclosed in note 25 and the value provided at 31 March 2019 was £6.6m (2018: £3.4m). Accordingly if the amount provided was 50% under or over estimated then the provision would change by £3.3m (2018: £1.7m).

3 Changes in significant accounting policies

The following changes in accounting policies are in the company's financial statements as at and for the year ending 31 March 2019.

A number of new standards are effective for periods beginning from 1 January 2018, including IFRS 9 'Financial Instruments' and IFRS 15 'Revenue from Contracts with Customers'. The effect of these new standards on the company's financial statements is described below.

IFRS 9 introduces new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) impairment for financial assets and 3) general hedge accounting. There was no material impact resulting from the application of this standard.

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires companies to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

As at 1 April 2018, the directors reviewed and assessed the company's existing trade receivables for impairment using reasonable and supportable information that is available without undue cost or effort in accordance with the requirements of IFRS 9 to determine the credit risk of the respective items at the date they were initially recognised. This is no change to the methodology applied in the financial statements for the year ended 31 March 2018 as materially the risk of future credit losses were already applied within the model which calculates the impairment provision and therefore no additional credit loss allowance has been recognised against retained earnings in the period as a result of the implementation of the new standard.

The company has adopted IFRS 15 'Revenue from Contracts with Customers' from 1 April 2018.

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced IAS 18 'Revenue', IAS 11 'Construction Contracts' and related interpretations.

The standard requires revenue to be recognised in line with the satisfaction of performance obligations identified within contracts between an entity and its customers, at an amount that reflects the transaction price allocated to each performance obligation. The effect of applying IFRS 15 results in the immediate recognition, due to the completion of the performance obligation, of certain developer related revenue, previously treated as deferred revenue. This income relates to diversions, requisitions and adoptions and its effect on our financial statements is detailed below.

Transition approach

The company has adopted IFRS 15 retrospectively to each prior period presented in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', using the practical expedient in paragraph C5(d) of IFRS 15, under which the company does not disclose the amount of consideration allocated to the remaining performance obligations or an explanation of when the company expects to recognise that amount as revenue for all reporting periods presented before the date of initial application – i.e. 1 April 2018. The details and quantitative impact of the changes in accounting policies are disclosed on page 179.

Water and wastewater services

The company supplies water and wastewater services to customers in Sussex, Kent, Hampshire and the Isle of Wight. The performance obligation is the supply of services over the contractual term and is considered to be satisfied as the customer consumes based on the volume of water supplied. This is the point at which revenue is recognised. The determination of the performance obligation does not result in a change to the company's approach to accounting for this revenue under previously applicable accounting standards.

Since the group is under a statutory obligation to provide water and wastewater services to its domestic properties these services could be provided to customers who are unlikely to pay. Under IFRS 15 such revenue is not recognised. Currently the company considers that at the point of billing customers there is no one identifiable group of customers who are unlikely to pay and so all revenue is recognised.

New connections and infrastructure charges

Under IFRS 15 the performance obligation is satisfied at the point of provision of the new connection to the network, so fees received in respect of the connection are recognised at this point. This does not result in a change to the company's approach to accounting for this revenue under previously applicable accounting standards.

Requisitions

For requisitions of water mains and public sewers, the company previously deferred the lump sum cash consideration received, and recognised the associated revenue to the income statement over a period of 12 years. Under IFRS 15, the company has determined that the performance obligation is satisfied at the point of completion of the requisition works and connection of the water main or lateral drain, and the total consideration receivable is recognised in full as revenue at that point. For the year to 31 March 2019, this has resulted in the recognition of £0.1 million (2018: £2.6 million) of revenue recognised that would previously have been deferred to the statement of financial position and amortised over 12 years. As a consequence of the prior year recognition of £2.6 million revenue from requisitions, amortisation of deferred revenue of £1.4 million, previously released to the income statement in the same period, has now been derecognised, resulting in a net increase of £1.2 million to revenue for the year to 31 March 2018. The adjustment to the opening statement of financial position as at 31 March 2018 was a reduction in deferred revenue of £10.5 million (as at 1 April 2017: £9.7 million) and a reduction in long term grants and contributions of £0.9 million (as at 1 April 2017: £0.5 million).

Diversions

Contributions received in respect of diversions of water mains and sewers were previously deferred to the statement of financial position and amortised to income over the life of the related assets. Under IFRS 15, it has been determined that the performance obligation, and the point of revenue recognition, is on completion of the diversion of the water main or sewer. For the year to 31 March 2019, £2.9 million (2018: £3.1 million) of revenue has been recognised that would previously have been deferred to the statement of financial position and amortised over the life of the asset. The adjustment to the opening statement of financial position as at 31 March 2018 was a reduction in long-term grants and contributions of £15.3 million (as at 1 April 2017: £12.4 million).

Adoptions

Adoptions of assets were previously recognised at fair value, deferred and amortised to the income statement over the life of the related assets. Under IFRS 15 the company recognises the fair value of the asset upon adoption i.e. the point at which control of the asset is obtained, within revenue as an increase to non-distributable reserves. For the year to 31 March 2019, this has resulted in the recognition of £8.5 million (2018: £23.7 million) of revenue recognised and taken to non-distributable reserves that would previously have been deferred to the statement of financial position and amortised over the life of the asset. The adjustment to the opening statement of financial position as at 31 March 2018 was a reduction in long-term grants and contributions of £46.7 million (as at 1 April 2017: £24.1 million).

Impacts on previously reported financial statements

The following tables summarise the impacts of adopting IFRS 15 on the company's previously reported statement of financial position as at 1 April 2017 and 31 March 2018 and its income statement and other comprehensive income for the year ended 31 March 2018 for each of the line items affected. There was no material impact on the company's previously reported statement of cash flows for the year ended 31 March 2018 however these have been restated to reflect the opening balance adjustments.

As a result of the difference in the treatment of adoptions as explained in the transition approach to IFRS 15 above, an adjustment has been made to the cumulative deferred tax liability in respect of adopted assets previously treated as non-qualifying of £4.2 million and £7.9 million as at 1 April 2017 and 31 March 2018 cumulatively and respectively.

3 Changes in significant accounting policies (continued)

Statement of financial position

	Impact of changes in accounting policies		
	As previously reported £m	Adjustments £m	As restated £m
1 April 2017			
Other	7,072.5	–	7,072.5
Total assets	7,072.5	–	7,072.5
Current liabilities – Deferred revenue	(42.7)	9.7	(33.0)
Non-current liabilities – Grants and contributions	(48.0)	37.0	(11.0)
Other	(6,027.7)	–	(6,027.7)
Total liabilities	(6,118.4)	46.7	(6,071.7)
Net assets	**954.1**	**46.7**	**1,000.8**
Retained earnings	907.7	22.6	930.3
Non-distributable reserves	–	24.1	24.1
Other	46.4	–	46.4
Total equity	**954.1**	**46.7**	**1,000.8**

	Impact of changes in accounting policies		
	As previously reported £m	Adjustments £m	As restated £m
31 March 2018			
Other	7,258.3	–	7,258.3
Total assets	7,258.3	–	7,258.3
Current liabilities – Deferred revenue	(55.1)	10.5	(44.6)
Non-current liabilities – Grants and contributions	(75.7)	62.9	(12.8)
Non-current liabilities – Deferred tax liabilities	(270.0)	(10.7)	(280.7)
Other	(5,794.7)	–	(5,794.7)
Total liabilities	(6,195.5)	62.7	(6,132.8)
Net assets	**1,062.8**	**62.7**	**1,125.5**
Retained earnings	1,016.4	16.0	1,032.4
Non-distributable reserves	–	46.7	46.7
Other	46.4	–	46.4
Total equity	**1,062.8**	**62.7**	**1,125.5**

Note: The above tables exclude the reclassification of derivative assets previously offset against non-current derivative liabilities (2018: £0.3 million non-current assets and £3.9 million current assets, 2017: £9.3 million non-current assets). See notes 14, 17 and 21.

3 Changes in significant accounting policies (continued)

Income statement and other comprehensive income			
	Impact of changes in accounting policies		
	As previously reported £m	Adjustments £m	As restated £m
For the year ended 31 March 2018			
Revenue	829.7	28.0	857.7
Other income	14.4	(1.3)	13.1
Corporation tax charge	(21.5)	(10.7)	(32.2)
Other	(667.9)	–	(667.9)
Profit for the year	154.7	16.0	170.7
Other	8.1	–	8.1
Total comprehensive income for the year	**162.8**	**16.0**	**178.8**

4 Segmental analysis

The directors believe that the whole of SWS's activities constitute a single class of business. The company's revenue is generated wholly from within the United Kingdom. The Southern Water Board and management team review all internal management information on a single segment basis and accordingly no segmental information is provided in this report.

5 Income

An analysis of the company's income is as follows:	2019 £m	2018 Restated* £m
Continuing operations		
Water and sewerage services:		
– Household – measured	**537.3**	509.0
– Household – unmeasured	**133.2**	134.4
– Non-household – measured	**141.6**	134.1
– Non-household – unmeasured	**5.0**	5.3
Total water and sewerage services	**817.1**	782.8
Bulk supplies	**3.8**	4.3
Infrastructure charge receipts	**12.2**	8.6
Requisitioned mains and sewers	**0.1**	2.6
Diversions	**2.9**	3.1
Adoptions (see note (a) below)	**8.5**	23.7
Other services	**31.7**	32.6
Total revenue before regulatory settlement	**876.3**	857.7
Regulatory settlement (see note (b) below)	**(135.5)**	–
Total revenue	**740.8**	857.7
Other operating income (see note (c) below)	**1.2**	1.1
Other income (see note 6)	**0.2**	11.2
Profit on disposal of fixed assets	**0.7**	0.8
Interest receivable (note 9)	**10.4**	1.0
Interest revenue from Southern Water Services Group Limited	**43.0**	56.9
Total income	**796.3**	928.7

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

(a) Revenue associated with the adoption of assets from customers is treated as non-distributable upon recognition, and amortised to retained earnings in line with the depreciation of the related assets.

(b) As reported on page 26 we have been co-operating with Ofwat in relation to its investigation into the management, operation and performance of our wastewater treatment works.

To ensure that our customers are not disadvantaged as a result of these matters, the company has agreed to make direct customer rebates totalling £135.5 million in forecast outturn prices (£122.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches identified in the investigation and has been provided for in the financial statements for 2018–19.

(c) Other operating income includes the release of deferred grants and contributions relating to non-current assets from the balance sheet, as amortised in line with the useful economic life of the related assets, and rents receivable.

6 Profit for the year

Profit for the year	2019 £m	2018 Restated* £m
Profit for the year has been arrived at after charging/(crediting):		
Depreciation on:		
– Owned assets	**248.6**	243.5
– Assets held under finance leases	**1.0**	1.0
	249.6	244.5
Included within **Operating costs: Depreciation and amortisation** in the income statement:		
Amortisation of intangible assets	**22.3**	15.0
Other income (see note (a) below)	**0.2**	11.2
Profit on disposal of fixed assets	**0.7**	0.8
Research and development expenditure	**1.0**	1.1
Rentals under operating leases:		
– Properties	**1.9**	1.9
– Vehicles	**2.5**	2.6
Employee costs (note 7)	**67.4**	63.9
Amortisation of grants and contributions (note 26) (restated*)	**(1.1)**	(1.0)
Regulatory settlement (see note (b) below)	**138.5**	–
Fees payable to the company's auditor in respect of:		
– Statutory audit of the company's financial statements	**0.3**	0.2
– Other services pursuant to legislation	**0.1**	0.1
– All other services	**0.1**	–

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

Other services pursuant to legislation and other non-audit services primarily relate to regulatory assurance fees.

(a) On 1 April 2017 the company completed the disposal of its non-household water and wastewater retail business, principally comprising billing and customer service activities, to Business Stream. Final reconciling transactions from the contract of sale resulted in a £0.2 million profit after costs in the current period (2018: £11.2 million profit after costs, which included a provision for unrecoverable debts of £2.1 million). Cash proceeds of £1.8 million (2018: £11.8 million) are disclosed under proceeds from disposal of business in the cash flow statement on page 168.

(b) As reported on page 26 the company has been co-operating with Ofwat in relation to its investigation into the management, operation and performance of our wastewater treatment works.

In addition to the provision for direct customer rebates of £135.5 million disclosed in note 5, a provision of a further £3.0 million has been made within operating costs for the proposed Ofwat penalty.

7 Employee information

(a) Employee costs (including directors' emoluments)	2019 £m	2018 £m
Wages and salaries	**95.7**	89.9
Social security costs	**10.7**	9.1
Pension costs – Defined contribution	**3.9**	3.0
– Defined benefit	**8.0**	6.7
Total employee costs	**118.3**	108.8
Less: charged as capital expenditure	**(50.9)**	(44.9)
Charged to the income statement	**67.4**	63.9

Employee costs that are charged as capital expenditure are those directly related to the construction or acquisition of assets.

The average monthly numbers of persons (including executive directors) employed by the company during the year was:

(b) Average number of persons employed by activity	2019 Number	2018 Number
Operations	**1,135**	1,160
Customer services	**211**	258
Corporate centre	**981**	871
	2,327	2,289

8 Directors' emoluments

Directors' emoluments	2019 £000	2018 £000
Aggregate emoluments (including benefits in kind)	**2,152**	2,127
Payments in lieu of notice	**208**	–
Pension contributions in lieu of notice	**9**	–
	2,369	2,127

No retirement benefits accrued to directors (2018: nil) under a Southern Water Services Limited defined benefit scheme. Retirement benefits of £29,795 accrued to directors (2018: nil) under a Southern Water Services Limited defined contribution scheme.

On 14 December 2018, William Lambe resigned as a director. He left Southern Water on 4 May 2019 at which point he received a payment in lieu of notice of £189,289 together with pension-related benefits of £27,916.

On 31 March 2019, Bill Tame resigned as Chairman and in addition to the emoluments disclosed above, received a payment of £62,500 for services performed for the company other than as a director to support the handover to Paul Sheffield as Acting Chairman.

Further details can be found in the Directors' Remuneration Report on pages 144 to 157.

Details of emoluments and benefits for the highest paid director	2019 £000	2018 £000
Highest paid director's aggregate emoluments and benefits	**1,172**	1,066

During the year the company made contributions of £10,000 (2018: £nil) to a money purchase pension scheme in respect of the highest paid director's qualifying services.

9 Net finance costs

Net finance costs	2019 £m	2018 £m
Finance income		
Interest receivable on swap instruments	**8.7**	–
Interest revenue from Southern Water Services Group Limited	**43.0**	56.9
Deposit income on short-term bank deposits	**1.7**	1.0
	53.4	57.9
Finance costs		
Interest payable on bank loans	**(2.4)**	(3.4)
Interest payable on other loans	**(12.9)**	(2.6)
Interest paid to Southern Water Services (Finance) Ltd	**(175.9)**	(139.3)
Indexation	**(34.7)**	(38.8)
Amortisation of issue costs	**(1.5)**	(1.5)
Amortisation of gilt lock proceeds	**0.1**	0.1
Amortisation of deferred credits	**9.7**	9.7
Amortisation of bond premium	**0.7**	0.7
Other finance expense (note 23)	**(4.4)**	(4.9)
Dividends on preference shares – see note (a), (b), (c), (d) and (e) below	**(10.9)**	(13.1)
	(232.2)	(193.1)
Amounts capitalised on qualifying assets	**23.0**	16.5
	(209.2)	(176.6)
Fair value (losses)/gains on derivative financial instruments		
Derivative financial instruments not designated as hedges (note 21)	**(216.6)**	46.3
Net finance costs	**(372.4)**	(72.4)

The interest revenue from Southern Water Services Group Limited relates to the long-term loan disclosed in note 14.

Borrowing costs included in the cost of qualifying assets during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 4.12% to expenditure on such assets (2018: 4.10%).

Dividends on preference shares

(a) Class A1 preference share dividends amounted to £40 per share and Class B £70 per share totalling £8.3 million (2018: £9.0 million). Of this amount £4.2 million was paid during the year, with £4.1 million accrued at 31 March 2019 and paid in June 2019.

(b) Dividends due to the Class A2 preference shareholders of £85.52 (2018: £108.07) per share totalling £1.7 million (2018: £3.5 million) were declared and settled in the year at base value plus an amount for out-performance and savings in the year ended 31 March 2018 (see note 20(ix)). £0.9 million has been accrued for amounts owed to Class A2 Preference shareholders as at 31 March 2019, of which £0.3 million relating to the base value element was paid in June 2019.

(c) On 6 April 2018, the company redeemed 12,892 of its Class A1 and Class A2 preference shares, at nominal value plus the premium on issue, and a value for estimated A2 dividends accrued, £0.6 million as at 31 March 2018. The amount paid totalled £13.5 million.

(d) On 25 September 2018, the company redeemed 9,852 of its Class A1 and Class A2 preference shares at nominal value plus the premium on issue, and an amount for A2 base value dividends accrued as at the redemption date of £0.1 million. The amount paid totalled £10.0 million.

(e) On 28 June 2019, the company redeemed all remaining 9,863 of its Class A1 and Class A2 preference shares, and 19,340 of its Class B preference shares, at nominal value plus the premium on issue, including settlement for fixed or base value dividends due to that date. The total amount paid was £34.0 million comprising principal redemption of £29.2 million and dividends of £4.8 million (including the amounts accrued to 31 March 2019 of £4.1 million and £0.3 million per notes (a) and (b) above respectively).

10 Taxation

Taxation	2019 £m	2018 Restated* £m
Current tax:		
Current year	**8.2**	10.8
Total current tax charge	**8.2**	10.8
Deferred tax:		
Origination and reversal of timing differences	**(30.8)**	27.8
Adjustment in respect of prior years	**1.9**	(6.4)
Total deferred tax (credit)/charge	**(28.9)**	21.4
Total tax (credit)/charge on (loss)/profit	**(20.7)**	32.2

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

The tax assessed for the year is different to the standard rate of corporation tax in the UK due to the following factors:

	2019 £m	2018 £m
(Loss)/profit before tax	**(253.6)**	202.9
Tax at the UK corporation tax rate of 19% (2018: 19%)	**(48.2)**	38.5
Permanent differences	**30.5**	8.2
Group relief received for nil payment	**(8.5)**	(6.1)
Differences between current and deferred tax rates	**3.6**	(2.0)
Adjustment in respect of prior years:		
Deferred tax	**1.9**	(6.4)
Total tax (credit)/charge for year	**(20.7)**	32.2

Factors that may affect future tax charges:

A reduction in the main rate of corporation tax to 17% from 1 April 2020 was enacted in the Finance Act 2016, and deferred tax balances at 31 March 2019 are calculated based on this rate.

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.

In addition to the amount recognised in the income statement, the following amounts relating to tax have been recognised in the statement of other comprehensive income:

Deferred tax		
	2019 £m	2018 £m
Arising on income and expenses recognised in other comprehensive income: Tax (credit)/charge relating to retirement benefit obligations	**(4.1)**	1.7
Total deferred tax (credit)/charge recognised in other comprehensive income/(loss)	**(4.1)**	1.7

11 Dividends

Amounts recognised as distributions to equity holders in the year		
	2019 £m	2018 £m
Current year interim dividend of £622.41 (2018: £822.52) per share	**34.8**	46.1
Current year interim dividend of £nil (2018: £142.86) per share	**–**	8.0
	34.8	54.1

The interim dividends of £34.8 million are paid to Southern Water Services Group Limited (SWSG). These dividends, along with associated group tax relief of £8.2 million, enable SWSG to pay the interest of £43.0 million due to Southern Water Services Limited on an inter-company loan as disclosed in note 14. These transactions are illustrated in the diagram on page 100 of the Annual Report.

No additional interim or final dividend has been declared for the year ended 31 March 2019 (2018: Interim additional - £8.0 million, final - £nil).

12 Intangible assets

Intangible assets	Externally generated		
	Assets in development £m	Other £m	Total £m
Cost			
At 1 April 2018	28.9	94.7	**123.6**
Additions	6.8	–	**6.8**
Transfers	(23.9)	23.9	**–**
Disposals	–	(2.3)	**(2.3)**
At 31 March 2019	11.8	116.3	**128.1**
Amortisation			
At 1 April 2018	–	62.5	**62.5**
Charge for the year	–	22.3	**22.3**
Disposals	–	(2.3)	**(2.3)**
At 31 March 2019	–	82.5	**82.5**
Net book amount			
At 31 March 2019	**11.8**	**33.8**	**45.6**
At 31 March 2018	28.9	32.2	61.1

The company does not currently have any internally generated intangible assets.

Included within additions above is £1.1 million of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing Costs'. The cumulative net book value of the borrowing costs capitalised amount to £1.4 million (2018: £1.4 million).

Other intangible assets include software, studies and development projects.

13 Property, plant and equipment

Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Infrastructure assets £m	Assets under construction £m	Other £m	Total £m
Cost						
At 1 April 2018	1,537.2	3,117.1	2,617.9	499.3	628.2	**8,399.7**
Additions	–	–	–	435.4	–	**435.4**
Transfers	1.0	147.4	98.8	(277.0)	29.8	**–**
Disposals	–	(0.5)	(5.5)	–	(6.5)	**(12.5)**
At 31 March 2019	1,538.2	3,264.0	2,711.2	657.7	651.5	**8,822.6**
Depreciation						
At 1 April 2018	721.9	1,283.2	113.9	–	415.4	**2,534.4**
Charge for the year	39.8	123.3	35.9	–	50.6	**249.6**
Disposals	–	(0.5)	(5.5)	–	(6.5)	**(12.5)**
At 31 March 2019	761.7	1,406.0	144.3	–	459.5	**2,771.5**
Net book amount						
At 31 March 2019	**776.5**	**1,858.0**	**2,566.9**	**657.7**	**192.0**	**6,051.1**
At 31 March 2018	815.3	1,833.9	2,504.0	499.3	212.8	**5,865.3**

Freehold land is stated at a cost of £51.7 million at 31 March 2019 and 31 March 2018 and is not depreciated.

The company's interest in land and buildings are almost entirely freehold.

Included within additions above is £21.9 million (2018: £16.7 million) of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing costs'. The cumulative net book value of the borrowing costs capitalised amount to £191.8 million (2018: £177.3 million).

Assets held under finance leases

Included in the amounts shown above are the following amounts in relation to property, plant and equipment held under finance leases:

Assets held under finance leases

	2019 Other £m	2018 Other £m
Net book amount at 31 March	**2.9**	4.5

14 Other non-current assets

Non-current receivables		
	2019 £m	2018 £m
Amounts owed by group undertakings	**130.0**	812.3

Amounts owed by group undertakings represent a loan to Southern Water Services Group Limited which is secured on the assets held under the Southern Water Services Group Security agreement and repayable on 31 July 2052 with interest payable at 7% per annum. During the year, repayments towards this loan totalling £682.3 million were paid to the company by SWSG.

15 Investments

Shares in subsidiary Southern Water Services (Finance) Limited		
	2019 £m	2018 £m
At the beginning and end of the year	**29.2**	29.2

The company has the following direct investments in subsidiary undertakings at 31 March 2019:

	Registered Office	Class of share capital	Activity
Southern Water Services (Finance) Ltd (SWSF)	Ugland House, PO Box 309, George Town, Grand Cayman	Ordinary (100%)	To raise debt finance
Southern Water Executive Pension Scheme Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant
Southern Water Pension Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant

SWSF is registered in the UK for tax purposes. The directors are satisfied that the carrying value of the investment in SWSF is supported by the underlying assets and activities of SWSF.

The company is currently in the process of closing SWSF.

16 Inventories

Inventories		
	2019 £m	2018 £m
Raw materials	**4.0**	2.5
Work in progress	**0.7**	0.4
	4.7	2.9

The increase in raw materials represents additional chemical stocks held at year end as part of the company's Brexit preparations.

17 Trade and other receivables

Trade and other receivables	2019 £m	2018 Restated* £m
Trade receivables	**299.1**	273.6
Provision for impairment	**(185.8)**	(177.4)
Net trade receivables	**113.3**	96.2
Loan to Southern Water Services (Finance) Limited	**110.7**	111.8
Amounts owed by other group undertakings	**2.8**	6.6
Other amounts receivable	**16.4**	16.7
Net accrued income	**71.9**	71.6
Prepayments	**17.4**	20.2
	332.5	323.1

* The prior year has been restated to show accrued income net of the related provision for impairment of trade receivables (previously included within net trade receivables).

Amounts owed by group undertakings are unsecured, interest-free and settled regularly. All entities are wholly owned within the group.

Accrued income as at 31 March 2019 includes water and sewerage income not yet billed of £58.3 million (2018: £53.3 million).

The directors consider that the carrying values of trade and other receivables are reasonable approximations of their fair values.

Provision for impairment

Movements on the impairment provision were as follows:

	2019 £m	2018 £m
At 1 April	**(180.0)**	(123.3)
Amounts reinstated	**–**	(34.6)
Impairment charge	**(10.7)**	(21.8)
Impairment charge for non-household receivables	**–**	(2.1)
Amounts written off during the year	**2.0**	1.8
At 31 March	**(188.7)**	(180.0)

At each reporting date, the company evaluates the recoverability of trade receivables and records allowances for impairment of receivables based on experience.

The company does not include in revenue and trade receivables those accounts that are deemed irrecoverable.

The following table provides information regarding the ageing of receivables that are specifically provided for:

	2019 £m	2018 £m
Current	**0.3**	0.2
1–2 years	**0.2**	0.3
2–3 years	**0.3**	0.5
3–4 years	**0.4**	0.5
more than 4 years	**0.6**	0.7
	1.8	2.2

A collective provision is recorded against assets which are past due but for which no specific provision has been made. This is calculated based on historical experience of levels of recovery.

The aged analysis of receivables that were overdue at the reporting date but not individually provided for is as follows:

	2019 £m	2018 £m
Current	**75.9**	72.0
1–2 years	**47.1**	47.3
2–3 years	**38.9**	37.0
3–4 years	**31.3**	28.5
more than 4 years	**73.9**	58.4
	267.1	243.2

The amounts above are reconciled to gross and net debtors in the tables below:

At 31 March 2019	**Gross £m**	**Provision £m**	**Net £m**
Accrued income – not due	**74.8**	**(2.9)**	**71.9**
Trade receivables			
Not due	**30.2**	**–**	**30.2**
Overdue not specifically provided	**267.1**	**(184.0)**	**83.1**
Overdue and specifically provided	**1.8**	**(1.8)**	**–**
	373.9	**(188.7)**	**185.2**

At 31 March 2018 (restated*)	Gross £m	Provision £m	Net £m
Accrued income – not due	74.2	(2.6)	71.6
Trade receivables			
Not due	28.2	–	28.2
Overdue not specifically provided	243.2	(175.2)	68.0
Overdue and specifically provided	2.2	(2.2)	–
	347.8	(180.0)	167.8

* The prior year has been restated to include accrued income net of the related impairment provision (previously the impairment provision was included wholly within net trade receivables).

18 Trade and other payables

Trade and other payables	2019 £m	2018 Restated* £m
Trade payables	**18.1**	21.0
Amounts owed to group undertakings	**134.7**	138.7
Capital creditors and capital accruals	**114.2**	107.1
Taxation and social security	**2.6**	2.8
Accruals	**57.0**	43.4
Deferred revenue	**35.7**	44.6*
	362.3	357.6

* Deferred revenue in the prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

The directors consider that the carrying values of trade and other payables are not materially different from their fair values.

All amounts owed to group undertakings due within one year are unsecured, interest-free and repayable on demand. All entities are wholly owned within the group.

19 Current borrowings

Current borrowings	2019 £m	2018 £m
Unamortised debt issuance costs (note 20 (iv))	**(1.5)**	(1.5)
Bond premium deferred	**0.7**	0.7
Deferred gilt lock proceeds (note 20 (v))	**0.1**	0.1
Deferred proceeds	**4.7**	9.7
Revolving credit facility	**170.0**	–
Class A £300m – 6.135% fixed rate 2019	**300.0**	299.5
Class A1 and A2 Preference shares	**–**	12.9
Other loans from subsidiary SWSF (note (i) below)	**30.3**	30.3
Obligations under finance leases	**0.2**	0.7
	504.5	352.4

The Class A £300 million bond was repaid on 1 April 2019.

(i) The loan from SWSF is unsecured, interest-free, and shall be repayable in whole or part upon demand at any time, provided that:

(a) On the date of such demand, no class A debt is outstanding, no class B debt is outstanding and no mezzanine debt is outstanding; or

(b) The consent of the Security Trustee is given.

20 Non-current borrowings

Non-current borrowings	Note	2019 £m	2018 £m
Loans from subsidiary Southern Water Services (Finance) Limited:	20(i)		
Class A £350m – 6.202% fixed rate 2029	20(ii)	**348.6**	348.5
Class A £150m – 3.716% index linked 2034		**237.1**	229.7
Class A £35m – 3.716% index linked 2034		**55.3**	53.5
Class A £350m – 6.650% fixed rate 2026	20(ii)	**348.8**	348.7
Class A £150m – 3.826% index linked 2023		**237.1**	229.7
Class A £350m – 5.010% fixed rate 2021	20(ii)	**349.0**	348.6
Class A £150m – 5.010% fixed rate 2041	20(ii)	**147.0**	147.0
Class A £200m – 4.510% fixed rate 2052	20(ii)	**197.2**	197.2
Class A £300m – 5.135% fixed rate 2056	20(ii)	**292.6**	292.6
Class A £300m – 6.135% fixed rate 2019	19, 20(ii)	**300.0**	299.5
Class A £175m – 2.790% fixed rate 2031	20(ii)	**174.0**	174.0
Class A £75m – 2.970% fixed rate 2036	20(ii)	**74.6**	74.5
Artesian £165m – 4.086% index linked 2033		**261.0**	252.8
Artesian £156.5m – 3.645% index linked 2032		**241.5**	233.9
Total Class A debt from Southern Water Services (Finance) Limited		**3,263.8**	3,230.2
Class B £250m – 4.510% fixed rate 2022	20(ii), (iii)	**–**	247.6
Unamortised debt issuance costs	20(iv)	**(13.0)**	(14.6)
Bond premium deferred		**8.8**	9.5
Deferred gilt lock proceeds	20(v)	**4.8**	4.9
Deferred proceeds	20(vi)	**85.8**	95.6
Other loans from Southern Water Services (Finance) Limited	20(vii)	**30.3**	30.3
Total loans and other borrowings from Southern Water Services (Finance) Limited		**3,380.5**	3,603.5
Revolving credit facility		**170.0**	–
Class B, Term Facility Agreement 2017 £150m – 6-month Libor plus 1.550% 2022		**–**	150.0
Class A £60m – 0.000% index linked 2025	20(viii)	**61.1**	64.6
Class A £40m – 0.000% index linked 2026	20(viii)	**43.7**	42.5
Class A1 and A2 Preference shares	20(ix)	**9.9**	32.6
Class B Preference shares	20(ix)	**110.0**	110.0
Obligations under finance leases		**1.0**	1.6
Total borrowings		**3,776.2**	4,004.8
Disclosed as current borrowings	19	**504.5**	352.4
Disclosed as non-current borrowings		**3,271.7**	3,652.4

These loans (excluding the preference shares) are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertakings of each of SWS, Southern Water Services (Finance) Limited (SWSF), SWS Holdings Limited, and SWS Group Holdings Limited. In the case of SWS, this is to the extent permitted by the Water Industry Act 1991 and Licence. Further, the company has a contingent liability arising on certain inter-company financing arrangements which will have the effect that if certain refinancings do not take place when the underlying instruments mature in 2021 to 2029, the company will make good certain obligations of its subsidiary SWSF. The directors do not believe this to be likely and the liability, if any, cannot currently be quantified as it will depend wholly on the circumstances at the time of the maturity.

Notes in respect of the specific instruments on page 195:

(i) Under the loan agreements between SWS and SWSF, SWSF advances an amount equal to each bond or other debt raised at the same interest rate plus 0.01%. Therefore each individual back-to-back inter-company loan has been separately disclosed.

(ii) Fixed rate borrowings are recognised net of issue costs and discounts on issue and are carried at amortised cost using the effective interest rate method.

(iii) The Class B £250 million was repaid on 18 February 2019.

(iv) Unamortised debt issuance costs represent issue fees paid to SWSF that are not otherwise accounted for within the amortised cost of specific loans. Where these costs are attributable to a specific instrument they are being amortised over the life of that instrument. The remaining costs are being amortised over the weighted average life of the loans advanced at the time the costs were incurred. As at 31 March 2019 unamortised debt issuance costs amounted to £13.0 million of which £1.5 million represents the short-term amount which is disclosed separately in note 19.

(v) Prior to the issue of the Class A £300 million bond in the year to 31 March 2008, SWSF entered into a gilt lock agreement, resulting in the receipt of £6.3 million, which was advanced to SWS along with the proceeds of the bond issue. The proceeds have been deferred in the financial statements of SWS and are being released to the income statement over the life of the loan.

(vi) Deferred proceeds represent consideration received by the company in connection with taking on various debt obligations that were 'out of the money' at the time the debt obligations were entered into. The deferred proceeds are amortised over the lives of the related debt instruments.

(vii) The loan from SWSF is unsecured, interest-free, and shall be repayable in whole or part upon demand at any time, provided that:

(a) On the date of such demand, no Class A debt is outstanding, no Class B debt is outstanding and no mezzanine debt is outstanding; or

(b) The consent of the Security Trustee is given.

(viii) The Class A £60 million loan is index linked with an interest rate of 0.00% until August 2025.

The Class A £40 million loan is index linked with an interest rate of 0.00% until May 2026.

(ix) The preference shares are redeemable at the option of SWS at any time.

The Class A1 and B preference shares, which do not carry voting rights, were issued on 23 July 2003, and are redeemable at their nominal value plus the share premium paid, on 31 March 2038 or at the company's option anytime earlier. Class A1 and B shares were issued at £1,000 per share and the amounts received totalled £260.0 million for both classes of shares. Class A2 preference shares were issued for £0.01 per share on 7 May 2003 and the amount received totalled £1,500. Class A2 shares, which do not carry voting rights, are also redeemable at nominal value. Shareholders are entitled to receive dividends annually as follows:

Class A1 – £40 per share

Class A2 – the base value dividend plus an amount for company out-performance and any savings arising from any refinancing of the mezzanine debt. The base value is £nil per share increasing by £15 every five years. (Out-performance from 1 April 2007 onwards is the difference between Southern Water Services Limited's audited 'profit before interest and taxation' and the targeted 'profit before interest and taxation' as determined by Ofwat in the periodic review.)

Class B – £70 per share

These dividends are payable on 31 March and 30 September each year.

An assessment of A2 preference share dividends for out-performance in the year ended 31 March 2019 will be made in September 2019.

On winding up the preference shareholders rank above ordinary shareholders with the preference shareholders being paid in order of Class A1, Class A2 then Class B.

On 6 April 2018, the company redeemed 12,892 of the A1 and A2 preference shares at nominal value plus premium, amounting to £12.9 million plus an estimated amount for the A2 dividend that would have fallen due on 30 September 2018. The total redemption value paid to shareholders including the estimated dividend was £13.5 million.

On 25 September 2018, the company redeemed 9,852 of its Class A1 and Class A2 preference shares at nominal value plus the premium on issue, and an amount for A2 base value dividends accrued as at the redemption date. The total amount paid was £10.0 million.

On 28 June 2019, the company redeemed the remaining 9,863 of its Class A1 and Class A2 preference shares, and 19,340 of its Class B preference shares, at nominal value plus the premium on issue, including settlement for fixed or base value dividends due to that date. The total amount paid was £34.0 million comprising principal redemption of £29.2 million and dividends of £4.8 million.

Maturity profile	2019 £m	2018 £m
The maturity profile of borrowings disclosed within this note is given below:		
Borrowings excluding finance leases:		
Between one and two years not by instalments	**353.0**	4.0
Between two and five years not by instalments	**249.2**	988.0
After five years not by instalments	**2,668.7**	2,659.5
	3,270.9	3,651.5
On demand or within one year not by instalments	**504.3**	351.7
	3,775.2	4,003.2
Finance leases:		
Between one and two years not by instalments	**0.1**	0.1
Between two and five years not by instalments	**0.7**	0.8
After five years not by instalments	**–**	–
	0.8	0.9
On demand or within one year not by instalments	**0.2**	0.7
	1.0	1.6
Borrowings including finance leases:		
Between one and two years not by instalments	**353.1**	4.1
Between two and five years not by instalments	**249.9**	988.8
After five years not by instalments	**2,668.7**	2,659.5
	3,271.7	3,652.4
On demand or within one year not by instalments	**504.5**	352.4
	3,776.2	4,004.8

It is the company's policy to lease its commercial vehicles under finance leases. Obligations under finance leases comprise optional residual value balloon payments due on vehicle leases at the end of the lease period, where the minimum lease payments (including finance charges) have been prepaid at the start of the lease. If the company opts not to pay the balloon payment, it must return the vehicle to the lessor.

The average lease term is five years.

For the year ended 31 March 2019, the average effective borrowing rate for leases was 4.17% (2018: 4.61%). Interest rates are fixed at the contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

All lease obligations are denominated in sterling.

The fair value of the company's lease obligations is approximately equal to their carrying amount.

The company's obligations under finance leases are secured by the lessors' rights over the leased assets disclosed in note 13.

21 Derivative financial instruments

Categories of financial instruments at fair value	2019 £m	2018 £m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	**46.2**	4.2
Total derivative financial assets	**46.2**	4.2
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	**(1,428.2)**	(1,292.2)
Total derivative financial liabilities	**(1,428.2)**	(1,292.2)

Changes in value of financial instruments at fair value	2019 £m	2018 £m
Profit for the year has been arrived at after crediting/(charging):		
Financial assets at fair value		
Designated as FVTPL	**3.2**	(5.1)
Financial liabilities at fair value		
Designated as FVTPL	**(219.8)**	51.4
Fair value (losses)/gains on derivative financial instruments	**(216.6)**	46.3

In November 2018 work was undertaken to amend the inflation-linked swaps held at Southern Water Services (Finance) Limited. Firstly, swaps were legally re-assigned from Southern Water Services (Finance) Limited to Southern Water Services Limited, before extending mandatory breaks from 2019 to 2025 on swaps with a notional value of £177.0 million, and re-couponing the receipt leg to increase the interest receivable of the extension period.

Other swaps with maturity dates of 2031, 2037, and 2041 were extended until 2046 by acquiring new instruments starting from the maturity date of the existing agreements.

These extensions, along with the existing remaining long-dated swaps, were then bifurcated with the result of increasing the interest receivable.

Upfront payments from Southern Water to the co-ordination bank/counterparties were required for all of these amendments, with the amounts totalling £113.6 million.

The change in fair value of the related swap instruments immediately resulting from this restructure has been deferred to the balance sheet for amortisation in line with the related re-couponed period.

The fair values of derivative instruments (interest rate swaps) at the reporting date are determined using quoted prices adjusted for credit risk and are stated net of the deferred fair values mentioned above.

The regulatory framework, under which revenues and the RCV are indexed, exposes the company to inflation risk. The company enters into inflation linked derivative financial instruments to manage its exposure to that risk.

Under interest rate swap contracts, the company agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the company to mitigate inflation risk on issued fixed rate debt held.

22 Deferred tax liabilities

Deferred tax is provided as follows:

Deferred tax liabilities	Accelerated tax depreciation £m	Revaluation of financial instruments £m	Retirement benefit obligations £m	Other – timing differences £m	Total £m
At 1 April 2017	510.8	(220.1)	(30.7)	(2.4)	**257.6**
Charge/(credit) to income statement (restated*)	9.2	19.5	(0.2)	(0.7)	**27.8**
Prior year adjustment:					
– Credit to income statement	(6.4)	–	–	–	**(6.4)**
– Charge to other comprehensive income	–	–	1.7	–	**1.7**
At 1 April 2018 (restated*)	513.6	(200.6)	(29.2)	(3.1)	**280.7**
(Credit)/charge to income statement	(4.5)	(27.2)	1.6	(0.7)	**(30.8)**
Prior year adjustment:					
– Charge to income statement	1.9	–	–	–	**1.9**
– Credit to other comprehensive income	–	–	(4.1)	–	(4.1)
At 31 March 2019	**511.0**	**(227.8)**	**(31.7)**	**(3.8)**	**247.7**

Deferred tax assets and liabilities are offset where the company has a legally enforceable right to do so.
The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2019 £m	2018 Restated* £m
Deferred tax liabilities	**511.1**	513.6
Deferred tax assets	**(263.4)**	(232.9)
	247.7	280.7

* Prior years have been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

23 Retirement benefit obligations

The deficit associated with retirement benefit obligations has increased to £186.7 million (2018: £171.7 million). The main reason for the increase in the deficit over the year is a decrease in the yields on AA-rated corporate bonds (this has decreased the discount rate used to calculate the value placed on the pension scheme liabilities) and the estimated impact of GMP equalisation of £1.8 million.

This has been partially offset by asset returns being higher than expected over the year (resulting in a higher value being placed on assets as at 31 March 2019), a small reduction in life expectancy and company contributions.

Pension schemes operated

The company principally operates one defined benefit pension scheme (final salary) and one defined contribution scheme, details of which are shown below:

1. Southern Water Pension Scheme (SWPS), a funded defined benefit scheme, was closed to new members on 31 December 1998, re-opened in July 2003 and closed once more to new entrants on 1 April 2005. This scheme has nine trustee directors. The Southern Water Services Executive Pension Scheme (SWEPS) was also closed to new entrants and merged with the SWPS on 1 April 2005.

   The Trustees are responsible for administrating the fund which is held separately from the company. Legal and General and Blackrock are unit registrars for Southern Water Pension Scheme unit holdings, and appoint custodians at individual pooled fund level (not client holding level). The directors of SWS are responsible for setting the accounting assumptions for the fund for inclusion in these financial statements.

   As part of the company's interactions with both the Trustees and when required the Pensions Regulator, the company looks to agree a long-term funding and risk management strategy for the pension liability. Following on from regular dialogue with the Trustees, and discussions and correspondence with the Pension Regulator regarding the deficit, the Board agreed a long-term funding solution for the scheme in 2018.

The main risks of the scheme are as follows:

a) Asset volatility: For the purpose of setting the contribution requirements, the calculation uses a discount rate set with reference to government bond yields, with allowance for additional return to be generated from the investment portfolio – whereas under FRS 101, the defined benefit obligation is calculated using a discount rate set with reference to corporate bond yields.

   The schemes hold a significant proportion of their assets in growth assets. The returns on these assets may be volatile and are not correlated to the value placed on the liabilities. This means that the deficit may be volatile in the shorter term, which may result in an increase in the contribution requirements and an increase in the net defined benefit liability recorded on the statement of financial position.

   However, the company believes that return-seeking assets offer an appropriate level of return over the long term for the level of risk that is taken. Furthermore, the scheme's other assets are well-diversified by investing in a range of asset classes, including liability driven investments, government bonds and corporate bonds.

b) Changes in bond yields: A fall in bond yields increases the value placed on the liabilities for reporting purposes and for setting the company's contribution requirements. However, in this scenario the scheme's investment in corporate and government bonds is expected to increase and therefore offset some of the increase in the value placed on the liabilities.

c) Life expectancy: The majority of the scheme's obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the scheme's liabilities. This is particularly significant where the longer duration and inflation-linked nature of the payments result in higher sensitivity to changes in life expectancy. The scheme does not contain a hedge against increases in future life expectancy.

d) Inflation risk: The majority of the scheme's benefit obligations are linked to inflation and higher out-turn inflation will lead to a higher benefit obligation (although in most cases caps on the level of inflationary increases are in place to protect the plan against extreme inflation). The majority of the scheme's assets do not provide a direct hedge against changes in inflation as they are either fixed-interest in nature e.g. corporate bonds and government bonds, or have an indirect link to inflation e.g. equities.

2. A second company stakeholder scheme, which is a defined contribution scheme, is also available to all employees.

   Contributions made to the defined contribution scheme for the year ended 31 March 2019 amounted to £3.9 million (2018: £3.0 million). No contributions were outstanding at either year end.

Members of all schemes receive an annual statement of their accrued benefits.

The latest actuarial valuation of the SWPS was carried out as at 31 March 2016 using the projected unit method. For closed schemes under this method the current service cost will increase as the members of the schemes approach retirement. The valuation for 31 March 2019 is due to be completed in November 2019.

The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on investments, and the level of inflation, which drives pension increases in the SWPS.

The principal assumptions in the valuation were as follows:

	2016 SWPS % per annum (pa)
Return on investments: pre-retirement Return on investments: post-retirement (pensioner/non-pensioner)	FI Gilt curve + 65 bps
Salary growth	2.50%
Pension increases on the excess over guaranteed minimum pensions (where capped at 5% pa)	3.00%

The term ‘FI Gilt curve’ refers to the generally available fixed interest gilt yield curve agreed by the Trustees and the company for the purposes of the 2016 actuarial valuation.

The assets of the scheme had a market value of £672.8 million at 31 March 2016. This was sufficient to cover 73% of the scheme’s benefits. The weighted average duration of the scheme liabilities is 21 years.

The timing and quantum of future contributions in relation to the deficit have now been agreed with the Trustees and Pensions Regulator. These contributions will be dependent on future levels of RPI, but if market breakeven rates are borne out at 31 March 2016 the expected base deficit contributions will be paid annually and total £223.5 million over the next 12 years. The first payment was made in November 2018.

Expected employer and employee contributions to the defined benefit scheme for 2019–20 are £23.7 million and £0.1 million respectively under the current Schedule of Contributions.

IAS 19 – assumptions, asset, liability and reserves disclosures

The company has employed an independent actuary to approximately update this valuation allowing for differences between the actuarial assumptions used by the scheme for funding purposes and those adopted by the company to measure the scheme’s liabilities in the financial statements, as well as adjusting for benefit accrual and benefits paid by the scheme.

The major assumptions used by the actuary are set out in the table below:

	2019 **% pa**	2018 % pa
Price inflation (RPI)	3.2	3.2
Price inflation (CPI)	2.2	2.2
Rate of increase in salaries (plus an age-related promotional scale)	2.4	2.4
Rate of increase of pensions in payment (MIS* members only)***	2.2	2.2
Rate of increase of pensions in payment (Old section** members only)***	3.2	3.2
Rate of increase of pensions in payment (all other members)***	3.1	3.1
Rate of increase for deferred pensions (MIS* members only)***	2.2	2.2
Rate of increase for deferred pensions (all other members)***	3.1	3.1
Discount rate	2.4	2.7

* MIS refers to the Southern Water Mirror Image Pension Scheme. Pensions in payment and deferment for this section will be indexed in line with the Consumer Price Index.

** For this section the Trustee will endeavour to meet any indexation of excess pension above the 5% per annum cap on increases that apply to other sections of the scheme.

*** In excess of any Guaranteed Minimum Pension (GMP) element.

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. For 2018–19, the company has used the post-retirement mortality assumptions based on the standard SAPS mortality tables together with future improvements in line with CMI 2018 improvements with a long-term improvement rate of 1.25% per annum.

	2019 Years	2018 Years
Longevity at age 65 for current pensioners		
Male	**22.3**	22.4
Female	**24.0**	24.1
Longevity at age 65 for future pensioners		
Male	**23.7**	23.7
Female	**25.6**	25.5

The assets and liabilities in the scheme and the expected rates of return at 31 March 2019 and 31 March 2018 were:

	Value at 2019 £m	Value at 2018 £m
Equities	**241.5**	207.9
Government bonds	**181.8**	176.8
Non-government bonds	**313.7**	339.4
Cash	**18.8**	12.6
Total market value of plan assets	**755.8**	736.7
Total value of plan liabilities	**(942.5)**	(908.4)
Accrued deficit in the plan	**(186.7)**	(171.7)
Related deferred tax asset	**29.2**	29.2
Net retirement benefit obligations	**(157.5)**	(142.5)

The equity investments and bonds which are held in plan assets are quoted and are valued at the current bid price.

Reconciliation of the present value of the scheme liabilities	**2019 £m**	2018 £m
At 1 April	**908.4**	919.8
Current service cost	**6.2**	6.7
Past service cost	**1.8**	-
Interest expense	**24.1**	25.3
Member contributions	**0.1**	0.2
Experience gain on liabilities	**(3.3)**	5.3
Actuarial (gain)/loss on liabilities:		
- due to changes in demographic assumptions	**55.6**	2.7
- due to changes in financial assumptions	**(13.7)**	(13.9)
Benefits paid	**(36.7)**	(37.7)
Scheme liabilities at 31 March	**942.5**	908.4

The sensitivity of the present value of the scheme liabilities to changes in the major assumptions used is set out below:

Sensitivity analysis of the scheme liabilities	Change in assumption		Impact on scheme liabilities (%)		Impact on scheme liabilities (£m)	
Discount rate	+/-	0.1%	-/+	2	-/+	19
Price inflation (RPI measure)*	+/-	0.1%	+/-	2	+/-	15
Mortality	+/-	1yr	+/-	4	+/-	37

* These movements have been calculated assuming that changes in the inflation assumption have a knock-on effect on the pension increase and salary growth assumptions (i.e. the 'real' increase rates are maintained).

The above sensitivity analysis is based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. The methods and types of assumptions used in preparing the sensitivity analysis did not change compared to the previous period.

Reconciliation of the value of the scheme assets	2019 £m	2018 £m
At 1 April	**736.7**	742.9
Interest income	**19.7**	20.4
Gain on assets above interest	**14.4**	3.9
Employer contributions	**21.6**	7.0
Member contributions	**0.1**	0.2
Benefits paid	**(36.7)**	(37.7)
Bid value of scheme assets at 31 March	**755.8**	736.7

The total return on scheme assets was £34.0 million (2018: return of £24.3 million).

Total cost recognised as an expense	2019 £m	2018 £m
Current service cost	**6.2**	6.7
Past service cost	**1.8**	–
Net interest cost	**4.4**	4.9
Total income statement expense before deduction for tax	**12.4**	11.6

Analysis of the amounts recognised in other comprehensive income	2019 £m	2018 £m
Actual return less expected return on pension scheme assets	**14.4**	3.9
Experience gain/(loss) arising on scheme liabilities	**3.3**	(5.3)
Loss due to changes in demographic assumptions	**(55.6)**	(2.7)
Gain due to changes in financial assumptions	**13.7**	13.9
Total (loss)/gain recognised in OCI before adjustment for tax	**(24.2)**	9.8

The cumulative amount of actuarial losses recognised in other comprehensive income is £279.4 million (2018: £255.1 million).

Analysis of the movement in the scheme deficit during the year	2019 £m	2018 £m
Deficit in the scheme at 1 April	**(171.7)**	(176.9)
Employer's contributions	**21.6**	7.0
Employer's current service cost	**(6.2)**	(6.7)
Employer's past service cost	**(1.8)**	–
Financing charge	**(4.4)**	(4.9)
Actuarial (loss)/gain	**(24.2)**	9.8
Deficit in the scheme at end of year	**(186.7)**	(171.7)

24 Regulatory settlement liability

Regulatory settlement liability	2019 £m	2018 £m
At 1 April	–	–
Increase in year	**138.5**	–
At 31 March	**138.5**	–

Included in:	2019 £m	2018 £m
Current liabilities	**3.0**	–
Non-current liabilities	**135.5**	–
	138.5	–

The company has been co-operating with Ofwat in relation to its investigation into the management, operation and performance of the company's wastewater treatment works. That investigation has resulted in Ofwat taking enforcement action. Notice of Ofwat's intention to issue Southern Water with a financial penalty amounting to £3.0 million has been published on its website. To ensure that the company's customers are not disadvantaged as a result of these matters, the company has agreed to make direct customer rebates totalling £135.5 million in outturn prices (£129.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches identified in the investigation and these amounts have been provided for in the financial statements for 2018–19. The company will be giving a number of formal undertakings to Ofwat in relation to the numerous measures that have been and are being put in place to ensure that the issues identified in the investigation have ceased and cannot be repeated.

25 Provisions for liabilities

Environmental obligations	2019 £m	2018 £m
At 1 April	**3.4**	0.5
Utilised in year	**(0.1)**	–
Increase in year	**3.3**	2.9
At 31 March	**6.6**	3.4

Included in:	2019 £m	2018 £m
Current liabilities	**1.2**	–
Non-current liabilities	**5.4**	3.4
	6.6	3.4

The environmental provision relates to management's best estimate for the decommissioning of abandoned sites and environmental commitments made for ecology work following the South Hampshire abstraction inquiry for the period up to 2030. No reimbursement is expected.

26 Other non-current liabilities

Other non-current liabilities	Deferred Revenue £m	Grants and contributions £m	Total £m
Balance at 1 April 2018 (restated*)	13.8	12.8	26.6
Receivable in year	–	2.3	2.3
Released to income statement	(0.4)	(1.1)	(1.5)
Balance at 31 March 2019	**13.4**	**14.0**	**27.4**

* Grants and contributions in the prior year have been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

These grants and contributions relate to property, plant and equipment.

Deferred revenue of £13.4 million (2018: £13.8 million) relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by SWS. The income will be credited to the income statement evenly over the life of the lease.

27 Called up share capital

Called up share capital	2019 £m	2018 £m
Equity shares		
Authorised		
46,050,000 ordinary shares of £1 each	**46.1**	46.1
Allotted and fully paid		
56,000 ordinary shares of £1 each	**0.1**	0.1
Non-equity shares		
Issued		
Preference shares		
9,863 (2018: 32,607) Class A1 shares of £1 each	**0.0**	0.0
9,863 (2018: 32,607) Class A2 shares of £0.01 each	**0.0**	0.0
110,000 Class B shares of £1 each	**0.1**	0.1

The redeemable preference shares are presented as a liability (see note 20) at an amount of £119.9 million including share premium of £119.8 million and accordingly are excluded from called up share capital in the balance sheet. The total statutory company share premium of £166.0 million includes ordinary share premium of £46.3 million.

On 6 April 2018, the company redeemed 12,892 of the A1 and A2 preference shares at nominal value plus premium, amounting to £12.9 million plus an estimated amount for the A2 dividend that would have fallen due on 30 September 2018. The total redemption value paid to shareholders including the estimated dividend was £13.5 million.

On 25 September 2018, the company redeemed 9,852 of the A1 and A2 preference shares at nominal value plus premium, amounting to £9.9 million plus an amount for the A2 base value dividend that would have fallen due on 30 September 2018. The total redemption value paid to shareholders including the base value dividend accrued was £10.0 million.

28 Share premium account

Share premium account	2019 £m	2018 £m
Equity share premium		
Balance at 1 April and at 31 March	**46.3**	46.3

29 Non-distributable reserve

Non-distributable reserve	£m
Balance at 1 April 2017 (restated*)	24.1
Profit for the financial year	23.7
Transfer to retained earnings	(1.1)
Balance at 1 April 2018 (restated*)	46.7
Profit for the financial year	8.5
Transfer to retained earnings	(1.4)
Balance at 31 March 2019	53.8

* Non-distributable reserves comprise the value of sewer adoptions previously recognised at fair value, deferred and amortised to the income statement over the life of the related assets. Under IFRS 15 the company recognises the fair value upon adoption i.e. the point at which control of the asset is obtained, through profit and loss to non-distributable reserves. This reserve is released to retained earnings in line with the amortisation of the related assets.
Further information on the transition to IFRS 15 can be found in note 3 to the financial statements.

30 Retained earnings

Retained earnings	£m
Balance at 1 April 2017 (restated*)	930.3
Equity dividends paid	(54.1)
Profit for the financial year (restated*)	147.0
Other comprehensive income for the year	8.1
Transfer from non-distributable reserve (restated*)	1.1
Balance at 1 April 2018 (restated*)	1,032.4
Equity dividends paid	(34.8)
Loss for the financial year	(241.4)
Other comprehensive loss for the year	(20.1)
Transfer from non-distributable reserve	1.4
Balance at 31 March 2019	**737.5**

* The prior year has been restated for the transition to IFRS 15 as explained in note 3 to the financial statements.

31 Notes to the statement of cash flows

	2019 £m	2018 Restated* £m
Continuing operations		
Operating profit	**117.9**	263.3
Adjustments for:		
Fair value of sewer adoptions	**(8.5)**	(23.7)
Depreciation of property, plant and equipment	**249.6**	244.5
Amortisation of intangible assets	**22.3**	15.0
Difference between pension charge and cash contributions	**(13.7)**	(0.3)
Amortisation of grants and contributions	**(1.1)**	(1.0)
Operating cash flows before movements in working capital	**366.5**	497.8
Increase in inventories	**(1.8)**	(0.2)
Increase in receivables	**(11.0)**	(23.6)
Increase/(decrease) in payables	**2.6**	(6.2)
Increase in regulatory settlement liability	**138.5**	-
Increase in environmental provisions	**3.2**	2.9
Cash from operations	**498.0**	470.7
Tax paid	**(8.2)**	(14.1)
Net cash from operating activities	**489.8**	456.6

Cash and cash equivalents	2019 £m	2018 £m
Cash and bank balances	**372.0**	164.4

Cash and cash equivalents comprise cash and short-term bank deposits. The carrying amount of these assets is equal to their fair value.

The table below details changes in liabilities arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the cash flow statement as cash flows from financing activities.

Analysis of net debt (including changes in liabilities from financing activities)	At 1 April 2018 Restated* £m	Cash flow £m	Fair value adjustments £m	New finance leases £m	Other non-cash changes £m	At 31 March 2019 Restated* £m
Cash and cash equivalents	164.4	207.6	–	–	–	**372.0**
Net liabilities from financing activities:						
Term facilities/index linked loans (note 20)	(257.1)	(15.3)	(2.4)	–	–	**(274.8)**
Loans from subsidiary (note 20)	(3,603.5)	247.7	(33.7)	–	9.0	**(3,380.5)**
Finance lease liabilities (note 20)	(1.6)	0.6	–	–	–	**(1.0)**
Redeemable preference shares (note 20)	(142.6)	22.7	–	–	–	**(119.9)**
Net interest rate swaps (note 21)	(1,288.0)	122.5	(216.5)	–	–	**(1,382.0)**
Total liabilities from financing activities	(5,292.8)	378.2	(252.6)	–	9.0	**(5,158.2)**
Net debt	**(5,128.4)**	**585.8**	**(252.6)**	**–**	**9.0**	**(4,786.5)**

* The prior year has been restated to separately disclose the value of derivative assets, previously offset against liabilities (see note 21).

Other non-cash changes of £195.3 million relate to the amortisation of loan issue costs, bond premium, gilt lock proceeds and deferred proceeds.

Balances at 31 March 2019 comprise:	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m	Total £m
Cash and cash equivalents	–	372.0	–	–	**372.0**
Derivative financial instruments	46.2	–	–	(1,428.2)	**(1,382.0)**
Unamortised debt issuance costs	–	–	1.5	11.5	**13.0**
Gilt lock proceeds	–	–	(0.1)	(4.7)	**(4.8)**
Borrowings due within one year	–	–	(505.7)	–	**(505.7)**
Borrowings due after one year	–	–	–	(3,277.7)	**(3,277.7)**
Finance leases	–	–	(0.2)	(0.8)	**(1.0)**
Net debt	**46.2**	**372.0**	**(504.5)**	**(4,699.9)**	**(4,786.2)**

Borrowings due within one year relate to amounts that are repayable on demand or within 12 months of the balance sheet date (see note 20).

32 Contingent liabilities

Environment Agency

As noted on page 26 in addition to the Ofwat settlement the company faces investigations from the Environment Agency regarding the performance of certain wastewater sites and the reporting of relevant compliance information. The company is working proactively with the Agency to resolve its investigations which are still evolving. Having considered the matter carefully the Board has concluded that it is not possible to make a reliable estimate for any obligation that may arise from these investigations for the following reasons:

- The uncertainty of the nature and rectitude of any charges;
- The uncertainty of the basis for any offence i.e. what level of culpability will be alleged and what level of culpability would be the basis for sentence (culpability being one of the key criteria that determines the level of fine);
- The uncertainty regarding the environmental harm risked by the commission of any offence i.e. what likelihood of harm will be alleged and what likelihood of harm would be the basis for sentence (likelihood of environmental harm being one of the key criteria that determines the level of fine).

The Board have taken these investigations extremely seriously and have continued to monitor and support the work of the Risk and Compliance directorate, who have continued to deliver a programme of improvements to the company's non-financial regulatory reporting including the collection, verification, reporting and assurance of data. Further information on this can be found in the company's Final Assurance Plan 2019, which is available at **southernwater.co.uk/our-reports.**

Other contingent liabilities

Companies of the size and scale of Southern Water Services Limited are sometimes subject to a number of claims, disputes and potential litigation. The significant ones currently include ongoing investigations by regulatory bodies (the EA and DWI) as well as a potential claim in respect of property search income. The directors consider that, where a liability is probable, and where it is possible to be estimated reasonably, an appropriate position has been taken in reflecting such items in these financial statements.

Following the South Hampshire abstraction inquiry, Southern Water Services Limited has committed to undertake certain environmental work on the rivers Itchen, Test and Candover Stream between 2018 and 2030. A provision has been made in the accounts of 2018–19 in relation to costs of the ecology work associated with this agreement and further details are disclosed in note 25 to the accounts. Certain compensatory costs may become due in the future, subject to conditions at that time and the impact of the ecology work undertaken. These have not been provided for and could increase the obligation by approximately £2 million.

Contractors submit claims to the company for the estimated final cost of their works. These claims are reviewed to assess where the liability for the costs rests and the amount that will actually be settled. The expected amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractor's claim and Southern Water Services Limited's valuation.

The company had no contingent liabilities for capital claims at the year-end (2018: £nil).

33 Financial commitments

(a) Capital commitments are as follows:

	2019 £m	2018 Restated £m
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	**615.2**	516.5
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	**15.8**	14.6

(b) The company as lessee

	2019 £m	2018 £m
Lease payments under operating leases recognised as an expense in the year	**4.4**	4.5

As at 31 March 2019 and 2018, the company had outstanding commitments for future minimum lease payments under non-cancellable operating leases in respect of vehicles and land and buildings which fall due as follows:

	Land and Buildings		Other	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Within one year	**1.7**	1.7	–	0.1
In the second to fifth years inclusive	**7.0**	7.0	–	–
After five years	**11.4**	13.2	–	–
	20.1	21.9	–	0.1

Operating leases are charged to the income statement over the lease term.

Operating lease payments represent rentals payable by the company for certain of its office properties and company vehicles.

Commercial vehicle leases are negotiated for an average term of five years, and rentals are fixed for an average of five years, with an option to extend on an ad hoc basis at the then prevailing market rate.

34 Related party transactions and ultimate controlling party

The immediate parent undertaking is SWS Holdings Limited.

The ultimate parent company and ultimate controlling party is Greensands Holdings Limited (GSH), a company incorporated in Jersey, which is the parent undertaking and controlling party of the smallest, largest and only group to consolidate these financial statements. Copies of the consolidated financial statements may be obtained from the registered office of GSH at Southern House, Yeoman Road, Worthing, BN13 3NX, or from the Southern Water website.

The largest shareholder in GSH as at 31 March 2019 is an institutional investment company advised by JP Morgan Asset Management owning 31.24%.

The company has taken advantage of the exemption under FRS 101 'Reduced Disclosure Framework' in not disclosing details of transactions with other companies which are 100% wholly owned. Equivalent disclosures are given in the group financial statements of GSH.

One of the non-executive directors of the company has declared their directorship in a company that provided advice in relation to cyber security to the members of the SWS board during the year. The value of the transaction was £2,617 and the amount outstanding as at 31 March 2019 was £nil.

35 Post balance sheet events

On 28 June 2019, the company redeemed all remaining 9,863 of its Class A1 and Class A2 preference shares, and 19,340 of its Class B preference shares, at nominal value plus the premium on issue, including settlement for fixed or base value dividends due to that date. The total amount paid was £34.0 million comprising principal redemption of £29.2 million and dividends of £4.8 million.

Independent auditor's report to the members of Southern Water Services Limited

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of Southern Water Services Limited (the 'company'):

- give a true and fair view of the state of the company's affairs as at 31 March 2019 and of the loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the income statement;
- the statement of other comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- the statement of cash flows; and
- the related notes 1 to 35.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including Financial Reporting Standard 101 "Reduced Disclosure Framework".

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other 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.

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Litigation and claims associated with the waste water plants; • Provision for impairment of trade receivables; • Revenue recognition – estimating unbilled household revenue; and • Classification of costs between operating and capital expenditure.
Materiality	The materiality that we used was £12.7m which was determined on the basis of 5% of operating profit.
Scoping	The company is in full scope of our audit. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.
Significant changes in our approach	Our approach is consistent with the previous year.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial 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 financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Litigation and claims associated with the wastewater plants	
Key audit matter description	During the year ended 31 March 2019 the company continued to be investigated by Ofwat into possible breaches of licence conditions and the company's statutory obligations relating to the management and operation of wastewater treatment works. In June 2019, management agreed a mitigation plan of the conducted breach with Ofwat comprised of a settlement amount of £135.5m (£123.0m in 17/18 prices) through a reduction of future customer billings and an additional £3.0m penalty. Due to the specific circumstances of the approach agreed with Ofwat to the past performance regulatory settlement to be repaid by the company through reduction in future customer bills, the accounting treatment of this arrangement is a matter of judgement. In addition, the company is facing investigations from the Environment Agency ('EA') regarding the performance of certain wastewater treatment sites. The EA investigation is still progressing with limited feedback and no legal action has arisen to date. Any liability arising should be accounted for as soon as the provision is considered likely and can be estimated appropriately. Management was not able to make a reliable estimate of any obligation from the EA investigation and therefore no provision has been accounted for in the current financial statements in accordance with IAS 37. We have identified a potential risk for fraud in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance. Further details are included on page 26 and within the Audit Committee report on page 135, critical accounting estimates and judgements note (note 2) and in note 24 to the financial statements.
How the scope of our audit responded to the key audit matter	We have: • obtained an understanding of key controls; • met with the company's legal advisers and carefully considered any advice provided up to the time of issuing the Annual report; • obtained and reviewed the mitigation and settlement plan prepared by the company including the associated impact of the settlement on the liquidity of the company and its continuance as a going concern; • assessed management's accounting recognition of the Ofwat regulatory settlement; • reviewed the Section 19 documentation associated with the Ofwat settlement; and • considered whether any alternative treatments of the cost in the income statement would provide a better accounting treatment; • reviewed correspondence with Ofwat and the EA and other regulatory agencies; • reviewed Board minutes and considered the Board's assessment that they are unable to quantify the risk of penalty, if any, arising from the EA investigation, including the review of supporting legal advice from third party advisers and discussion with their legal advisers; • obtained legal letters; and • reviewed the completeness and accuracy of the disclosures made by the company in respect of the regulatory matters.
Key observations	We are satisfied that the appropriate recognition approach has been adopted for the Ofwat settlement and concluded that the disclosure and supporting explanations provided were appropriate. We are satisfied that the treatment of the potential EA fine as a contingent liability reflects the best available evidence at the time of issuing the accounts and is supported by external legal advice.

Provision for impairment of trade receivables	
Key audit matter description	At 31 March 2019 the company has an impairment provision of £188.8m (2018: £180.0m) and accrued an impairment charge during the year of £10.7m that represents 1.3% of the company's revenue (2018: £23.9m and 3.1% of revenue). The company has a significant domestic customer base and due to regulations is not allowed to interrupt water supply, including in the event of non-payment. A proportion of the company's customers do not or cannot pay their bills, which results in the need for a provision to be made for non-payment of the customer balance. The impairment provision is a key area of judgement within the company and is also an area of scrutiny by the regulator. The impairment provision is based on assumptions made on the forecast collectability of receivables across both invoiced amounts and accrued revenues. We focused our work on the estimation of the impairment provision on the following areas: • The accuracy of customer data included within the aged receivables report, specifically whether customer data has been correctly classified based on the ageing of their receivables; and • The reasonableness of the cash collection assumptions made by management. We have identified a potential risk for fraud in relation to this audit matter due to its influence on key metrics which management use to monitor and report business performance. Further details are included within the Audit Committee report on page 135, critical accounting estimates and judgements note (note 2) and in note 17 to the financial statements.
How the scope of our audit responded to the key audit matter	We have: • obtained an understanding of key controls within the impairment estimation process; • engaged an IT specialist to test management's IT system logic and methodology; • performed test of details to verify accuracy of information within the aged receivables report to assess whether the customer receivable is accurately categorised based on information contained within the company's billing cycle; • verified that the final provision has been calculated in line with the policy of the company and in line with the requirements of IFRS 9 Financial Instruments; • challenged management's impairment policy and methodology specifically on whether the recoverability assumptions are reflective of current cash collection rates and whether the final provision is in line with industry peers; • assessed the cash collection performance in the year against management's budgets; and • audited specific provisions and adjustments included in the total provision balance by understanding the rationale for the adjustment and agreement to supporting documentation.
Key observations	We are satisfied that the assumptions applied in assessing the impairment of trade receivables are reasonable and have been applied appropriately to compute the impairment provision.

Revenue recognition – estimating unbilled household revenue	
Key audit matter description	For customers with meters, the revenue recognised depends upon the volume of water supplied, including an estimate of the sales value of water supplied between the date of the last meter reading and the year end. The total unbilled income accrual for the year to 31 March 2019 is £136.7m (2018: £131.8m). The most judgemental area of the estimation of unbilled revenue related to the usage estimate, which is based on historical data and assumptions around consumption patterns. Due to the level of management judgement, the estimation of unbilled household revenue has been identified as a key audit matter. Incorrect estimates of water consumption could lead to overstatement of revenue in the period. We have identified a potential risk for fraud in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance. Further details are included within the Audit Committee report on page 135, critical accounting estimates and judgements note (note 2) and in note 5 to the financial statements.
How the scope of our audit responded to the key audit matter	We have: • obtained an understanding of key controls within the unbilled revenue estimation process; • reperformed management's analysis of the accrued income amount; • performed a retrospective assessment of the previous year's accrual by comparing bills raised during 2018–19 relating to the 2017–18 accrual to determine the accuracy of management's forecasting; • tested the accrued income balance by selecting a sample of individual properties and verified historical billing rates for each selection to confirm the appropriateness of the accrual; • performed substantive testing of manual adjustments applied by management to the period end accrued income balance; and • involved IT audit specialists to test the accuracy of the system generated reports utilised by management in determining the required accrual.
Key observations	We are satisfied that management's estimates in relation to the recognition of unbilled revenue are appropriate.

Classification of costs between operating and capital expenditure	
Key audit matter description	The company continues to invest significantly in infrastructure renewal and replacement, with property, plant and equipment and intangible asset additions of £442.2m (2018: £440.2m) in the period that includes £60.2m (2018: £56.5m) of capitalised overheads. Expenditure incurred to increase the capacity or enhance the network is treated as capital expenditure (“capex”). Expenditure incurred in maintaining the operating capability of the network is expensed in the year in which it is incurred (“opex”). Capital projects can contain a combination of enhancement and maintenance activity which are not distinct and hence the allocation of costs between capital and operating expenditure is inherently judgemental. This risk also includes the inappropriate capitalisation of overheads. We have identified a potential risk for fraud in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance. Further details are included within the Audit Committee report on page 135, critical accounting estimates and judgements note (note 2) and in note 13 to the financial statements.
How the scope of our audit responded to the key audit matter	We have: • obtained an understanding of key controls surrounding the capitalisation of costs; • assessed the company’s capitalisation policy to determine compliance with relevant accounting standards; • assessed the application of the capitalisation policy to the costs incurred by selecting a sample and agreeing to third party invoices; • obtained an understanding of the nature of the new cost centres, and the basis behind the percentage of overheads to be capitalised to the new cost centre; • inspected the calculations behind the percentages applied to new cost centres and validated the calculations for accuracy and consistency across the business; and • tested the accuracy of the overheads capitalisation by re-performing management’s calculation for a sample of cost centres, and agreeing key inputs to the supporting documentation.
Key observations	We consider that the classification of costs between operating and capital expenditure is appropriate.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality	£12.7m (2018: £11.7m)
Basis for determining materiality	Materiality has been determined as 5% (2018: 5%) of operating profit.
Rationale for the benchmark applied	We determined materiality based on operating profit as this is the key metric used by management, investors, analysts and lenders.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.64m (2018: £0.58m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our audit was scoped by obtaining an understanding of the entity and its environment, including internal control, and assessing the risks of material misstatement. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report other than the financial statements and our auditor's report thereon.

Our opinion on the financial 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 financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial 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 this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, 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.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's 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 financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: **www.frc.org.uk/auditorsresponsibilities**. This description forms part of our auditor's report.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Opinion on other matters prescribed by our engagement letter

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the provisions of the Companies Act 2006 that would have applied were the company a quoted company.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- the company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the directors' remuneration report to be audited is not in agreement with the accounting records and returns.

We have nothing to report in respect of this matter.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report 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 company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Anthony Matthews FCA
(Senior statutory auditor)

for and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom

12 July 2019

WATER for LIFE®

southernwater.co.uk

Southern Water
Southern House
Yeoman Road
Worthing
West Sussex
BN13 3NX

Registered no. 02366670

4853_07.19

from Southern Water®