Annual Report and Financial Statements

For the year ended 31 March 2022

from Southern Water®

WATER for LIFE®

Welcome to our Annual Report and Financial Statements 2021–22

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

We provide essential water services to 2.6 million customers and wastewater services to more than 4.6 million customers across Kent, Sussex, Hampshire and the Isle of Wight.

Registered Office
Southern Water
Southern House, Yeoman Road
Worthing, West Sussex BN13 3NX

Registered no: 02366670

from Southern Water®

Always improving, for the benefit of our customers, the environment and our communities

We are committed to making a positive impact. This means ensuring all our customers have access to high-quality, affordable and efficient water and wastewater services.

Investment in our people, our communities and the environment is at the heart of our strategy and we always prioritise the needs of our customers and stakeholders.

Our customers and communities

We work hard every day to ensure that we are improving our customer experience and having a positive impact on our communities.

The environment

We are always improving our processes and systems because we want to be a business that leaves the planet a better place.

Our people

We are continually working to build the skills that our employees need, to ensure they can collectively shape a sustainable future for our industry.

Our future

Our ambitions mean we need to take bold action. We have a clear vision to create a resilient water future for our customers in the South East.

Always improving, for the benefit of our customers and the environment

We have ambitious goals and can only reach them with the support of our people and communities.

Understanding and supporting **our customers and communities**

Reducing debt and supporting our customers

Vulnerability Lead Rachel Ryan-Crisp describes how our new hardship fund is offering debt relief, bill reductions and tailored financial support to our customers.

Read more on page 17

Support to get back Home and Well

Vulnerability Liaison Officer Stuart Bailey talks about how the Home and Well partnership is supporting our customers leaving hospital.

Read more on page 45

Tackling blockages at a local level

Fat, Oil and Grease (FOG) and Unflushables Manager Elvira Gabos explains how our local approach to tackling blockages is helping more customers.

Read more on page 35

Protecting and improving **the environment**

Understanding our impact

Head of Asset Systems and Processes Cigolene Nguyen explains how we are measuring the carbon embedded in our construction programmes for the first time.

Read more on page 61

Reducing the use of storm overflows

Head of the Storm Overflow Task Force, Dr Nick Mills explains how we are collaborating to reduce flooding and the use of storm overflows across our region.

Read more on page 39

Improving the health of our harbours

Senior Environmental Strategy Specialist Henry Badman outlines the importance of partnership working through our Healthy Harbours Summit in Hampshire.

Read more on page 31

Enabling and empowering **our people**

Supporting young adults in our community

Community Partnerships and Programme Manager Alex Willumsen explains how a donation to the Mountbatten Hospice on the Isle of Wight is changing the lives of young adults with life-limiting illnesses.

Read more on page 67

Dive right into Southern Water

Recruitment Manager Simon Dickinson talks about how our new-look employer brand is helping future employees and our communities get a better understanding of who we are and what we stand for as a business.

Read more on page 69

We are constantly innovating to meet our promises and prioritise the current and future needs of our customers.

Always improving our water treatment

Project Manager Chris Hall is leading a pilot to test innovative new filtering technology at our Otterbourne Water Treatment Works, improving water quality for our customers.

Read more on page 68

Ensuring a supply of high-quality water for **the future**

Our purpose, vision, strategy and values

Our strategy defines how we operate. Our purpose, vision and values provide the strong cultural framework that informs our decision-making and business strategy.

Our purpose

Why we exist

We provide **water for life** to:

enhance health and wellbeing

protect and improve the environment

sustain the economy

Read more about how our **purpose informs our Long-Term Priorities** on page 50

Our vision

Our ambition

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

Our strategy

How we achieve our purpose

The current five-year planning period: **our strategy** for 2020–25

- Deliver great service
- Use water wisely
- Protect and improve the environment
- Fit for the future

Read more about **our performance** on pages 76 to 91

Our governance

Our Board draws on both the principles of leadership, transparency and governance published by Ofwat, as well as those of the UK Corporate Governance Code.

Read more **on governance** on pages 136 to 193

Our approach to risk management

Designed to provide a clear and consistent framework for managing and reporting risks associated with our operations to executive management and to the Southern Water Board. The framework seeks to promote better decision-making, avoid incidents and encourage the best outcome for our customers, the environment and our company.

Read more **on risks** on pages 108 to 120

Our values

Fundamental beliefs that underpin everything we do

Our **three values** sit at the core of our ethical decision-making framework.

Our culture

Ethical foundation enabling better decisions every day

Ethical decision-making and modern compliance frameworks sit alongside our vision, purpose and values, helping our leadership team, employees and partners to **do the right thing**.

Read more **about our culture** on page 27

Our approach to sustainability

To deliver what our customers and stakeholders want and expect from us, we need to go beyond regulatory compliance to demonstrate long-term stewardship of the environment, deliver social value and ensure we are responding to our customers' and stakeholders' needs as we plan for the future.

Environmental

- We have refreshed our approach to environmental management to reduce our carbon emissions and water usage and optimise our positive impact on wildlife and habitats.
- We have considered the recommendations of the Task Force on Climate-Related Financial Disclosure (TCFD), explaining how we are managing the impacts of climate change by reference to governance, strategy, risk and metrics.
- Our asset management strategy is improving our understanding of the risks across our network through better use of real-time condition data.

Read more on pages 54 to 61

Social

- In recognition of our continued focus on workplace diversity, we have reached Number 46 on the Inclusive Top 50 UK Employers List for 2021, moving up from 49 in 2020.
- In partnership with the Department for Work and Pensions we have offered a range of six-month placements at water treatment sites across our region, as part of the Kickstart Scheme.
- We have offered financial assistance to 140,445 customers during 2021–22 (2020–21: 122,434) and increased the number of customers on our Priority Services Register by 56%.

Read more on pages 62 to 70, and page 79

Governance

- Our Risk Committee was reconstituted as the Health and Safety and Operational Risk Committee, helping to continually develop a safety culture across the organisation.
- Our newly established Environment, Social and Governance Committee is responsible for our material environmental, social and governance matters, supporting us in delivering our desired ambitions, performance plans and positioning.
- The Board remains committed to ensuring the company's culture is founded on ethics, integrity and the company's values. During the year we have added an assessment of maturity in Ethical Business Practice to our Statement of Compliance return templates.

Read more on pages 136 to 193

Southern Water at a glance

What we do

We are constantly innovating to meet our goals and prioritise the current and future needs of our customers and the environment

Engaging with our stakeholders

To create a resilient water future, we must work with our customers and key stakeholders to co-imagine and co-create solutions in all aspects of our business.

Read more about **our stakeholders** on pages 44 to 49

Driving innovation and fostering partnerships

Our bluewave innovation hub has been part of eight successful collaborative bids for funding in Ofwat's £200 million Innovation Fund, which will support programmes including catchment management, asset management and water safety planning.

Read more on **catchment management** on page 54

Key facts about our operations

Cleaning and returning wastewater

1,371m
Average daily wastewater received in litres

367
Wastewater treatment works

Treating and storing water

204
Service reservoirs

80
Treatment works

Delivering water to customers

556m
Average daily water supply in litres

2.6m
People served

Removing wastewater

4.6m
People served

3,476
Pumping stations

WATER for LIFE

from Southern Water

Where we do it

Our region is as diverse as the communities we serve

Covering more than 700 miles of coastline, national parks and forests, as well as numerous Areas of Outstanding Natural Beauty, each community across our region presents its own challenges and opportunities as we plan for the future.

Understanding the key matters impacting the South East

Environmental

As our climate continues to change, we need to adapt to protect our local environment and improve it where we can.

- Our region is water-stressed and Hampshire in particular is facing acute water shortages. We must reduce how much we take from local rivers to protect precious ecosystems from population growth and rising demand. We are investing £147 million in new sources, including Havant Thicket reservoir (with Portsmouth Water), water re-use and water transfers, to keep taps flowing and our local rivers healthy.
- Following £30 million of upgrades at our wastewater treatment works in Hailsham, less phosphorus will be discharged into the Pevensey Levels (a Special Area of Conservation and Site of Special Scientific Interest). This will prevent excess nutrients from stifling biodiversity.
- We have committed £400,000 to complete a first-of-a-kind survey of Thanet's entire drainage system to identify ways to protect customers' homes from flooding and our coastline from potential pollution.

Investment

We know storm water releases have a huge impact on our coastal communities and local economies, so we are working hard to find new ways to manage the impacts of increased storms and surface water run-off on our networks and sites. As part of a larger investment programme across our wastewater network totalling more than £400 million:

- We are making £18 million of upgrades at our Budds Farm Treatment Works – including new storm tanks and pipework – to increase its capacity and provide greater resilience during extreme weather.
- We led the Harbours Summit with key partners to address the declining health of Chichester, Langstone and Pagham harbours and agreed joint steps to restore these habitats. We are taking action by investing £72 million by 2025 to improve the local water quality.
- We are completing £21 million of upgrades to 2025 at our Swalecliffe Wastewater Treatment Works, including lengthening the site's short sea outfall, to enhance the coastline and reduce any impact on water-based leisure and business.

Social

We work with our Community Action Group of employees and our Water Futures 2030 panel, made up of young people and customers, to make sure that any donations we make go where they are needed most. Over the past year:

- Seventeen charities and community groups in Hampshire and the Isle of Wight shared a total of £104,000. They included: Citizens Advice Swale, Sandown and Shanklin Independent Lifeboat Service, Horndean Infants, Off the Record South East and One Community.
- Twenty-two causes across Sussex received grants totalling £132,000, including: 4 Sight Vision, B+H Food Partnership, Chestnut Tree House, CPRE Sussex, Equine Partners CIC, FareShare Sussex, Spear Brighton and Sustainable Sussex.
- Nine charities and community groups in Kent shared a total of £68,000 in 2021–22, including Dandelion Time, Kentish Stour Countryside Partnership, Martha Trust, Romney Marsh Day Centre and Sheppey Matters.

Read more about **how we are meeting the needs of our regional stakeholders** on pages 44 to 49

Highlights and challenges

Value delivered to communities, the environment, our employees and suppliers

The environment, and **our role in protecting and improving it,** is central to every decision we make

Read about our **Storm Overflow Task Force** on page 39

Read about our **Harbours Summit** on page 31

Environment

Overview of performance

- Our dedicated Storm Overflow Task Force was launched in November 2021. Its five groundbreaking pathfinder projects align with our ambitious £1.5 billion investment programme, which will set out what will be needed from Southern Water and others to achieve a significant reduction in pollution incidents.
- The world's focus on COP26, the publication of the Environment Act and the impacts of extreme weather all served as timely reminders of the need to continue to drive energy efficiency, invest in low-carbon nature-based solutions and increase our renewable energy generation.
- Mitigating and adapting to the damaging impacts of climate change remain key priorities. We published our Net Zero Plan in July 2021 and our third Climate Change Adaptation Report in December 2021.
- Our Catchment First programme continues to help reduce nitrogen leaching into the region's water sources, protecting them from plant and algal growth which can clog water sources and deprive them of oxygen.

Future plans

- We welcome the new mandatory requirement for Biodiversity Net Gain (BNG) outlined in the Environment Act 2021. Later in 2022 we will launch our BNG Masterplan.
- We will continue to lead efforts to protect and restore Chichester, Langstone and Pagham harbours, funding and facilitating a stakeholder group to drive the use of the newly created natural capital baseline to agree environmental targets for improvement.
- We will publish a new sludge management strategy, finalise plans for Combined Heat and Power units on our sites and begin the roll out of our largest ever solar programme in 2022. We are also looking at our offsetting requirements and emerging carbon market creation along our coastline.
- We will continue to move towards compliance with the Task Force for Climate-Related Financial Disclosures (TCFD) and we aim to be fully compliant for 2023–24.
- Reducing our use of single-use plastics remains a priority. Later this year we will publish an update to our policy and commission a new audit to assess our progress to date. We will continue to support the national Refill campaign and City to Sea's plastic-free Rethink Periods programme, which aims to reach 500 schools across our region by the end of 2022.

Communities

Overview of performance

- Southern Water donated over £300,000 to regional causes, supporting local charities, community and volunteer groups with vital funding.
- Our employees delivered 1,438 hours of employee volunteering in 2021–22, including beach cleaning, building bike tracks for schools, stream clearing and community garden activities.
- We funded two school rain gardens in Sussex, supporting outdoor learning and helping children understand the value of our underground water supplies.
- We supported four independent lifeboat teams across the Isle of Wight and Hampshire to help them stay equipped and on the water.
- Our employee mentoring programme was launched offering support to young people in West Sussex through mock interviews and employability groups to explore opportunities in the water industry.

Future plans

We are in the process of expanding our Community team to deliver a refreshed engagement strategy. This includes:

- School visits, community talks, site tours, Science, Technology, Engineering and Mathematics (STEM) activities, apprenticeships and mentoring.
- Targeted community outreach, support for communities affected by our capital schemes and expanded volunteering services.
- Improvements to our operational sites to increase biodiversity and help educate our communities to be more water efficient.
- Further community and customer hardship grants.

Read more on pages 66 to 67

Highlights and challenges continued

Value delivered to communities, the environment, our employees and suppliers continued

We directly employ over 2,000 people and work hard to build new capabilities to deliver better services for customers and the environment

Read more on page 70

Suppliers

Overview of performance

- We have continued to manage the impacts of COVID-19, ensuring continuity for suppliers.
- Our source-to-pay process has been optimised to make it easier to do business with us.
- We have developed a best practice contract management framework and established a procurement-driven community of practice in order to steward, develop and up-skill our contract management capability.
- Our Supplier Code of Conduct has been cascaded to our partners. It sets out what we value as a company, the principles which define who we are, how we work and what we stand for.

Future plans:

Our key focus is to help safeguard the viability of our supply chain, which has already come under increasing pressure from the impacts of COVID-19 and EU-transition shocks. Delays and disruption have become the norm, and this situation has been made worse by market price pressure and other socio-political shocks, such as the war in Ukraine.

Our focus going forward will be to:

- Create a resilient, outcome-based supply chain that can adapt to shocks, contributes to business performance and enables us to achieve our ambitions.
- Optimise our Supplier Relationship Management programme – broaden its reach across all critical suppliers and enrich content, including our Supplier Code of Conduct, to better leverage the expertise of our supply chain and align it with business strategy.
- Continue to build a sustainable supply chain ensuring environmental and societal impacts are considered and proper governance is in place to mitigate them.
- Continue in our efforts to work with our supply chain to mitigate the impacts of inflation.

Employees

Overview of performance

- Southern Water promotes a culture of inclusivity, and this year saw the launch of our new Equality, Diversity and Inclusion (ED&I) information hub, including resource groups, campaigns and tools.
- Following several interventions, such as blind CV screening and the use of gender neutral language, we have seen an improvement in the diversity of candidates applying for roles across the business.
- We joined the Women's Utilities Network, giving our female employees access to training, networking and mentoring opportunities.
- 18% of our employees are currently being supported to undertake formal and informal learning, whether through apprenticeships, degrees and qualifications or courses and certifications, with 8% completing an apprenticeship in the past 12 months.
- Our average number of learning days per year is 3.16 per full-time employee.

Future plans

- We continue to support a hybrid working model, allowing many of our employees the continued flexibility to work both from home and our sites/offices.
- We will be launching our management academy to provide clear support and development progression for our people.
- We are re-introducing a graduate management programme with planned intakes over the next three years to help ensure we have the right skills and capabilities for the future.
- We are working more closely with our peers in the water industry in order to attract a more diverse workforce.

Read more on pages 62 to 65

Highlights and challenges continued

Our operational delivery highlights

We work hard every day to ensure that we are **making progress** in improving our services for our customers and the environment

Read more on pages 76 to 80

Deliver great service

Our performance in 2021–22

- Thanks to significant efforts to improve resilience and work with our customers at property level to reduce blockages, we have seen a second year of improved performance for external flooding with us reducing incidents to 3,944 (2020–21: 4,409), resulting in a £0.948m reward.
- Unfortunately, internal flooding incidents increased to 614 (2021: 393), as a result of a number of severe weather events over the summer period, resulting in a penalty of £7.835 million.
- Disappointingly, our water quality measure Compliance Risk Index (CRI) score has risen to 6.69, (2020–21: 4.53), as a result of increased scores at our service reservoirs and consumer taps. We also experienced quality failures at our Burham Treatment Works in November 2021.
- We have seen a reduction in the time our customers are without water during an incident (for more than three hours) achieving nine minutes, 22 seconds (2020–21: 12 minutes, 43 seconds), although we missed Ofwat's target of six minutes and eight seconds.
- In terms of customer satisfaction (C-MeX) we ranked 16th out of 17 water companies in the UK (2020–21: 16th). As a result, we have incurred a penalty of £4.5 million.
- We saw a notable increase in complaint volumes during the year as a result of the Environment Agency prosecution outcome and increased scrutiny around storm overflow releases. The total number of written complaints we received in 2021 was 9,131.

Future plans

- We will continue to focus on reducing supply interruptions for customers by a further 18% during 2022–23.
- We are setting up a new Digital team and refreshing our website, which will increase access to self-serve tools for our customers – due to launch towards the end of 2022.
- Our Hazard Review programme will continue to focus on improvements at our water supply works and help to increase our CRI score.

Use water wisely

Our performance in 2021–22

- During 2021–22, we reduced leakage levels to 94.9 megalitres per day (Ml/d), a three-year rolling average, (2021: 98.5 Ml/d) against Ofwat's target of 93.9 Ml/d. We have increased investment in-year by £1.2 million to accelerate the roll out of our Advanced Pressure Management System.
- During the height of the COVID-19 pandemic in 2020, we saw individual water usage increase by around 8% with so many of our customers spending more time at home. However, over the past year, we have started to see household usage levels drop to an average of 133.6 litres per person, per day during 2021–22 (2021: 137.6).
- The pandemic has also meant that we were not able to make our usual Water-Saving Home Visits during periods of lockdown. However, over the past year we are pleased to have more than doubled the number of visits we were able to make, achieving a cumulative water saving of 359 cubic metres per day (2021: 105) over the year.
- Through our water-saving communications campaigns, in our targeted water-stressed areas, we have achieved an 11% increase in positive perception. A total of 71% of customers surveyed claim to have reduced their water usage.

Future plans

- We will continue to roll out our virtual Water-Saving Home Visits, and promote the use of our online water calculator, Get Water Fit, which can be found at **southernwater.co.uk/help-advice/getwaterfit-your-water-saving-calculator.**
- We are developing a series of smart metering trials in our most water-stressed areas.
- We have expanded our detection team and will continue the roll-out of our Advanced Pressure Management System to drive down the volume of leakage in our network.

Read more on pages 81 to 82

Highlights and challenges continued

Our operational delivery highlights continued

Read more on pages 83 to 87

Protect and improve the environment

Our performance in 2021–22

- Our Treatment Works Compliance has improved to 97.94% for 2021 (2020: 97.1%) as a result of changes to management processes at our wastewater treatment works. This year we saw a total of seven failed treatment works (2021: 10).
- Although the total number of pollution incidents has reduced (per 10km of sewer), with us achieving 93.63 (2020: 101.52), we know we must go further to reduce these incidents. We are disappointed to have recorded an increase in serious category 1 and 2 pollutions from four in 2020 to 12 in 2021. We recorded 372 category 1-3 pollution incidents (2020: 400) in year. We are committed to this through our Pollution Incident Reduction Plan and we have increased our self-reported incidents, reaching 90% (2020: 88%) in 2021.
- Meeting 100% of the required standards, a total of 60 of our 84 bathing waters achieved Excellent status during the 2021 reporting year (2019: 58). We continue to work with partners along our more than 700 miles of coastline to increase this number.
- Our renewable energy generation target for 2021–22 was 21.3%, and we achieved 15.85%, falling short of where we wanted to be. As a result, we incurred a penalty of £1.326 million.
- Renewable Energy Guarantees of Origin (REGOs) have been purchased through to April 2024, ensuring that 100% of the energy we use is green.
- We beat our target for reducing the amount of water we take from the River Itchen at the most sensitive time of the year for river flows, in September, earning us the maximum reward of £0.5 million.
- We achieved a 100% biosolid recycling record during 2021–22 (2021: 100%). Biosolids (a by-product of the treatment process) are recycled as a fertiliser.

Future plans

- Pollution awareness training will become compulsory for all employees in the company.
- We are trialling a new method to collect and report data in real time, in order to upgrade our Beachbuoy storm release notification service.
- We will use the results of our first-ever natural capital baseline assessment of our land holdings to direct investment and feed learning into our Natural and Social Capital Framework.

Fit for the future

Our performance in 2021–22

- We measure the number of mains repairs per thousand kilometres of our entire water main network. Our Ofwat target was 118.3. During the year we outperformed this achieving 101.5 (2020–21: 150), resulting in a reward of £0.9 million.
- We achieved an improvement on last year's number of sewer collapses, but the Ofwat target of 226 incidents was not met. We achieved 314 incidents (2021: 315), resulting in a penalty of £4.110 million.
- In July 2021 we launched GetConnected, our new online portal for customers to make it easy for customers to submit, track progress and pay for their water and wastewater connection applications.
- We refreshed our approach to non-household retailer engagement, helping reduce the number of long unread meters and providing an increased range of credit support options, which has led to an improved retailer experience rating, moving us up four industry places from 11th to 7th this year.
- We have created a sustainable development policy which sets out our expectations in relation to drainage and water efficiency when developers are drawing up their plans.

Future plans

- While we have not been able to carry out school visits due to the pandemic and subsequent lockdowns, we plan to reinvigorate our work in this area following the appointment of a dedicated Community Education Officer in March 2022.
- In partnership with our local Rivers Trust we will launch a new education programme for primary school children in Hampshire later this year.
- We will continue to modernise and rationalise our networks through our Network 2030 programme.

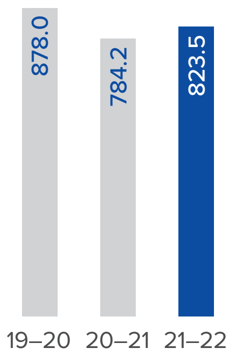
Read more on pages 88 to 91

Highlights and challenges continued

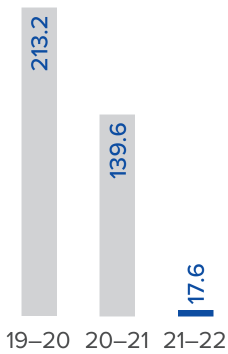
Financial highlights

Read more on pages 92 to 101

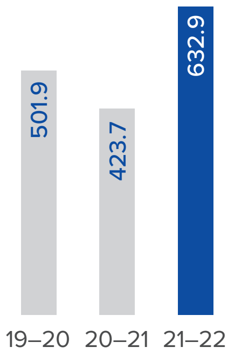
Revenue[1] (£m)
(before amortisation of regulatory settlement provision)



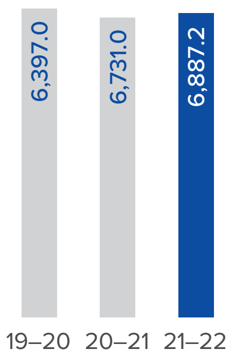
Profit before interest and tax[1] (£m)



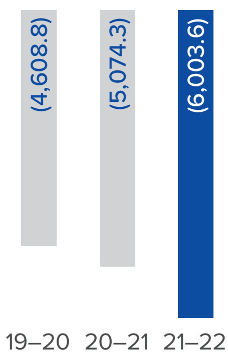
Capital investment[2] (£m)



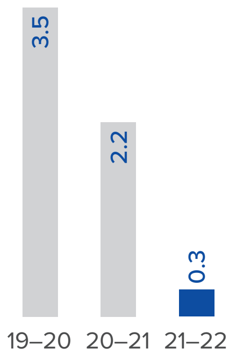
Non-current assets (£m)
(excluding debt)



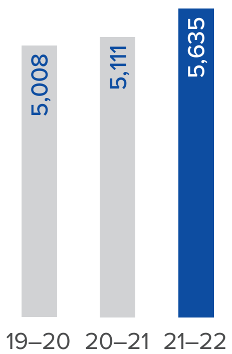
Net Debt[3] (£m)



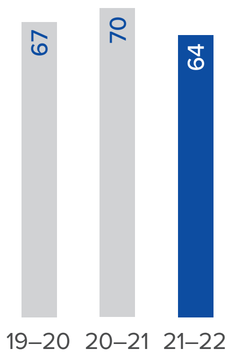
Return on capital employed (ROCE)[4] (%)



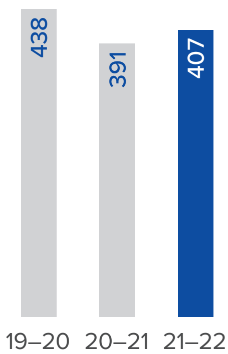
Regulatory Capital Value (RCV)[5] (£m)



Net debt/RCV[6] (%)



Average water and wastewater customer bill (£m)



1. Following its investigation into our wastewater treatment works compliance reporting, Ofwat imposed a penalty under Section 22A of the Water Industry Act. We provided in full for this proposed regulatory settlement in the financial statements for 2018–19, reducing profit in that year. We are now making rebates to customers, through revenue, over the period from 2020–25 and these are offset in the income statement by the amortisation of the provision made in 2018–19.
2. Capital investment for 2020–21 includes an intangible asset of £124.6 million recognised for the future payments to Portsmouth Water in relation to the right to water from the construction of the Havant Thicket reservoir. This is a non-cash valuation in the year and payments will be made to Portsmouth, over the period to 2100.
3. Net debt for 2020-21 and 2019-20 has been restated to following the release of a deferred credit held on the Balance Sheet following a review of the substance of the transaction as described in note 1 to the financial statements
4. ROCE is presented as the ratio of profit before interest and tax (£17.6 million) to non-current assets excluding debt (£6,887.2 million) less current liabilities excluding borrowings and lease liabilities (£427.2 million) from the Statement of Financial Position.
5. Regulatory Capital Value (RCV) a measure of the value of our regulatory capital asset base as published by Ofwat. The RCV for March 20 has been restated to reflect the adjustments made by Ofwat at the end of the last regulatory period.
6. 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).

CASE STUDY

Understanding and supporting our customers and communities

Our new Hardship Fund is offering tailored financial support where it's needed most

"We started the Hardship Fund as a pilot, with a limited budget of £300,000 but have since expanded it to a £20,000-a-month business-as-usual offering to our customers in vulnerable circumstances. We provide three main types of assistance from the fund: debt relief, bill reductions and support to purchase household items where needed. Each of these is aimed at helping different segments of our customers.

"Debt relief supports customers with a large debt that has built up through no fault of their own. For example, a customer may be the victim of domestic abuse, have a debilitating illness or have suffered a bereavement. They will never be able to raise the funds needed to pay the debt so we agree to write it off for them.

"Bill reductions are intended to support customers experiencing a short-term financial shock, typically through loss of employment or the death of the family's main earner. In this situation we can offer to reduce their bills by 50% for an agreed amount of time.

"We offer small grants to customers when we see a specific need. These are customers who have paid all their bills, and they are typically already on one of our support tariffs or schemes, and just need a little extra to replace a broken washing machine or cooker. We support by offering to purchase what's needed. In most cases we've purchased white goods, but we also bought one customer a bed as they were suffering with back problems.

"We take a different approach, depending on the particular needs of each customer; it's great to be able to offer direct support when we can."

Rachel Ryan-Crisp
Vulnerability Lead

Stakeholders impacted

50%
reduction in bills can ease short-term financial shock.

£240k
annual Hardship Fund supports our customers when they need it most.

Chair's statement

Welcome to our Annual Report and Financial Statements for 2021–22.

Read more about our **Capital Structure** on pages 102 to 107

Highlights

- Against continuing challenges, our transformation continues apace positioning the business for the upcoming price review and to deliver benefits to our customers.
- The acquisition of a majority stake in our parent company by a fund managed by Macquarie Asset Management in August 2021 is enabling us to increase investment and accelerate our business plans.
- Our effective incident response meant that fewer than 300 of our 2.6 million water customers experienced an interruption to supply during Storm Eunice.
- We are making good progress in meeting the obligations of our Section 19 undertakings with Ofwat as part of our continued focus on compliance.
- Strengthening of the Board.

"We have made ambitious delivery commitments backed up by new investment to help us drive customer benefits."

Keith Lough
Chair

Over the past year, Southern Water and the communities we serve have continued to face significant challenges. Throughout this time, the provision of essential services has continued, due to the commitment of our colleagues and suppliers. My thanks go to all those who have been part of this excellent team effort, for their dedication and hard work while taking care of the wellbeing of each and every person. We want all our people to feel comfortable with bringing their authentic selves to work every day, and respecting equality, diversity and inclusion.

While we have been moving out of the pandemic, Storm Eunice and other extreme weather events have tested our teams. The impacts of climate change and an increasing population in our region present real challenges, making protecting our water resources and fulfilling our purpose even more important.

Living and breathing our values of succeeding together, doing the right thing and always improving in everything we do, is helping us to rebuild trust with our stakeholders. This follows mistakes we made in the past, resulting in a record fine last year from the Environment Agency. Our focus is now on delivering for the here and now, and for the future.

The announcement of the acquisition of a majority stake in our parent company by a fund managed by Macquarie Asset Management in August 2021 has enabled us to increase investment and accelerate our business plans. This acceleration means we can take huge steps forward in reducing pollution incidents and leakage by improving the resilience of our network. This will have a positive impact for our customers, the local environment and the regional economy.

During 2021, we received the best bathing water quality results we have ever had. We know our industry needs to do more but to ensure that our rivers and seas are kept clean by reducing the use of storm overflows during heavy rain.

Keeping the environment at the centre

We welcomed the government's amendment to the Environment Bill in October, aimed at reducing any negative impacts from storm overflow releases over time. These releases, used by the industry when sewer networks struggle to cope with heavy rain, act as a pressure release valve to avoid flooding to properties and businesses. We recognise the negative impact of these releases on our rivers and seas is no longer acceptable. The regulatory and public scrutiny in this area demonstrates the need to find positive solutions as soon as we can. In November, we set up our own Storm Overflow Task Force, to take the lead in this area. Its groundbreaking pathfinder projects will require extensive partnership working involving many stakeholders, including other water companies, regulators, agriculture, industry and developers.

Looking forward to the next business plan period 2025–30, our environmental stewardship will be vital in achieving a water-resilient South East where the environment is protected and enhanced. Our new Independent Strategic Environment Group will inform and drive collaborative work in this area, accelerating actions to decarbonise as well as to adapt to climate change. We have already expanded our Catchment First programme, reflecting the importance of our catchment work and we are embedding natural and social capital decision-making into our day-to-day plans.

We have also formed a Customer and Community Challenge Group to help inform our next business plan. Sessions have already started and we will continue to have conversations with this group to focus on areas such as engagement with communities and plans for water efficiency.

Maintaining essential services for all our customers

Coming out of the pandemic, and in the wake of cost of living increases, we continue to support our most vulnerable customers. We know that higher fuel prices and living costs will all have an impact on our customers. Affordability is a priority for us, and we will continue to monitor the situation and provide direct support where we can.

Chair's statement continued

Read more on the **EA's investigations** on page 38

Read more on our **Sustainable Bond Impact Report** on pages 74 to 75

We saw some exceptionally severe storms during 2021–22, challenging our operational teams who work around the clock to keep our customers' taps flowing and toilets flushing. As a result of Storm Eunice, we lost power to 330 of our water and wastewater sites between Friday morning and Monday afternoon, as 112mph gusts of wind battered the South East of England. Despite this, our teams managed to keep water supplied to all but 300 of our 2.6 million water customers. They also managed to ensure that there were no major pollution incidents. This is something I am extremely proud of and I would like to thank everyone involved for their contribution.

We use digital channels to provide essential services to our customers and employees. Digital resilience and cyber security are therefore kept under constant review to make sure that we can keep everyone updated and supported.

Moving forwards

Our inaugural Sustainable Bond Impact Report updated our investors on how we are supporting the financing of our investments and activities to deliver sustainable outcomes across a number of our core priorities, including pollution prevention, compliance and leakage. The report shows that in addition to the £825 million of sustainable bonds issued in May 2020, we issued a further £300 million in March 2021. These funds contribute to our investments in our water and wastewater services to 2025.

We are making good progress in meeting the obligations of our Section 19 undertakings with Ofwat as part of our ongoing focus on compliance. Our work in this area is now focused on embedding new ways of working which help us maintain compliance and protect the environment. In accordance with our Section 19 Undertaking, we also published our latest environmental performance reporting data on our website in March 2022, showing pollution, final effluent compliance, flow and spill reporting data. We also published Defra's bathing water quality results.

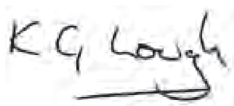
We remain under scrutiny as a company and as an industry. An Environment Agency investigation into our wastewater sampling compliance for the period 2013–17 is ongoing, and we continue to provide all possible assistance. As announced in the media in November 2021, all water and wastewater companies in England and Wales are subject to a separate investigation into flow at sewage treatment works and enforcement cases have been opened into six water companies so far, but not us. We have provided a significant amount of information to our regulator and will continue to assist with any investigations.

As we move into the third year of our five-year delivery plan, I would like to acknowledge the exceptional work done by our retiring CEO, Ian McAulay. The Board and I would like to thank him for the leadership and skill he has shown in carrying Southern Water through an enormously challenging period since he joined the company in 2017. He has led the transformation across the business and its culture, putting in place strong governance, operational and systems changes, which have enabled new investment in our business and from which we will now build. Ian's report as outgoing CEO follows mine.

The recruitment for a successor has been completed, with the appointment of our Chief Operating Officer, Lawrence Gosden, as CEO from 1 July 2022. This smooth succession will allow us to continue our capital investment programmes and transformation at pace. Lawrence's extensive knowledge and leadership within the industry will be invaluable as we drive the business forward. Importantly he will now lead us through the development of the next business plan for the period to 2030.

Our CFO, Sebastiaan Boelen, is also moving on and Nadim Ahmad will be appointed as interim CFO later in July 2022. I would like to thank Sebastiaan for his continuing careful stewardship throughout the past three years. More information about changes to our Board is available in the Corporate Governance section of this report on pages 125 to 175.

In closing, I would like to thank our colleagues and partners for demonstrating our company values throughout their work. The commitment and dedication of our people to support the communities we serve, continues to make a positive difference and the hard work is greatly appreciated.



Keith Lough
Chair
15 July 2022

Strategic Report

Chief Executive's summary

We continue to focus on delivering high-quality services for our customers and ensuring the safety and wellbeing of our employees, while protecting our precious natural resources.

"Our business is about creating a resilient water future for people, and protecting and enhancing the environment."

Ian McAulay
Chief Executive Officer during the reporting period.

Highlights

- Being part of the water industry's £7.1 billion investment, with our share of that being £2.2 billion invested across the region driving innovation and partnerships between 2020–25.
- Improving wastewater services with £1.5 billion of investment (as part of the above £2.2 billion) to upgrade our ability to process greater volumes of sewage and the capacity to store more storm water.
- Investing a further £700 million in continuing to deliver reliable supplies of clean drinking water, through routine maintenance and improvement work as well as fixing leaks.
- Bringing in significant investment of £1 billion into the Greensands group, including £530 million into the company, from a fund managed by Macquarie Asset Management, widening and deepening our investment plans. This includes an additional £230 million of investment, over and above the allowance set by the industry regulator Ofwat.
- Maintaining supplies and services for our customers in another year made difficult by COVID-19.
- Adapting our frontline operations and developing more flexible working styles for employees.
- Setting up our Storm Overflow Task Force to drive rapid reductions in flooding and the use of storm overflows.

The past year has seen us providing water and wastewater services – life's essentials – while we have been coming out of the COVID-19 pandemic. This has been a difficult time for our customers and our frontline employees have been working in challenging conditions.

We have set ourselves ambitious targets across several areas of our operations, with a particular focus on pollutions, leakage and reducing storm overflows. Our regulators, communities and the government have quite rightly been asking how our industry can improve performance to enhance protection of the environment while providing high-quality services to customers. The plans we will put in place and the initiatives contained within them, will require an appropriate funding structure to be agreed with Ofwat, our shareholders and our Board.

The prosecution of our company by the Environment Agency (EA) and subsequent fine in July 2021 for historic breaches during 2010 to 2015 has inevitably led to a need for us to rebuild the trust and confidence people have in us to act responsibly and transparently. We know that we need to focus on reducing pollutions, managing our assets and performance improvements, while protecting and enhancing the environment around us.

We have worked hard to transform our company culture to put in place processes that support several areas including self-reporting, and I am pleased to say that our high level of self-reporting is now recognised and scores above average for our sector. The regular updates from our culture dashboard act as a barometer of our company culture, helping us to keep track of our development and showing how we live our company values – succeeding together, doing the right thing and always improving. We continue to provide information via our website to inform customers and our stakeholders about our performance, and our online Beachbuoy service provides near real-time data to the public about bathing water quality.

Ensuring environmental resilience

Our commitment to protecting the environment is at the centre of our purpose and all the work we deliver. We have started to implement a natural capital approach throughout our business, creating our first Natural and Social Capital Framework and completing our first natural capital baseline assessment. This way of thinking will help shape our plans at a time when the climate and biodiversity around us are in urgent need of our protection, and we have increasing challenges due to a growing population in our water-stressed region.

Our Net Zero Plan, published in July last year, showed how we plan to reach net zero carbon emissions by 2030. Tackling carbon emissions is key to reducing the harmful greenhouse gases which cause climate change. That is why we have been involved in developing the sector's routemap to commit to zero operational emissions by 2030.

We have also made a commitment to zero pollution by 2040. Meeting this target will not be easy. Pollution reduction is an area where we have already made improvements and we published the third update to our Pollution Incident Reduction Plan (PIRP). The plan sets out how we will invest £145 million to 2025 in a series of projects to reduce pollution incidents. Last year we recorded 372 pollution incidents, and while this is a 7.5% reduction on the previous year, it is unacceptable and far from where we want, and need, to be.

Reducing spills from storm overflows is a key area of focus, where our dedicated Storm Overflow Task Force will develop groundbreaking projects in five catchments over the next two years, using natural solutions such as water gardens and swales to cut or slow the flow of water into our systems. This will support our industry's efforts to protect the health of our rivers and seas from pollution. We would also urge moves by Ofwat and the EA to ensure that there is a level playing field for reporting of pollution incidents and storm overflow releases.

Our Catchment Risk Management team is looking at a variety of projects to use nature-based solutions to challenges across different areas in our region, in both river water catchments and areas where we rely on underground (groundwater) sources, such as aquifers. To address the urgent threat to the natural capital of the harbours, we are working with local and national organisations in Pagham, Chichester and Langstone Harbours to develop a coordinated programme of action with the Save our Harbours summits.

Keeping our customers front of mind

We want to give a high level of customer service and maintain affordability in these challenging economic times. We are disappointed not to have improved our position in the Ofwat Customer Measure of Experience (C-MeX) table for the year finishing 16th out of 17 companies. We continue to invest in digital services as an enabler, and we are constantly improving self-serve options for customers to contact us.

The COVID-19 pandemic has had an impact on the wellbeing and mental health of people, and now inflationary pressures and world events will have a further impact on our customers' financial situation. In February we announced a fall in the average combined household bill for water and wastewater treatment services of £5 a month (1.3%), however we know that affordability is still an issue for many customers, particularly at a time when energy bills are increasing. We have reached out to those in need to include them on our Priority Services Register, increasing the number of customers on the register by 56%, and providing tailored financial support through our Hardship Fund and other schemes to 140,445 customers.

We make sure that we protect our water supply network for the benefit of our customers. Any attempts to compromise our network are taken seriously and we are prepared to bring prosecutions. Over the past year we have successfully prosecuted a company and an individual who unlawfully accessed our network.

Read more on **Save our Harbours** on page 31

Read more about our **customer performance** on pages 76 to 80

Chief Executive's summary continued

Read about our **ownership** on pages 104 to 107

Read more on **financial performance** pages 92 to 101

Our financial performance

As mentioned by our Chair, a fund managed by Macquarie Asset Management acquired a majority stake in our parent company during the year, investing over £500 million into Southern Water which will be used to enable us to increase our capital investment programme and accelerate our plans to make the necessary improvements to our operational performance, pay the Court fine and reduce gearing.

During 2021-22, we made a capital investment totalling a record £617 million, excluding capitalised interest, to upgrade our water and wastewater network. This aims to provide a better and cleaner service for our customers and local communities. The investment programme includes projects to reduce the levels of phosphorus discharged from our wastewater treatment works, upgrade treatment works to meet the needs of an increasing population and provide greater resilience during extreme weather events. It also aims to improve our resilience to water shortages, particularly in Hampshire, to reduce water we take from local waterways and increase expenditure to refurbish water and wastewater assets.

Our operating profits fell significantly to £16.0 million from £138.8 million in the prior year, largely because of the £90.0 million fine imposed following the Environment Agency's prosecution I have already mentioned.

Excluding the fine, operating costs increased by £19.8 million, principally from proactive maintenance activities to improve our wastewater compliance and pollution performance to reduce the risk of future equipment failures and pollutions from sewer blockages, as well as activities to support the catchment management, natural capital and Target 100 programmes.

No dividends were declared for the year, following the commitment by our Board that the company will not make dividend payments until it is clear that to do so will not undermine the company's financial resilience and our transformation programmes to improve both operational and financial performance.

Being brilliant at the basics – and more

Ensuring that we have resilient water sources long into the future is fundamental to what we do. The new reservoir planned at Havant Thicket as part of our Water for Life Hampshire programme is a good example of this. Working in partnership with Portsmouth Water, the new reservoir will enable us to maintain supplies to customers while protecting precious chalk streams.

While we are working to ensure our delivery of essential services to customers into the future, we know that our performance needs to get better. We have made improvements in our delivery, but in some key areas these improvements are still not reaching the targets set for us by our regulators.

We aim to reduce pollution incidents and minimise leakage. In both these areas, we improved our performance last year compared to the previous year, however we are still not meeting our targets.

Our wastewater treatment works compliance has improved from 10 failed works in 2020 to seven in 2021, however this remains above our target of zero.

In wastewater, we performed better than our regulator's target for the number of external sewer flooding incidents, due to continued efforts to improve resilience. However, internal flooding incidents increased in 2021, following several severe weather events over the summer period.

We must lower our Compliance Risk Index (CRI) score. This is only possible by reviewing the whole process from catchment level to customer taps. The importance of water in public health means we must continue to improve our disappointing CRI score. A key part of this is the upgrading of several of our sites. We are investing in major upgrades at both our Testwood and Otterbourne water supply works to be delivered by 2030.

Customers want and deserve a good, clean reliable supply of water, and it was positive that as well as seeing no more than 300 customers out of supply during Storm Eunice, we also met our unplanned water outage target. Our regulators have confirmed that our incident response during Storm Eunice was exceptional. In preparation for this storm, we made sure that our response was effective by being predictive, prescriptive and preparative.

We published our sustainable development policy in April 2022, explaining how property developers can work with us to promote water efficiency and neutrality for new homes. Our score for serving our developer customers (D-MeX) last year improved by 1.37, however our position remained static on 15th place in the overall ranking. We continue to implement our Developer Services improvement programme.

Protecting the environment is at the centre of our work, and we received the maximum reward for performing better than our target for water abstraction at the River Itchen, helping preserve our precious and unique chalk streams there.

We received a one-star (poor) performance rating in 2021 from the EA. This has gone down from the company's two-star (requires improvement) performance rating in 2020. Our one-star EPA rating is due to four red metrics; pollution, serious pollutions, supply demand balance index (SDBI) and treatment compliance. As a company committed to protecting the environment and serving our customers, we were disappointed by the assessment, but are striving hard to continue to drive improvements and this is reflected in good signs of performance in 2022.

I am confident that our new ESG Committee will provide valuable oversight of the development and delivery of our sustainability ambitions.

Challenges we face as a business

Climate change and population growth are a dual threat meaning that the future holds many challenges. We have been working with local stakeholders to look at how we can take steps towards water neutrality. This means reducing the amount of water we use, and making water saving and recycling part of our daily lives.

To help sustain clean water, reduce floods, capture carbon and provide wildlife habitats, we have created a £5 million Environment Improvement Fund that is delivering projects to protect the natural environment in Kent, West Sussex and Hampshire over the next three years.

Our programme to support and incentivise customers to reduce their personal average daily water use to 100 litres by 2040 aims to reduce water consumption by 7% by 2025 and upgrade all our meters to smart meters. At the same time, we have been working hard to reduce leakage, fixing a record 12,000 pipes.

Reducing blockages is the focus of an ambitious scheme to identify emerging risks, by rolling out up to 22,000 sewer level sensors in Kent, Hampshire, the Isle of Wight and Sussex.

Reflections on the year and our future priorities

We have entered year three of this current business plan period, and we need to make sure that we deliver fully on our commitments. Building the strategy towards the next business plan period will require extensive planning to meet the environmental challenges we are facing, including climate change, water neutrality and net zero. Our refreshed environment strategy will help guide us along an adaptive planning pathway.

Working together as a team, it is our people that make the business work, and I am exceptionally proud that we are again rated among the Inclusive Top 50 UK Employers. We continue to provide learning and development for all our employees. Over 8% of our people have started or completed an apprenticeship in the last 12 months and a new management academy is being put in place.

It has been a privilege to have spent 37 years in the water and environment sector, and to have been able to lead Southern Water since 2017. I would like to thank both the Board and my colleagues for the support they have shown to me in that time. The time is now right to hand over the reins and I wish Lawrence success in his new role as CEO and have every confidence that he will drive ever increasing levels of performance going forwards.

I am confident that we have a strong foundation for high-quality performance to take us towards the resilient water future that we need to have in the South East. I would like to thank our employees and suppliers for their hard work and commitment. I know we can move forwards to give our customers and our communities the service and public value they deserve, delivering better and faster into the future.

Ian McAulay
Chief Executive Officer
30 June 2022

Note: Ian McAulay retired as Chief Executive Officer on 30 June 2022. Lawrence Gosden was appointed as Chief Executive Officer on 1 July 2022.

Read more about **our people** on pages 62 to 65

Our journey of transformation

We are **committed to transparency** and openness with our customers and stakeholders

Resilience is at the centre of our strategy to become brilliant at the basics while transforming key areas of our business. We believe there is a substantial opportunity to adopt a more integrated approach to the way we deliver our services over the 2020–25 business plan period; using circular thinking to look at the bigger picture, and how we might collaborate with our peers and other industries to deliver joint solutions to some of our bigger challenges.

Improving our operational performance

A number of key strategic projects delivering improvements in network digitalisation, logistics and asset maintenance were agreed by the Southern Water Board in 2020, and programmes to deliver them are now well under way.

Read more about **how these projects are improving our performance** on pages 76 to 91

Asset maintenance

A well-operated and maintained asset system is critical for us to deliver on our vision.

This is why we have been working hard to get a better understanding of our assets by improving the data we capture. It means we can now be more proactive, creating detailed asset care plans for our sites.

Logistics

We are in the process of setting up a new logistics function.

That will ensure our field teams have access to the right equipment to maintain our assets, when and where they need it.

Digitalisation

More than 100 sewer-level sensors were trialled during 2021.

And in January 2022 we began the roll out of 22,000 of them across our network. This is allowing us to spot any weaknesses or failures so we can proactively fix issues before they impact our customers or the environment.

Monitoring our bathing waters

To build on the success of our Beachbuoy bathing water monitoring service.

We are now working with local authorities and the Environment Agency to trial new real-time water quality testing technology at key points along our coastline.

Changing and measuring our culture

We are focused on improving our performance, behaviours and compliance, building on our values, and this is reflected in our quarterly 'measures of culture' dashboard. Metrics such as levels of colleague engagement, integrity, understanding of our values and our Code of Ethics help to give us a routine temperature check and enable our leadership to take proactive steps to positively influence our culture.

We have focused on helping our employees connect with our purpose and values through regular Values Awareness Weeks and Star Awards over the past year. Our Learning and Development team has reviewed our manager training to incorporate practices and processes that further promote equality and diversity, and our customers and the environment sit at the heart of everything we do. Ethical business practice material has now been integrated into wider management training information, and a stand-alone module on 'handling concerns' has been developed and is being piloted.

Our Health, Safety, Security and Wellbeing team conducted a survey to better understand the needs and concerns of colleagues at every level of the business. The findings are now being used to update many of our existing processes and guidance documents.

In terms of improving governance, we have added an assessment of maturity in Ethical Business Practice to our Statement of Compliance return templates to our regulators, to encourage review and targeted focus. Our policies related to 'business conduct' have also been reviewed and this has led to the expansion of our Code of Ethics, while development of our Speak Up whistleblowing process has increased our focus on investigation and risk review.

We continue to work closely with the Institute of Business Ethics (IBE) as we embed our ethical business practice and consolidate our three-lines of defence assurance model. We have also consulted with the IBE on core aspects of our programmes including best practice on bullying, harassment and discrimination.

Read more on pages 156 to 157

Reducing pollution incidents

We published our first Pollution Incident Reduction Plan (PIRP) in August 2020 and have just published our third PIRP update. The plan aims to significantly reduce the volume of pollution incidents. In total £145 million will be invested to improve performance and drive down pollutions to 2025.

Our PIRP has progressed from concept and team set up in year one, through a pilot phase in year two with multiple initiatives tried and tested, to targeted delivery in year three. There are currently three strategic programmes under way, which are driving improvements in terms of the digitisation of our network, updates to our control room, and planned preventative maintenance.

Many initiatives have become well embedded as part of business-as-usual including pollution awareness training programmes and the introduction of an operator framework aligned to external NVQ standards. The investigation team has been restructured to include a 'human factors' investigator, and considerable improvements have been made to processes to introduce more timely and accurate reporting of root cause analysis so immediate actions can be taken and built into future iterations of the plan.

There are five areas of focus for our year-three PIRP; the most immediately impactful of which will be the 'Top 250 Wastewater Pumping Station Upgrade' and network cleaning programmes. The upgrade programme focuses on any site that has had a pollution incident in the past three years, with a forecast spend of £15 million.

Other areas of focus will be wastewater treatment works inlets, reducing pollutions from spills and so-called 'black start' programmes identifying issues with power outages on site.

Read more on page 84

Transparency and accountability

Our performance is independently scrutinised by a number of regulators including Ofwat, the Environment Agency and the Drinking Water Inspectorate. We supply these regulators and our wider stakeholders with regular updates throughout the year.

Read more about our **stakeholder engagement** on pages 46 to 47

Our business model

How we **create and protect** value

What drives us

Our purpose is to provide **water for life** to:

enhance health and wellbeing

protect and improve the environment

sustain the economy

Our purpose is why we exist. It drives our long and short-term decision-making and is centred around the value we provide to our customers and stakeholders. Living our purpose ensures that we are able to deliver water for life and our vision of a resilient water future for our customers in the South East.

The external environment

The way we operate as a business is impacted by a number of external factors – social, political, environmental, economic, regulatory and technological – that we must consider and manage the impact of.

Read more about **our external environment** on pages 36 to 43

What we rely on:

For any business to be truly sustainable it needs to consider its impacts and dependencies, and this means going beyond tracking financial and operational measures to consider social and environmental measures, such as the six capitals outlined below, as they can affect the ability of our organisation to create value over time.

Natural

Natural resources that we rely on, such as water.

People

Skills, capabilities and wellbeing of our employees and partners.

Financial

Financial health, including equity, debt and pensions.

Manufactured

Sites, equipment, networks and IT.

Social and Relationship

Engagement, our reputation and the value we create for our communities.

Intellectual

Knowledge, systems, processes, procedures and the data we hold.

Key relationships:

Understanding what matters most to our stakeholders is fundamental to us living and breathing our purpose and achieving our vision of a resilient water future.

Our stakeholders

Stakeholders that influence what we do

- Customers
- Environment
- Regulators
- Regional stakeholders
- Investors

Stakeholders we generate value for

- Customers
- Communities
- Environment
- Employees
- Retailers
- Suppliers

Read more about **our stakeholders** on pages 46 to 47

How we are creating value

What we do:

We provide essential water services to 2.6 million customers, and wastewater services to more than 4.6 million customers across Kent, Sussex, Hampshire and the Isle of Wight.

See our **water cycle** on pages 32 to 33

How we do it:

Our Water for Life Business Plan 2020–25 takes us one step closer to achieving our vision of a resilient water future for customers in the South East. Developed following extensive consultation with our customers and stakeholders, over the five-year period it will deliver significant performance improvements, including a 15% reduction in leakage, improvements to 183 kilometres of rivers and a further 155,000 customers supported through financial assistance schemes, with bills reducing by 18% in real terms.

Our five-year strategy

- **Deliver great service**
- **Use water wisely**
- **Protect and improve the environment**
- **Fit for the future**

Embedding risk and value processes into operations

Our risk and value (R&V) process underpins how we deliver our services. It improves our decisions about how to invest, build and run our business, and allows us to collaborate more effectively with our suppliers and partners.

Our approach to sustainability

Making sure we know what matters most to our customers and stakeholders is vital to us achieving our vision. We must consider their priorities alongside those of our business, as well as our ability to create value in the long term.

Read more about **performance against our five-year strategy** on pages 76 to 91

Delivering for our stakeholders

The water cycle touches and enables every part of life, so our stakeholder base is diverse.

Customers

Our customers expect us to deliver wholesome water and effectively remove wastewater. They want us to deliver services sustainably, at affordable prices while supporting those in vulnerable circumstances.

Communities

Water for life is a shared responsibility which means we must build partnerships in our communities with interest groups and local charities as well as future customers. Our employee volunteering programme helps us to connect with our communities.

Regional stakeholders

Our work, and the land we manage, impacts a wide variety of regional stakeholders, from county and parish councils to farmers and developers. We engage with them to develop and execute our plans.

Retailers

Retailers provide customer and billing services to non-household (commercial) customers across our region. We provide wholesale and emergency services to their customers.

Employees

We know we must attract, develop and retain a diverse and inclusive workforce. We are also responsible for looking after their health, safety, security and wellbeing.

Suppliers

Our construction and maintenance programmes generate jobs, skills and income for our supply chain and the local economy. We rely on our suppliers to deliver our services.

Environment

Our natural environment, including reservoirs, river catchments and bathing waters provide spaces for wildlife, recreation, and create value in terms of tourism. We work hard to protect and improve them while delivering our essential services.

Regulators

We have a number of regulators, and their priorities help define our business plans so we must constantly look to engage and influence them, where we can.

Investors

To add value for our investors, we manage risk and provide an appropriate return, when we can. We invest their money to provide for growth and resilience. Regulatory price controls help to align shareholder value with customer and environmental priorities.

Our business model

Thinking and planning more holistically

Using multi-capitals thinking to ensure responsible decision-making

Read more on page 55

Our approach

It is becoming obvious that standard financial accounting practices are failing to fully take account of the impacts and risks associated with our natural and social resources. Using multi-capitals thinking is helping us to keep our responsibilities to customers, our communities and the environment at the forefront when making business decisions. Through a better understanding of Southern Water's impacts and dependencies on the six capitals – natural, social, human, intellectual, as well as financial and manufactured – we can more easily see any trade-offs, supporting the development of a sustainable long-term approach to planning.

The six capitals

- Human
- Intellectual
- Social and Relationship
- Manufactured
- Financial
- Natural

WATER for LIFE

from Southern Water

Examples of where we have considered multiple capitals

Transitioning to a six capitals approach to decision-making requires us to think differently about traditional cost models and to assign value in areas which Southern Water and the wider industry have not traditionally operated. The first challenge is how to accurately assign value to something like the broader benefits we bring to the communities we serve beyond our core services; or the amenity value or the biodiversity value of the green spaces we own.

In January 2022 we published our natural and social capital framework. This outlined a roadmap for how we will embed evaluation of these two capitals into our decision-making going forward. This is a huge step forward and is already influencing our Risk and Value (R&V) process. In February we began three pilot studies to run our usual R&V process through this new framework. The results of the pilot are due later in 2022 and will help shape our investment decisions in the build up to the next business plan period (PR24).

Future plans

We are facing a climate emergency and biodiversity crisis, as well as complex and evolving risks from population growth, ageing infrastructure, growing inequality and the short- and long-term impacts of the COVID-19 pandemic. Our customers, stakeholders, investors and regulators are increasingly demanding that we operate in a way that creates public value.

While we are already incorporating elements of, and metrics relevant to, the six capitals approach within our existing decision-making and reporting, the key challenge is to work with our regulators and our peers to develop a consistent and systematic approach across the industry.

UK Water Industry Research (UKWIR) has commissioned a team to develop a future Asset Planning Framework based around multi-capitals thinking, which will provide a common framework for asset planning and investment decision-making as the water industry begins to plan for its next business plan period 2025–30.

CASE STUDY

Protecting and improving the environment

Working in partnership to improve the health of our harbours

"The rare chalk stream catchments of the south coast and the internationally significant harbours into which they drain are unique features of our region. We rely on the healthy function of these ecosystems to provide essential water and wastewater services.

"The harbours of Chichester, Langstone and Pagham are already protected but despite this they are in decline. Population growth, declining water quality and climate change are all contributing factors, but we recognise that we have a crucial role to play so this year we set in motion ambitious plans to reverse that decline and restore the harbours.

"Working in partnership, we pulled together a summit of 18 key stakeholders to agree a shared vision for the recovery of the harbours by 2030. As well as funding and facilitating the new partnership, we also commissioned the first ever full-scale natural capital baseline assessment of the harbours. Published in February 2022, this is guiding investment of our £5 million Environmental Improvement Fund – also created this year – to find nature-based solutions to the water quality challenges in the catchments of the harbours.

"Alongside existing investment in treatment and network improvements, we believe the leadership role we have taken, by setting up the summits this year demonstrates our commitment to be a force for good in the communities we serve, and go beyond our regulatory obligations when we know it's the right thing to do for the environment."

Henry Badman
Senior Environmental Strategy Specialist

Stakeholders impacted

£5m
Environmental Improvement Fund to help improve river health across the south and in the harbours.

18
key stakeholders have been involved in the summits.

Our business model

The water **cycle**

Our vision is to create a resilient water future for our customers in the South East

Water is collected

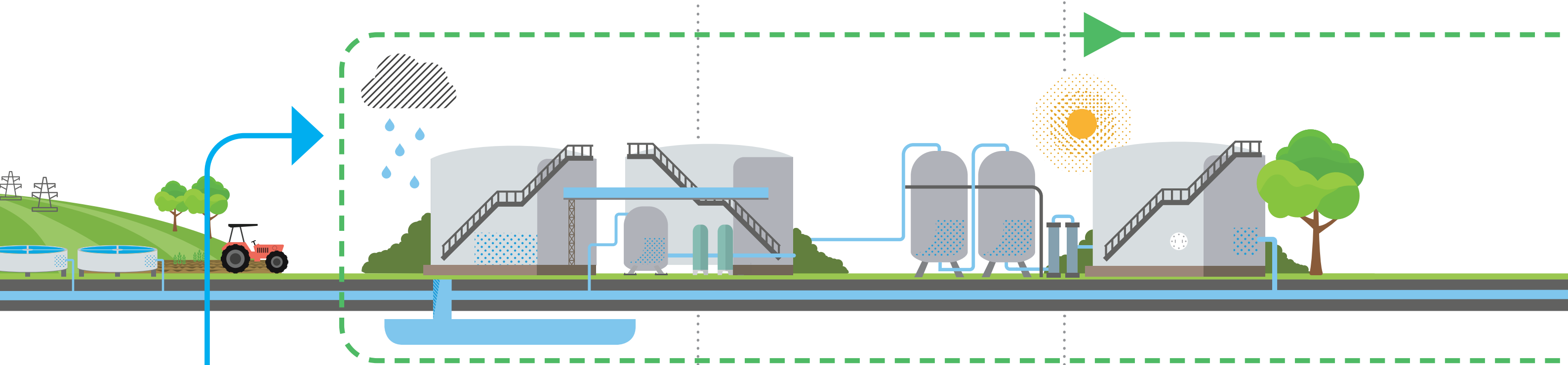
About 67.4% of the water we supply comes from groundwater (water stored underground in aquifers), 28.2% is taken from rivers and 4.4% comes from our reservoirs.

Water is cleaned

Our 80 water supply works treat raw water to the highest standards, making it safe to drink.

Clean water is put into the supply

Our 13,866-kilometre network, 205 service reservoirs and 697 pumping stations deliver a continuous supply of clean water to our customers at a regulated pressure level.



Associated risk

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 resources.

Associated risk

Failures at our treatment sites and across our network could result in a risk to public health due to reduced water quality and/or disruptions to supply. We use several chemicals in the treatment of water which, if not handled correctly, could result in injuries to employees and/or customers. Area-specific risk assessments inform our monitoring programme, ensuring we are sampling for relevant substances to make sure we are treating water correctly.

Associated risk

If we fail to meet required standards, public health could be put at risk, our customers could experience supply disruption or a reduced water quality. We may also experience increased leakage from our network.

Maintenance and development

We constantly monitor our sites and networks, conducting maintenance and developing new assets and equipment to make sure they are meeting the standards set by our regulators. Failure to monitor, maintain and increase the capacity of our sites and networks could pose risks to public health, and result in disruptions to supply, injury to our employees or customers, and damage to property.

Our use of water and its return to the environment is a continuous cycle. Managing our impact at every stage is critical to protecting future resources. Our environment is constantly changing, and it is essential that we continue to adapt and prepare for the challenges of population growth and climate change.

Customers enjoy our water

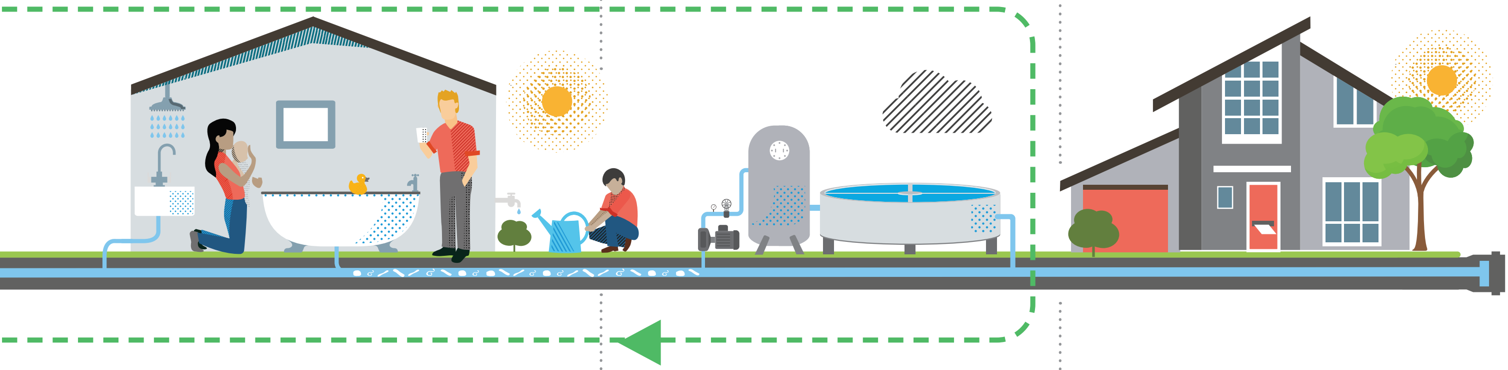
Customers across the South East go about their daily lives enabled by a supply of safe, clean drinking water and the removal of wastewater from their homes and businesses. In 2021–22, we put 556 million litres per day into supply.

Wastewater is collected and treated

Our 39,900 kilometres of sewers and 3,476 pumping stations collect wastewater from our customers' homes and businesses, and from the drains outside. Each day, 1,371 million litres of wastewater is received at our 367 treatment works, meeting strict environmental standards before being returned to the environment.

Customers are billed

Our Customer teams calculate and distribute customers' bills, handle payments and manage any related account queries.



Associated risk

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 protect rivers and bathing waters.

Associated risk

If we do not remove wastewater effectively and manage our network, we may cause sewer flooding, environmental pollution and unnecessary distress to our customers. Potentially hazardous substances and processes are used that could cause injury. Varying rainfall patterns, extreme weather events and rising sea levels all contribute to an increased risk of flooding if our infrastructure is overwhelmed. This could also lead to contamination of water supplies and infiltration/inundation of our sewers and sites.

Associated risk

Errors in our billing calculations or customer information could lead to poor levels of customer satisfaction, and a rise in contact and complaints, which could damage the company's reputation and increase our operating costs. Failure to properly protect customer data could also lead to significant fines under Data Protection (GDPR) and Networks and Information Systems (NIS) directives.

Ensuring future supply

Climate change and population growth in the South East present very real challenges that initiatives like our Water for Life – Hampshire programme are looking to address through bulk water transfers with neighbouring water companies, water recycling projects and a host of other initiatives, all of which will be needed to secure reliable water supplies for the future. We are also working to reduce the amount of water lost through leaks on our network, and we are working with our customers to help them use less water.

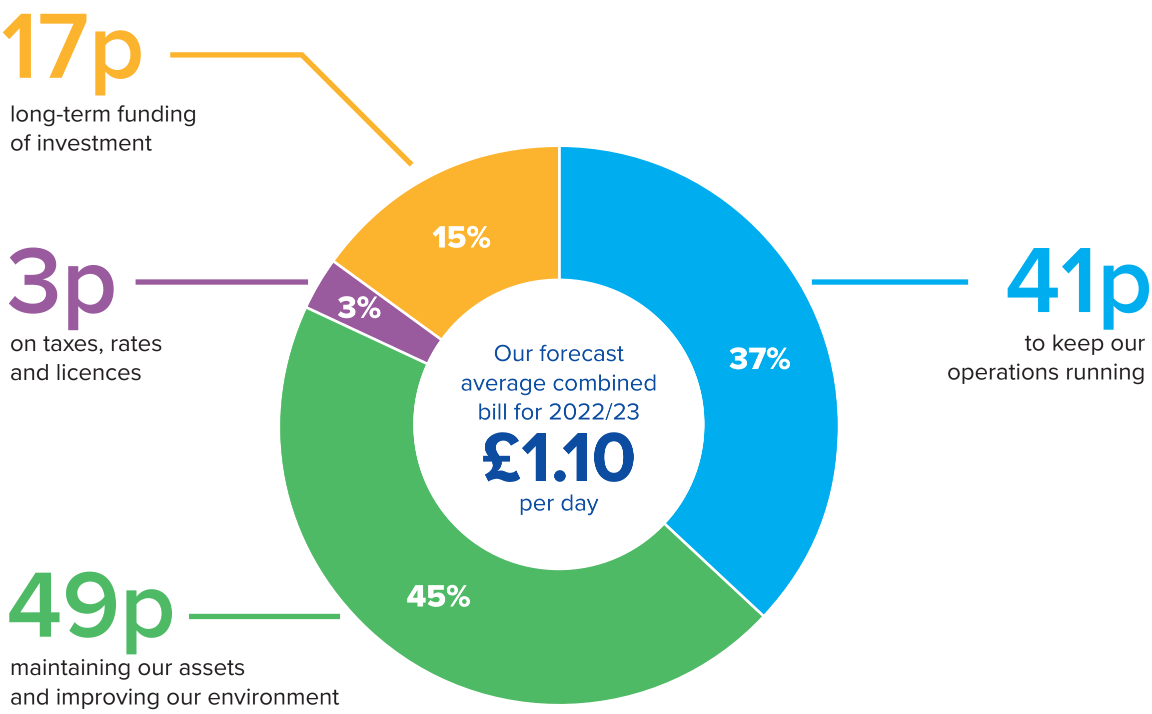
Associated risks

At each stage of the cycle there are several opportunities and risks, including penalties and rewards applied by Ofwat where we fail to meet or exceed performance targets. We always seek to maximise opportunities, while also identifying, managing and mitigating any risks.

Our business model

Read more about our **performance** on pages 76 to 91

Where our customers' money goes



On average, our customers will pay £1.10 a day for us to provide wholesome drinking water and take their wastewater away in 2022–23.

CASE STUDY

Protecting the environment

Tackling blockages at a local level

"We've just entered year three of our Local Area Catchment blockage reduction programme. Year two was bigger than ever, reaching 10,000 properties, in nine discreet blockage hotspot areas and talking to more than 4,000 customers on their doorsteps.

"We send out letters and advertise in local media before we visit each location, and then we walk the streets. The team is out literally lifting manholes to find blockages, carrying out sewer flushing and speaking to customers as they go door-to-door. We also distribute leaflets and hand out gunk pots that help people to store and dispose of their unwanted fat, oils and grease rather than putting it down the drain.

"Although it will take time for us to see the long-term impact of these visits, we know that customers really respond to them. We carried out a survey recently in those areas we'd already visited and we used the customer feedback to update our letters and leaflets. We piloted this approach in year one, we've hit nine areas in year two and we plan to expand to 12 areas over the coming year.

"The same team also visited a number of historic hotspots across our region, visiting a further 5,600 customers to discuss the impact of blockages."

Elvira Gabos
FOG and Unflushables Manager

Stakeholders impacted

10,000
properties reached.

12
new areas will be visited in 2022–23.

Our external environment

The water sector

Water and wastewater services are provided by a number of companies, serving more than 25 million households and commercial customers in England and Wales. There are currently 11 licensed water and wastewater companies, with some smaller licensed companies providing water-only services to customers.

Since the industry was privatised in 1989, a regulatory framework has been in place to ensure that customers receive a good standard of service at a fair price, managed by the industry economic regulator Ofwat. This framework has seen these water and wastewater companies invest billions of pounds maintaining and improving sites, technology and services, and, in turn, enhancing the environment.

The challenges of population growth and climate change mean that the water industry must significantly change the way it operates over the coming years. As a result, the policy landscape is continually evolving. The 25-Year Environment Plan, Environment Bill, review of the Water Industry National Environment Programme and preparation for the next business plan period 2025–30, are just some of the key drivers for change in the water sector and beyond.

In 25 years from now, within Southern Water's region, we are anticipating losing a third of our water sources as a result of climate change. We will also see a reduction in the amount of water we are allowed to take from rivers and underground sources, and our population will have grown by 15%. Without action, we predict a supply deficit by 2030, equivalent to around 50% of our current supply.

We are working proactively with the rest of the sector, regulators and others on workable solutions to these challenges, which we simply cannot solve alone. Concerns around storm overflows and chalk streams are examples where a multi-sector approach is essential, and we fully support the government's efforts to facilitate a collective response.

We are actively exploring new ways of working including through nature-based solutions and natural capital approaches, such as wetlands creation, river restoration projects and tree planting, as part of our long-term planning. We are also part of a sector-wide commitment to deliver net zero water and waste services by 2030.

Read about **how we engage with our regulators** on pages 43 to 44

Working with our regulators

We are subject to regulation of our price and performance by economic, quality and environmental regulators, as outlined below.

The Department for Environment, Food and Rural Affairs (Defra) determines the overall water and sewerage policy framework in England, setting standards, drafting legislation and creating special permits, such as drought orders. **defra.org.uk**

Ofwat is the economic regulator of the water and sewerage sectors. It protects the interests of consumers by promoting appropriate competition, making sure water companies properly carry out their functions and ensuring they have the adequate finance in place. **ofwat.gov.uk**

The Environment Agency is the environmental regulator of the water and wastewater sector in England. It is the principal adviser to the government on the environment, and the leading public body improving and protecting the environment of England. It works with a range of organisations to reduce flood risk, promote sustainable development, and secure environmental and social benefits. **gov.uk/government/organisations/environment-agency**

The Drinking Water Inspectorate is the drinking water quality regulator and enforces the Water Quality Regulations set by the Government. To do this, it checks the tests carried out on drinking water by water companies, along with carrying out company inspections. **dwi.gov.uk**

The Consumer Council for Water represents water and wastewater consumers. It also investigates consumer complaints that have not been satisfactorily resolved by water companies. **ccwater.org.uk**

Natural England advises the government by providing practical guidance, grounded in science, on how to best safeguard England's natural wealth. Its purpose is to protect and improve England's natural environment and encourage people to enjoy and get involved with their surroundings. **gov.uk/government/organisations/natural-england**

We consider and **manage the impact** of our external environment

Political environment

Decisions made by politicians have the potential to significantly impact the way we operate. We must ensure that we follow any directions set by government, and that we adapt quickly to policy developments. As a result, we work closely with regional and national policymakers to understand the development of any policies that will have an effect on our business, while ensuring they understand the economic, environmental and social value we deliver for our communities in the South East.

Social environment

As a provider of essential services, we have a direct impact on our local communities. We also own, or help to manage, pieces of land found in areas of natural beauty or environmental significance that are valued and enjoyed by both residents and visitors to our region. As a result, we must consider what matters to all of these stakeholders as we deliver our services today and plan for the future. This means continuously building relationships and ensuring we consult with them in the development and execution of our plans.

Regulatory environment

We must operate as a sustainable business. This means being responsive to regulatory changes, and working with our regulators to understand and prepare for future challenges while ensuring we fulfil our current regulatory requirements. Our relationships with our various regulators – economic, drinking water quality and environmental – are vital to ensure the resilience of our business and we work closely with them through consultations and regular meetings, to share our progress and our plans for the future, as well as influencing market reform where we see opportunities.

Economic environment

Like any other business, we are impacted by changes in investor markets, interest rates, inflation and other market rate movements, and we must manage these to reduce risks to our financial stability and protect our investors' interests. We must also pay attention to the economic climate as it will have a direct impact on our customers and their ability to pay their bills. We know that there are a number of areas across the South East experiencing high levels of deprivation, particularly as a result of COVID-19 and recent increases in energy costs, so we make it a priority to offer support and advice to our customers who might find themselves in vulnerable circumstances.

Innovation and technology

We are always improving our services, taking advantage of new technologies and innovative ideas. We know these could come from anywhere – from our customers, across different industries and different countries, as well as ideas from colleagues within our business. Innovation is very important to us, as one of our three core values is 'always improving', which is why we set up our own bluewave innovation hub, bringing design thinking to projects across the business. We also know that new technology brings with it a number of risks, and we are focused on continuously improving our cyber security to meet the needs of the business.

Environmental factors

Our natural environment is under pressure from population growth and climate change. We must continue to adapt and prepare to manage their future impacts. This includes taking action to plan for and mitigate climate change by reducing our own emissions and the environmental impact of our operations. The water cycle is continuous so we must ensure that we are removing water from, and returning it to, the environment safely and responsibly. We must also make sure that we are engaging with all stakeholders to reduce our collective impact on the water environment.

Our external environment continued

Since 2017, our Chief Executive Ian McAulay has been leading the transformation of Southern Water focused on a thorough review of people, processes and systems.

Read more on pages 245 and 249 of the financial statements

Regulatory investigations

As has been reported previously, Southern Water was subject to a detailed investigation by the Environment Agency (EA) regarding permit breaches at some of our wastewater treatment works in two regions during the period 2010 to 2015. On 9 July 2021, the company was sentenced and fined £90 million plus £2.5 million of costs for these historic offences.

As has also been reported previously, we continue to assist the EA in its separate investigation into legacy issues relating to wastewater sampling compliance for the period 2013 to 2017. This is ongoing and we do not know when the investigation stage will be concluded, and we do not know if or when any charges against the company are likely, or how many charges may be brought. The EA has not stated what its intentions are so far as the next steps in the investigation are concerned, and as a consequence the Board has concluded that it is not yet possible to make a reliable estimate of any financial obligation that may arise from this investigation, but will keep the situation under review.

As has been reported in the media, in November 2021 the EA and Ofwat launched an investigation into flow compliance at sewage treatment works belonging to all water and wastewater companies in England and Wales. In March 2022, Ofwat opened enforcement cases into six water companies; Southern Water was not one of those companies. However, all water and wastewater companies in England and Wales remain subject to ongoing investigations as they continue to review the information they have gathered.

In May 2018 chlorate was detected at High Park reservoir. The Drinking Water Inspectorate (DWI) brought a prosecution for a breach of Regulation 31 Water Supply (Water Quality) Regulations 2016 in relation to the storage and use of Hypochlorite at the High Park booster station. The DWI did not pursue a case for unfit water. A guilty plea was entered on 24 May 2022 and the court issued a fine of £16,000.

CASE STUDY

Enabling a supply of high-quality water for the future

Working together to reduce our use of storm overflows

"We're already seeing the effects of climate change and significant population growth adding more pressure to the sewer system and we know that these issues will likely only get worse. That's why we've teamed up with local authorities and partners across our region to find new and innovative solutions to managing this issue – and created our Storm Overflow Task Force.

"We know that our customers and our regulators want us to reduce our use of storm overflows, which is why we're already working to deliver this, with five groundbreaking projects being implemented across the region over the next two years. These projects will reduce the amount of surface water, from road and roof run-off, entering our sewer network during a storm, reducing the need to use overflows and also helping to reduce flooding.

Stakeholders impacted

"There are three main types of interventions that these projects will be looking to use:

- **Source control** – removing and slowing the flow of rainwater through rainwater harvesting, permeable paving, green roofs, etc.
- **Optimisation** – making better use of our existing networks through better management of connections, our equipment on site (such as pumps) and smarter networks with increased monitoring and alarms in place.
- **Enhancements** – building better and bigger sewers, storm tanks and treatment works.

"In partnership, we'll also promote simple actions that everyone can take to help, such as installing water butts to recycle rainwater or reducing the amount of paved gardens and driveways.

"A number of trial sewer lining projects have already started in North Hampshire, and we'll be launching a series of interventions in Kent over the summer."

Dr Nick Mills
Head of the Storm Overflow Task Force

5
Pathfinder projects will trial interventions across our region.

Our external environment continued

We've identified the main factors that affect our business now and in the future

Engaging customers

Through continuous engagement with our customers, we know that they have become more interested in their essential services and the importance of them to overall health and wellbeing, driven by the impacts of COVID-19 and recent increases in the cost of living. We also know that they have been using more water at home, and we have seen a greater desire for them to participate in the protection of future water resources through recent consultations, as well as our blockage prevention and water efficiency campaigns.

What really matters to our stakeholders (material issues):
Health, safety, security and wellbeing; Public health; Affordability and vulnerability; Trust, transparency and legitimacy; Water use

Affected capitals:

How we are responding:

- We used a new framework to help us to see the impact of COVID-19 on our customers' water use. It showed that, compared to the average for the prior three-year period, 2020–21 had seen an overall 8% uplift in individual daily usage.
- Throughout 2021–22 our water efficiency campaigns focused on raising awareness about the benefits of water-saving behaviours on the environment, reinforcing the key message that saving water, saves you money and cuts carbon.

Read more on pages 81 to 82

- Our Drought Plan consultation revealed that our stakeholders want more consistency between our Water Resources Management Plans and our Drought Plan; more information on the environmental impacts of drought permit and order options and more clarity around our dependency on these permit and order options in Hampshire.

Read more: **southernwater.co.uk/our-story/water-resources-planning/droughtplan**

Affordability and vulnerability

As a result of the impacts of COVID-19, the rising cost of living and hikes in energy prices, we know that many of our customers have been put under enormous financial pressure. We have made it a priority to offer support where we can, and we are reducing our bills over the next five years by 18%. Our focus over the past year has been to offer tailored support, working in partnership with other support organisations in our communities to reach more of our customers who find themselves in vulnerable circumstances. As a result, we continue to grow both our Priority Services Register and the number of customers on our support tariffs and schemes.

What really matters to our stakeholders (material issues):
Affordability and vulnerability; Diversity and Inclusion; Customer service; Energy and water use; Data protection

Affected capital:

How we are responding:

- Our Vulnerability team went straight back out into our communities following the easing of lockdown restrictions, attending Food Banks and Job Centres in order to deliver support directly to those who needed it most.
- We continue to directly case manage our most vulnerable customers, ensuring those who are struggling financially have payment plans and discounts that work for their own individual circumstances.

Read more on page 79

- We set up a Customer Hardship fund – providing debt write-offs, bill reductions or household goods for our customers who are struggling.

Read more on page 17

Key to our capitals

In order to create an integrated view of the value we create, we are starting to use the following stocks of value or 'capitals' that can be affected or transformed by our activities and outputs.

Natural · People · Financial · Manufactured · Social and Relationship · Intellectual

Increasing customer expectations

We know that we are in a privileged position as a monopoly provider of essential services to our customers. This position comes with a responsibility to make sure that we deliver the best possible service, while protecting the environment and keeping bills affordable. In order to do this, we need to always improve our internal capabilities, how we do things and the technology and systems that enable us to keep our customers' taps flowing and toilets flushing.

What really matters to our stakeholders (material issues):

Customer service; Affordability and vulnerability; Data protection; Energy and water use

Affected capitals:

How we are responding:

- Our average combined household bill for water and wastewater treatment services fell by £5 (1.3%) this year.

Read more on page 34

- We have made significant changes to the Your Account portal based on direct customer feedback.
- We have launched a new FAQ service on our website, using AI technology, to help our customers find what they need, faster.

Read more on page 78

Securing long-term resilience

Our customers expect us to maintain a level of service and this means having plans in place to adapt to the challenges of population growth and climate change, as well as mitigate any potential risks, both internal and external. We do this by developing a rich understanding of the connection between our processes and the wider community around us by building partnerships across sectors, for example through regional water resources and drainage management planning.

What really matters to our stakeholders (material issues):

Climate change; Public Health; Biodiversity and natural capital; Responsible supply chain; Water use; Political and regulatory environment; Local economies; Energy use; Stakeholder engagement and networks

Affected capitals:

How we are responding:

- Through Water Resources South East, we are collaborating with our neighbouring water companies to manage the region's water resources, ensuring an affordable, resilient and sustainable water supply.

Read more: **wrse.org.uk**

- We are already making connections to neighbouring water company networks in water-stressed areas to increase supply during periods of high demand.
- Our Water for Life Hampshire programme is developing a new network of water mains across the region.

Read more: **southernwater.co.uk/our-story/water-for-life-hampshire**

- We are consulting with stakeholders across our region on our Drainage and Wastewater Management Plans to ensure we reduce flooding and pollutions in the future.

Read more: **southernwater.co.uk/dwmp**

Our external environment continued

Transparency and accountability

We know that our past behaviours and legacy reporting failures mean that we need to rebuild relationships with our stakeholders based on trust. This means being open, honest and transparent, and this is something we take very seriously. We know we still have some way to go to address stakeholder concerns regarding our pollution performance and wastewater treatment compliance, in particular. We also know that questions have been raised about the ownership structure of the sector, and our regulator, Ofwat, has called for further transparency around board leadership and decision-making processes. We are committed to providing clarity on these issues and we continue to report openly, setting out our performance commitments and delivering year-on-year improvements.

What really matters to our stakeholders (material issues):
Compliance; Health, safety, security and wellbeing; Public health; Trust, transparency and legitimacy; Company structure, ownership; Political and regulatory environment; Stakeholder engagement and networks; Human rights; Fair and equal pay

Affected capitals:

How we are responding:

- We have published our third Pollution Incident Reduction Plan detailing our investment and year-on-year improvements.

Read more: **southernwater.co.uk/our-performance/reports/pollution-reduction-programme**

- We have Event Duration Monitors (EDMs) on 87.8% of our storm overflows giving us visibility and, more importantly, the ability to report pollutions more accurately.
- We have made further improvements to our Beachbuoy release monitoring service.

Read more on pages 84 and 86

Delivering public value

We are fully supportive of Ofwat's efforts to explore how the water sector can deliver more public value. We are working with them to develop a clear understanding on expectations so that we can track our performance against measurable objectives and reflect these in our company targets, making them as simple for our customers and stakeholders to understand as possible. We are committed to developing consistent definitions, frameworks and reporting tools to clearly communicate our progress.

What really matters to our stakeholders (material issues):
Health, safety, security and wellbeing; Public health; Biodiversity and natural capital; Affordability and vulnerability; Diversity and inclusion; Local economies; Community engagement; Skills and employment; Human rights; Fair and equal pay

Affected capitals:

How we are responding:

- We launched our new Community Grants and Customer Hardship Fund to support our communities.

Read more on page 17

- After 18 months of virtual volunteering, in-person activities finally resumed in early October. Teams of volunteers went across our regions to support local communities with a wide range of activities.

Read more on page 66

- Our customer engagement programme is continuous, and this year we have focused on being more inclusive, inviting future generations and informed customers to help us make important business decisions.

Read more on page 46

Key to our capitals

In order to create an integrated view of the value we create, we are starting to use the following stocks of value or 'capitals' that can be affected or transformed by our activities and outputs.

Natural   People   Financial   Manufactured   Social and Relationship   Intellectual

Climate change

Climate change is already having a noticeable impact on our natural environment. To understand how we must adapt to the changes it brings, we complete regular risk assessments. We then use these to plan well into the future to understand what changes we are likely to experience in our region. This means continuing to reduce leakage and encourage reductions in water usage, but it also means exploring opportunities for water sharing with our peers, as temperatures increase and water resources come under pressure. We also need to work with our partners to prepare for more intense rainfall and more surface water, which increase the risk of flooding and pollution incidents.

What really matters to our stakeholders (material issues):
Climate change; Public health; Energy use; Biodiversity and natural capital; Responsible supply chain; Water use; Materials and solid waste

Affected capitals:

How we are responding:

- We published our third Climate Adaptation Report in December 2021.

Read more: **southernwater.co.uk/our-performance/reports/climate-adaptation-consultation**

- Our Net Zero Plan (to 2030) was published in July 2021.

Read more: **southernwater.co.uk/our-performance/reports/net-zero-plan**

- We have developed a methodology for our natural capital accounts which is helping us embed it in our decision-making processes.

Read more on page 55

- We are consulting on and reviewing our Water Resources and Drainage and Wastewater Management plans to 2050.

Read more: **southernwater.co.uk/our-performance/have-your-say-on-our-future-plans**

Regulatory expectations

Government and regulators are rightly challenging water companies to go faster and further, particularly on environmental priorities, long-term resilience and looking after vulnerable customers. The policy landscape is continually evolving. The 25-Year Environment Plan, Environment Bill, review of the Water Industry National Environment Programme and preparation for the next business plan period 2025–30 are just some of the key drivers for change in the water sector and beyond.

What really matters to our stakeholders (material issues):
Compliance; Public health; Company structure, ownership; Trust, transparency and legitimacy; Political and regulatory environment; Responsible supply chain; Stakeholder engagement and networks

Affected capitals:

How we are responding:

- We have continued to drive changes in people, processes and systems to set our environmental performance record straight and meet the expectations of our customers, regulators and wider stakeholders.
- We are working with government, regulators and wider stakeholders to help shape the development of our long-term plans and test new approaches to deliver better outcomes for the environment and the communities we serve.

Read more: **southernwater.co.uk/our-performance/have-your-say-on-our-future-plans**

Engagement with stakeholders

Read about our **materiality assessment** on pages 48 to 49

Read more in our **s172 Statement** on pages 71 to 73

What matters most to them

Customers

Customers expect us to ensure access to clean, safe and affordable water and effective and efficient wastewater services. They also expect us to protect and improve our natural environment.

Top three material issues:

- Customer service
- Public health and compliance (environmental stewardship)
- Affordability and vulnerability

Communities

We know that our impacts on the local environment and, in turn, tourism and health and wellbeing are critically important to our communities.

Top three material issues:

- Local economies
- Public health and compliance (environmental stewardship)
- Health, safety, security and wellbeing

Employees

Our employees expect Southern Water to be a place where everyone is cared for, supported and engaged, so they can be at their best every day.

Top three material issues:

- Health, safety, security and wellbeing
- Skills and employment
- Diversity and inclusion

Suppliers

We could not deliver essential services to our customers without our supply chain so they expect to be treated in the same way as our own employees.

Top three material issues:

- Health, safety, security and wellbeing
- Responsible supply chain
- Human rights and fair and equal pay

Regional stakeholders

Whether county or parish councils or local landowners, our regional stakeholders expect us to consult them on our plans, keep them informed of local issues and partner with them on projects that benefit our customers, communities and the environment.

Top three material issues:

- Compliance
- Public health
- Health, safety, security and wellbeing

Environment

Central to our purpose is the need to protect and improve our natural environment if we are to create a resilient water future for our customers in the South East.

Top three material issues:

- Climate change
- Compliance and reducing pollutions
- Water use

Regulators

Our regulators expect us to be compliant, meet our statutory obligations and improve our performance where we fall below the targets they set us.

Top three material issues:

- Compliance
- Public health
- Health, safety, security and wellbeing

Retailers

Retailers expect us to deliver reliable wholesale services, which means maintaining and improving our sites and networks so they are fit for the future.

Top three material issues:

- Compliance
- Public health
- Health, safety, security and wellbeing

Investors

Our investors expect us to operate in an environmentally and socially conscious manner while upholding the highest standards of corporate governance.

Top three material issues:

- Climate change
- Compliance
- Trust, transparency and legitimacy

CASE STUDY

Transforming our customer experience

Helping our customers get back Home and Well from hospital

"The Home and Well partnership with Hampshire Citizens Advice, Scottish and Southern Energy Networks (SSEN), our local NHS Trusts and Portsmouth Water was originally meant to be launched back in March 2020. Sadly, COVID-19 stopped us in our tracks and we had to rethink it a bit. This also provided the opportunity for other utilities to come on board, and Southern Gas Networks and South East Water are now part of the partnership.

"The idea was to offer holistic support to people leaving hospital. Advisers from Home and Well would be in the discharge wards, and able to talk to patients as they got ready to go home. At this point they would check that the individual was on the cheapest energy and water tariffs, and that they had access to everything they needed to live comfortably at home after a long spell in hospital.

"Because of COVID-19, it has been running as a referral scheme from health care professionals to specially trained Citizens Advice employees, and although we've still been able to reach a lot of people we're now looking forward to getting back into the hospitals and talking directly to patients.

"In the meantime, our team has been promoting the scheme with other health-related organisations to make links across our region and make sure everyone knows what support Southern Water can offer. I was delighted when the scheme won the Customer Vulnerability Award at the Utility Week Awards in March 2022 – this recognises the innovative and collaborative nature of the project."

Stuart Bailey
Vulnerability Liaison Officer

Stakeholders impacted

56%
increase in the number of people on our Priority Services Register in 2021–22.

Engagement with stakeholders continued

Our engagement throughout the year

OUR CUSTOMERS

Stakeholders involved:

Outcome of engagement:

- We have conducted continuous engagement with our young people group to help drive our long-term plans. They challenged us to increase the pace of change and to focus on environmental improvements, such as nature-based solutions.
- We engaged customers through our household panel and then ran a bespoke challenge session on storm overflows and releases along our coast. We explained the action we were taking, and they then helped us spot gaps in our plans and strategy.
- We asked customers to help us refine our long-term priorities – and brought both household and future customers together to compare views, find points of alignment and spot any conflicts or gaps in our strategy.

STRATEGIC ENVIRONMENT PANEL

Stakeholders involved:

Outcome of engagement:

- Members of the panel, from environmental groups, regulators and business groups, have supported the development of our refreshed environment strategy.
- Throughout the year the panel has been updated on, and has helped inform, our future water resource and drainage management plans.
- We have also kept members updated on direct action taken on pollution prevention, river health and our plans to reduce reliance on storm overflows.

COUNTY PLANNING WORKSHOPS

Stakeholders involved:

Outcome of engagement:

- Co-creation of our Drainage and Wastewater Management Plans (DWMPs) through a series of workshops in each river basin catchment across our region.
- Collaborations have included regulators, Lead Local Flood Authorities, Drainage Boards, National Parks, wildlife interest groups and neighbouring water companies.
- Expectations are for tangible improvements in environmental, social and economic quality as a result of better storm overflow performance, nature-based solutions for surface water management and stronger policies and positions on mains sewer connections for rural communities. They wanted to continue to collaborate, co-create and co-deliver.
- We have created a set of draft investment needs proposals which have been published for consultation. We will respond to any further issues raised in December.

COMMUNITY ACTION GROUP

Stakeholders involved:

Outcome of engagement:

- Our Community Action Group is made up of 30 employees, 30 customers and 30 young people living across our region who support the development of our activities and planning.
- The employee group meets every six weeks to discuss and process community grant awards, review our employee volunteering scheme and input into future strategy.
- The customer and young people groups help us to shortlist and then select their chosen partners for investment.

REGIONAL FORUMS AND LOCAL GROUPS

Stakeholders involved:

Outcome of engagement:

- To improve our incident response, we work closely with Local Resilience Forums to share information about our most vulnerable customers so that we can reach them quickly when they need support.
- Our employees take part in a host of regional partnership forums, discussing everything from river health and nitrate management to regional flooding resilience plans.
- Our Catchment teams work with farming clusters to develop solutions to improve land management, reduce risks to water quality and river flows, and create sustainable drainage to cope with heavy rain.

KELP SUMMIT

Stakeholders involved:

Outcome of engagement:

- We continue to follow and support the vital work of the Sussex Kelp Restoration Project and have provided a letter of endorsement from our CEO.
- In November 2021 we attended the inaugural Kelp Summit in Shoreham to hear how the project is progressing, identify areas where we may be able to assist and build on our existing relationships with the many partners involved.
- We continue to liaise closely and share data upon request.
- Sussex Wildlife Trust are the lead with input from a variety of partners including Sussex Inshore Fisheries and Conservation Authority (Sussex IFCA) and the Blue Marine Foundation.

STORM OVERFLOW TASK FORCE

Stakeholders involved:

Outcome of engagement:

- We have partnered with Local Authorities in five key areas, across Kent, Hampshire and the Isle of Wight, to trial a series of interventions for reducing the pressure of surface water run-off on our sewers and storm overflows.
- We are already running a trial of these interventions in North Hampshire, the results of which are helping to inform work in another four areas.
- Our Deal Task Force has just released its first detailed report outlining the interventions planned in the surrounding area over the coming months.

EMPLOYEE VOICE GROUP

Stakeholders involved:

Outcome of engagement:

- The Employee Voice group is responsible for raising key topics that matter to our people and working together to resolve issues and concerns. One example has been improvements in the management of site maintenance with our contractor Engie, meaning our sites are cleaner and safer for employees.
- Operations Employee Voice representatives have played a key role in driving positive change for their teams around health and safety, fleet and facilities and wellbeing.
- Several focused working groups have been set up around specific topics such as facilities, pay, reward and policy reviews.

Our focus areas

Our stakeholders' material issues inform our business priorities

Read more on page 44

Our approach to materiality

Having a thorough understanding of what matters most to our stakeholders is a priority and we consider these material issues alongside our own priorities and their ability to create value. The materiality matrix opposite represents the output of that assessment. Having clear visibility of these issues is critical as it helps inform our business strategy and our ability to create long-term value.

Determining and prioritising material issues

To assess the strategic relevance of each material issue, we considered its effect on our ability to create value, internally (for the company, our investors and employees) or externally (for customers, communities, our suppliers and the environment). This value could be financial or non-financial.

The level of interest to stakeholders is based on views gathered through direct engagement throughout the year. This includes the insight gathered as part of the consultation process for the business plan period 2020–25.

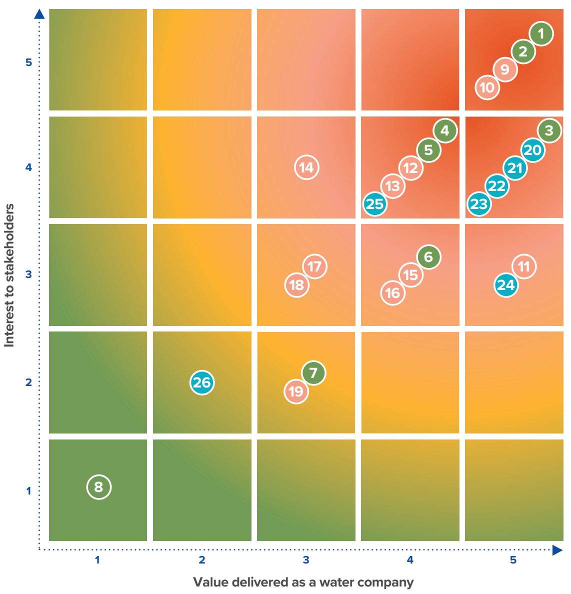
Material issues matrix

To compile our materiality assessment for 2021–22, we consolidated feedback from our various stakeholder groups, as detailed on page 44, which resulted in 26 key issues impacted by internal or external factors or sometimes both. These issues have been plotted on the next page, from low to high in terms of level of interest to stakeholders and how much each issue affects our ability to create value.

Our assessment process

Step One	Step Two	Step Three
Defining our issues The results of our stakeholder engagement activities (see pages 46 to 47) informed the selection of issues. We also considered our corporate strategy, vision and values. Further, we identified potentially material issues by monitoring external trends including the UN Sustainable Development Goals, assessing risks, and reviewing best practice including ESG frameworks such as the Global Real Estate Sustainability Benchmark (GRESB).	**Prioritising the issues** The significance of the issues was assessed, to prioritise them. We scored each issue on two scales: the importance of the issue to stakeholders, and the significance of the issue for us to create value. Each received a score from one to five, reflecting our existing Enterprise Risk Management process. One indicating no impact/negligible ability to influence and very infrequent stakeholder interest. Five indicating critical impact for all functions/ high levels of control, and significant interest of many stakeholders.	**Test and review** We tested the prioritisation scores with internal groups to validate the process and ranking. Executive Leadership Team members were included in this process, as well as senior managers and subject matter experts across our business.

Focusing on what matters to our stakeholders



Our material issues

Environmental	Link to principal risks
1 Compliance	Compliance – see page 117
2 Climate change	Climate change – see page 117
3 Water use	Water – see page 115; Delivery – see page 118
4 Biodiversity and natural capital	Compliance and Climate change – see page 117
5 Energy use	Climate change – see page 117
6 Materials and solid waste	Climate change – see page 117; Wastewater – see page 115; Resources – see page 119
7 Land management and access	Compliance and Climate change – see page 117
8 Air quality	Compliance – see page 117; Health and safety – see page 119

Social	Link to principal risks
9 Health, safety, security, and wellbeing	Health and safety – see page 119
10 Public health	Water – see page 115
11 Customer service	Customer – see page 116
12 Affordability and vulnerability	Customer – see page 116
13 Diversity and inclusion	People – see page 120
14 Local economies	Customer – see page 116
15 Community engagement	Customer – see page 116
16 Skills and employment	People – see page 120
17 Human rights	Resources – see page 119
18 Fair and equal pay	People – see page 120
19 Social mobility	People – see page 120

Governance dimension	Link to principal risks
20 Company structure, ownership	Compliance – see page 117
21 Trust, transparency, and legitimacy	Compliance – see page 117
22 Data protection	Compliance – see page 117; IT – see page 118
23 Political and regulatory environments	Financial – see page 116; Corporate affairs – see page 120
24 Stakeholder engagement and networks	Customer – see page 116; Corporate affairs – see page 120; Delivery – see page 118
25 Responsible supply chain	Resources – see page 119
26 ESG governance	Corporate affairs – see page 120

Our strategic ambitions

Our long-term priorities **inform both our current five-year strategy** and plans for the next business plan period

In our Water for Life Business Plan 2020–25 we outlined six long-term outcomes that would deliver a step change in the way we deliver our services. They outlined the collaborative action we intended to take with customers and stakeholders to co-create a preferred, shared future for water in the region. These outcomes emerged from talking to our stakeholders, but also from regulatory expectations and operational imperatives. They included a focus on: recycling; clean rivers and coasts; collaborating to sustain the economy of the South East; innovating to create sustainable communities, and helping our customers recognise the value of water in their daily lives.

These outcomes have evolved in line with the expectations and needs of our customers, communities and the environment. The long-term priorities discussed below have been shared with our stakeholders and will help inform our plans for the next price review (PR24), as well as helping us achieve our vision of a resilient water future. To read more visit our consultation hub: **southernwater.co.uk/our-performance/have-your-say-on-our-future-plans.**

Read more about our **approach to sustainability** on pages 52 to 75

Our purpose is to provide water for life to:

enhance health and wellbeing

protect and improve the environment

sustain the economy

Current trends

- Growing population
- Changing shape of communities
- Evolving customer expectations and attitudes
- Increasing use of technology
- Rising concerns over the environment
- Climate emergency

Challenges

- Water scarcity
- Increased flooding
- Affordability
- Meeting customers' expectations
- Decarbonisation

Enablers

- Collaboration
- Technology and innovation
- Resilience

Key priorities

- Understanding and supporting our customers and communities
- Ensuring a reliable supply of high-quality water for the future
- Protecting and improving the environment
- Enabling and empowering our people

Underpinned by our values

Our vision, purpose and values, alongside ethical decision-making and modern compliance frameworks, help our leadership team, employees and partners make better decisions every day.

Succeeding together

Doing the right thing

Always improving

Our current delivery strategy to 2025

Deliver great service

We are focused on delivering a great customer experience. This means resolving customer issues quickly and delivering clean, safe water, through a reliable, future-proof network, at a price that everyone can afford. We will achieve this by installing new water mains, and refurbishing our treatment works to cut supply disruptions and deliver the clean, wholesome water we all need.

Read more on pages 76 to 80

Use water wisely

We are investing more than ever in new technology to find and fix leaks on our network while we continue to upgrade and replace our mains. We are working with local authorities and developers to encourage the building of water-neutral homes that use the latest water-efficient technology. Our focus on reaching Target 100 by 2040 means we will continue to work with community partners, local businesses and customers to collectively reduce our water use.

Read more on pages 81 to 82

Protect and improve the environment

We know we need to go beyond doing no harm to our environment and look to improve and enhance it where we can. To 2025 we are investing close to £1 billion in improvements that will deliver environmental benefits to the region's rivers and bathing waters, while reducing flood risk, cutting our carbon footprint, and supporting schemes that improve the biodiversity of the South East. We continue to transform our sewer network, using smart technologies to predict and prevent sewer blockages and burst pipes.

Read more on pages 83 to 87

Fit for the future

Our regional water resource and drainage plans are developed looking out to 2050. We do this so we can ensure future generations enjoy the same access to water and wastewater services in the years to come as we do today. Our region is water stressed and climate change is only going to make it increasingly difficult to supply the water we all need. That is why we are already working in partnership with other organisations and experts – through collaborations such as Water Resources South East (WRSE) – to start building a regional water resource management plan. We also continue to generate biogas and green energy at our wastewater treatment sites.

Read more on pages 88 to 91

Sustainability

Overview

Ensuring **we act in a responsible, sustainable way** as we deliver our purpose and support the social, economic, and environmental wellbeing of our region

We know the resilience of our business is directly linked to the economy of our region, the communities we serve and our environment. We can only deliver our vision and purpose if we act in a responsible manner, understanding what matters to our customers and stakeholders, and embedding environmental, social and governance (ESG) matters in our decision-making.

WATER for LIFE®

Our purpose is to provide water for life

from Southern Water®

ESG focus areas

Environment	Social	Governance
Protect and improve the region's environment.	Enhance people's wellbeing and sustain the region's economy.	Be a responsible and trusted business focused on prioritising the current and future needs of our customers.
Long-term goals • Deliver improvements that protect and restore the local environment. • Protect our customers and environment from the pressures of climate change. • Use resources efficiently and responsibly manage waste.	**Long-term goals** • Ensure public and employee health and safety, and support community wellbeing. • Provide a fair and inclusive experience for customers, employees and suppliers. • Support opportunities for local people and partners to make a positive impact.	**Long-term goals** • Embed and embrace new capabilities and systems that enable culture change and business transformation. • Work in partnership with stakeholders and collaborate with others to tackle our environmental and social goals. • Responsibly invest to achieve our ambitions and transparently report our performance.

Alignment to the UN Sustainability Development Goals

6 Clean water and sanitation 12 Responsible consumption and production 13 Climate action 14 Life below water 15 Life on land	3 Good health and well-being 8 Decent work and economic growth 11 Sustainable cities and communities	9 Industry, innovation and infrastructure

Board's sustainability-related activities

Board activity this year included review and discussion on our environment strategy and performance, our activities to support vulnerable customers, and our culture change programme.

Read more about **Board activities** on page 160

Our journey of embedding ESG

Our approach to sustainability and being a responsible business aligns with the United Nations Sustainability Goals (UN SDGs). The SDGs comprise 17 global goals to be achieved by 2030 that were adopted by the UN in 2015. Of the 17 goals we have now identified nine that we feel we can contribute most to through our operations, investments and commitments.

We recognise that our customers, stakeholders, and investors are increasingly interested in how we respond to sustainability matters and wish us to disclose data and information on our activities and performance. We are monitoring the range of external reporting frameworks with which we can align our reporting. While seeking to align with the most relevant, we are focused on sharing information that supports our purpose and the topics identified as priorities by our customers and stakeholders. For example, for the first time this year we have voluntarily disclosed information on our progress towards managing our climate-related risks and aligned these disclosures with the recommendations of the Task Force for Climate-Related Financial Disclosures (TCFD).

We also supply information to independent ratings and indices on ESG matters. We performed well in the 2021 Global Real Estate Sustainability Benchmark (GRESB) which assesses the ESG performance of infrastructure assets. We were awarded a Green Star rating, with a score of 91 out of a possible 100 – an improvement on our 2020 score of 70. We also improved our position in the 2021 Inclusive Top 50 UK Employers, moving to 46th from 49th in the previous year.

We understand the value of partnerships to strengthen the work we do and the value they bring to us. We are building partnerships to tackle many of our largest challenges, working with local organisations, peers, other sectors and academia. This year we joined Business in the Community (BITC) to support us in driving our responsible business ambitions.

Future plans

We continue to evolve the way in which we disclose and report on ESG matters. In 2022–23 we intend to enhance our ESG reporting to allow us to share additional data and information on our responsible business activities.

We remain committed to participating in independent benchmarks and indices, identifying those where we can obtain best insight to continually improve our performance and effectively benchmark our credentials.

In 2022 we will submit information to GRESB, for the seventh year, and participate for the first time in the Responsible Business Tracker of BITC; the results of these benchmarks will inform our ongoing responsible business activities. We also intend to enhance information provided on our website and consider participation in other benchmark initiatives and reporting frameworks.

We continue to integrate ESG matters, including natural capital and carbon, into our business activities, long-term investment planning and our Risk and Value process that guides investment decision-making, and our engagement with our suppliers, advisers and contractors.

Sustainability continued

Demonstrating environmental leadership

Environmental disclosures

Read more on pages 83 to 87

Overview

It is our responsibility to help protect the water environment for future generations. This means not only looking after the environment but finding ways to leave it in a better state than we found it. This means using nature-based solutions where possible, adapting to climate change and ensuring we manage our operations in a sustainable way.

Environmental compliance

Our Environmental Management System is our most effective tool for managing environmental risk and is monitored throughout the year to flag compliance and performance risks. The system continues to be certified to the ISO 14001 standard and remains a successful mitigation for compliance risks in relation to waste management and control, pollution prevention, water quality, water resources, consumables (energy and chemicals), customer nuisance concerns, amenity, and global biodiversity.

Our environment policy has been reviewed and amended to reflect our new environmental ambitions. As we rebuild trust and can evidence that compliance is just part of the way we work, we can focus more attention on our environmental performance improvement programmes.

Water quality: The water reaching customers' taps continues to meet the Drinking Water Inspectorate's (DWI) stringent water quality tests, with 99.97% of samples meeting all the necessary standards. Our target was to achieve 100% compliance. We monitor water quality at treatment works, treated water storage facilities and customers' taps.

Catchment First: Catchment First is our transformational change programme, which has grown year on year since its introduction. Through this, we are placing catchments at the heart of our decision making and focusing on collaboration with external partners for long term resilience.

The programme includes actions we've promised to deliver under the Water Industry National Environment Programme (WINEP) alongside a range of further voluntary actions, to accelerate the delivery of environmental best practice.

Over the current financial programming period, our WINEP projects are helping to improve resilience by reducing the risk of nitrates and pesticides reaching our drinking water abstractions. We're doing this through working in partnership with farmers and land managers and engaging with several farmer clusters across our supply area.

Over the course of the year, our farmer engagement activity included 25 farms taking part in multi-year trials to record changes in soil health and soil carbon, three trial sites demonstrating nitrogen availability after cover crops and supporting a group of seven farmers focusing on net zero greenhouse gas emissions.

We have also worked with 83 farms to implement tailored nitrate reduction measures in priority catchments, signing up over 3,500 hectares of new measures during the year. In combination with a further 1,200 ha of multi-annual measures started previously, this accounts for an estimated reduction of 64,000 kg of nitrogen based on farmscoper modelling. In addition, during the year we also completed 17 specialist advice visits and made 25 farm capital grant awards, helping reduce the risk of water pollution near to our drinking water abstractions.

Alongside our regulatory programme, the Catchment Team also began work on a further series of projects, financed through our Environment Improvement Fund. Project design and engagement work has now started on a series of six new projects, with delivery expected from 2023 onwards. These sites include large scale sites in Western Rother, Beult and Chichester Harbour catchments where we are co-designing a series of integrated wetland and sustainable land management sites to pilot the delivery of multiple benefit outcomes. This work is being completed in partnership with multiple stakeholders including wildlife trusts, rivers trusts and other local environmental charities.

Biodiversity: Our operations are intrinsically linked to the natural world and, as a significant landholder along the south coast, we have a responsibility to make a positive contribution towards nature recovery. We can do this by enhancing the biodiversity value of our land, alongside the operational tasks we perform every day.

This year we continued to improve the condition of existing habitats through changes in management regimes of grassland and are on course to deliver biodiversity improvements at 10% of our sites. We also created a new £75,000 grant to fund small scale biodiversity improvements on sites ranging from owl boxes and bug hotels to habitat creation and enhancement. This work has been supported by the creation of our new Environmental Champions Network – a group which we intend to expand later in 2022.

Alongside the work on our own operational sites, we are also contributing to the planting of 11 million trees by 2030, alongside 11 other UK water companies. And we are working with our colleagues in Capital Delivery to create a standard of 10% biodiversity net gain on our engineering projects.

Later in 2022, we will launch our Biodiversity Net Gain Masterplan which will include detailed plans for site enhancements and changes to our grounds maintenance; as well as outlining the role tree planting, wetland creation and future markets may play in our biodiversity and carbon offsetting plans.

Natural capital

There is a growing expectation from regulators for us to view investment over the long term and through a multiple capital lens.

In February we reviewed the early outputs from our new Natural and Social Capital framework. This provides a long-term roadmap to support the embedding of multi-capitals thinking into our investment planning. The framework will continue to evolve as we test its application in the creation of six baseline natural capital accounts.

Our reputational performance commitment initially committed us to deliver natural capital accounts for three areas the Test and Itchen, Arun and Western Streams and the Medway catchments, but we believe we can go further to include an additional three catchments.

Working with the Wildlife Trust this year we completed the first-ever natural capital baseline assessment of our land holdings.

This is the first time we have assessed the nature recovery potential, biodiversity, carbon and nutrient value of our land holdings. We will now use the outputs to direct investment in natural capital enhancements across our sites and feed learning into our new framework.

As well as helping us better understand the current value and opportunities of our own estate, we have also started applying natural capital accounting principles to our work in Chichester, Langstone and Pagham harbours. As part of our leadership of the Harbours Summit we have produced the first full-scale natural capital baseline for the harbours and their catchments. The summit partners are now using this to measure the condition of the harbours and, in time, their recovery.

Sustainability continued

Our approach to climate change

Task Force on Climate-Related Financial Disclosures

Read more details of our **carbon emissions** on page 198

Our approach to climate change

Climate change impacts, amplified by population growth, present huge challenges to the water industry, particularly in the South East, and are a principal risk to Southern Water's ability to operate. Mitigating this risk will make sure that we are able to maintain high-quality, resilient services for our customers. The diagram on page 60 provides an overview of our approach to climate change.

An increase in the number of storms is one negative impact of climate change we are already experiencing. As a result of Storm Eunice in February 2022, we lost power to 330 of our water and wastewater sites, as 112mph gusts of wind battered the South East of England. Despite this, we managed to keep taps running for the vast majority of our customers, with less than 300 out of 2.6 million experiencing a loss of supply (0.01%). We also managed to ensure that there were no major pollutions. We did this through the 24/7 deployment of hundreds of additional people – including electricians, engineers and tanker drivers, and teams to remove trees and other debris that were blocking and damaging the network.

Mitigating our carbon emissions: We have responded to the climate emergency by committing to reach net zero carbon for the emissions associated with operating our services by 2030. In 2021–22 we can report that our emissions were 81.6 kilotonnes of CO2e (2021: 91 kilotonnes CO2e). We have maintained this performance due to the renewable-backed power that we have purchased from our suppliers since April 2021. For details on our emissions footprint see page 198.

Our use of energy: In 2021–22 Southern Water used 548,166 MWh of energy for water and wastewater operational purposes, a very slight decrease on 2020–21. Wastewater is the largest user of energy, accounting for 72% of consumption. Most of this energy is used to power our pumps and blowers.

We also generated 71,612 MWh of energy in wastewater via our CHP engines, which offsets 23% of our wastewater consumption and prevents the need for this energy to be imported. Water supply accounts for the remainder of the energy needed to power our operations, with solar generation totalling 2,264 MWh, helping to ease the need for imported energy at our supply works. We currently generate 15.85% of our electricity from renewable sources.

Capitalising on the treatment of bioresources is another way we are tackling our operational carbon emissions. We are reviewing options for our fleet of Combined Heat and Power (CHP) engines, considering financial, environmental, and other considerations, and as part of our wider energy and sludge strategy. We are also working to better understand our broader carbon emissions footprint. We have implemented a process to measure carbon emissions from our construction and refurbishment projects (see case study page 61) and have started a project to review the so-called 'Scope 3' emissions from our wider value chain, as well as explore interim decarbonisation targets that align with the methodology of the Science-Based Targets Initiative.

We will publish an update on our Net Zero Plan later in 2022 and include any capital investment required in our business plan submission to Ofwat for the period 2025–30.

Adapting to a changing climate: This year we published an updated risk assessment for Defra to demonstrate our approach to climate adaptation; this is our third such report. Existing plans looking at the long-term impacts of climate change include our Resilience Action Plan, Water Resources Management Plan, Drought Plan and Drainage and Wastewater Management Plans. Read our Climate Adaptation Report at: **southernwater.co.uk/our-performance/reports/climate-adaptation-consultation**

Transparency and disclosure: This is the first year we are reporting against the Task Force for Climate-Related Financial Disclosures (TCFD). We fully support the TCFD and are committed to aligning our disclosures with its recommendations.

Below is a summary of how we are integrating climate-related risks and opportunities into our risk management and strategic planning processes.

We acknowledge we have more work to do, including work we have started to mature our scenario assessment of climate-related risks and opportunities, and developing our approach to climate-related financial impact disclosures.

	Our response	More information
Governance The governance around climate-related risks and opportunities	In 2021–22 the Board approved our Net Zero Plan and established an ESG Committee. The executive accountable for climate change is our Chief Environment and Sustainability Officer. Climate change is a principal risk, and the Risk Committee received an update on emerging risk that heavily featured climate change. Executives at a Strategy and Regulation Committee reviewed the Climate Adaptation Report and approved our updated Carbon Policy. Plans for 2022–23: ESG Committee to review broadening the approach to climate change adaptation and review progress on Net Zero Plan delivery. Executive-led review of wider climate change governance arrangements.	Read more about our **ESG Committee** on page 143 Read more about our **principal risks** on pages 112 to 120
Strategy The actual and potential impacts of climate-related risks and opportunities on our business, strategy and financial planning	Climate change is a key driver for our corporate strategy and long-term ambitions. Third Climate Change Adaptation Report published, informing our risk management activities out to 2050. Net Zero Plan informing our business planning into 2030 and beyond. Climate change an integral part of our Environment Plan and environment strategy. Defining process and capabilities to embed climate change criteria in our Risk and Value investment business case process. Plans for 2022–23: Update on progress on our Net Zero Plan. Ongoing strategic planning to include net zero carbon target and long-term climate risk management.	Read about our **Long-Term Priorities** on pages 50 to 51 Read more on our **environmental disclosures** on pages 54 to 55 Read our latest **Net Zero Plan: southernwater.co.uk/our-performance/reports/net-zero-plan** Read more on our **Sustainable Finance Impact Report** on pages 74 to 75

Sustainability continued

Our approach to climate change

Risk management	Our response	More information
How we identify, assess, and manage climate-related risks	Physical and transition risks of climate change are integrated within our Enterprise Risk Management processes. They are identified as principal risks and reported to Audit Committee. Published third Climate Change Adaptation Report: qualitatively assessed risks on two-degree and four-degree scenarios; consulted with stakeholders. Defining climate-related risks in existing processes for managing delivery of our investment programme. Climate change risks and opportunities assessment criteria included in ongoing updates to Water Resources Management Plan, Drainage and Wastewater Management Plans, and pathfinder projects under the Storm Overflow Task Force. Risk-based review, customer insights and stakeholder engagement are critical inputs. Plans for 2022–23: Further assessment and modelling of physical climate risks. Formal identification of transition risks and risk management plans. Climate change and carbon assessments being included in our major infrastructure projects. Developing methodology to integrate climate change scenario planning in our long-term investment plans. 	Read more **about risks** on pages 108 to 120 Read more about **how we engage stakeholders** on pages 46 to 47 Read more about our **Water Resource Management Plan: southernwater.co.uk/our-story/water-resources-planning/water-resources-management-plan-2024** Read about our **Drainage and Wastewater Plans: southernwater.co.uk/dwmp** Read about **Water for Life Hampshire: southernwater.co.uk/our-story/water-for-life-hampshire** Read our latest **Climate Adaptation Report: southernwater.co.uk/our-performance/reports/climate-adaptation-consultation**

Metrics and targets	Our response	More information
The metrics and targets used to assess and manage relevant climate-related risks and opportunities	Climate change features in our Enterprise Risk Management arrangements. It is a principal risk and is included in our Risk Taxonomy, with seven associated sub-topics used in the resulting risk profile. Established process for monitoring delivery of our Net Zero Plan and reporting to Executive Leadership Team. Report scope 1, 2 and 3 emissions annually in line with Streamlined Energy and Carbon Reporting (SECR) and emissions assured by independent consultant. Report emissions and energy data annually to the Global Real Estate Sustainability Benchmark (GRESB). Ongoing work to measure and report our capital and process emissions. Plans for 2022–23: Review scope 1, 2 and 3 emissions with a view to exploring interim carbon reduction targets that are aligned with the methodology of the Science-Based Targets Initiative (SBTi).	Read more **about risks** on pages 108 to 120 Review our **GHG emissions data** on pages 198 to 199 Read our latest **Climate Adaptation Report**: **southernwater.co.uk/our-performance/reports/climate-adaptation-consultation**

Task Force on Nature-Related Financial Disclosures:

Our relationship with the environment is vital to our business. Ensuring we act in a responsible, sustainable way is an essential part of how we work. We therefore welcomed the launch of the Task Force on Nature-Related Financial Disclosures and its publication of a prototype disclosure framework during 2021.

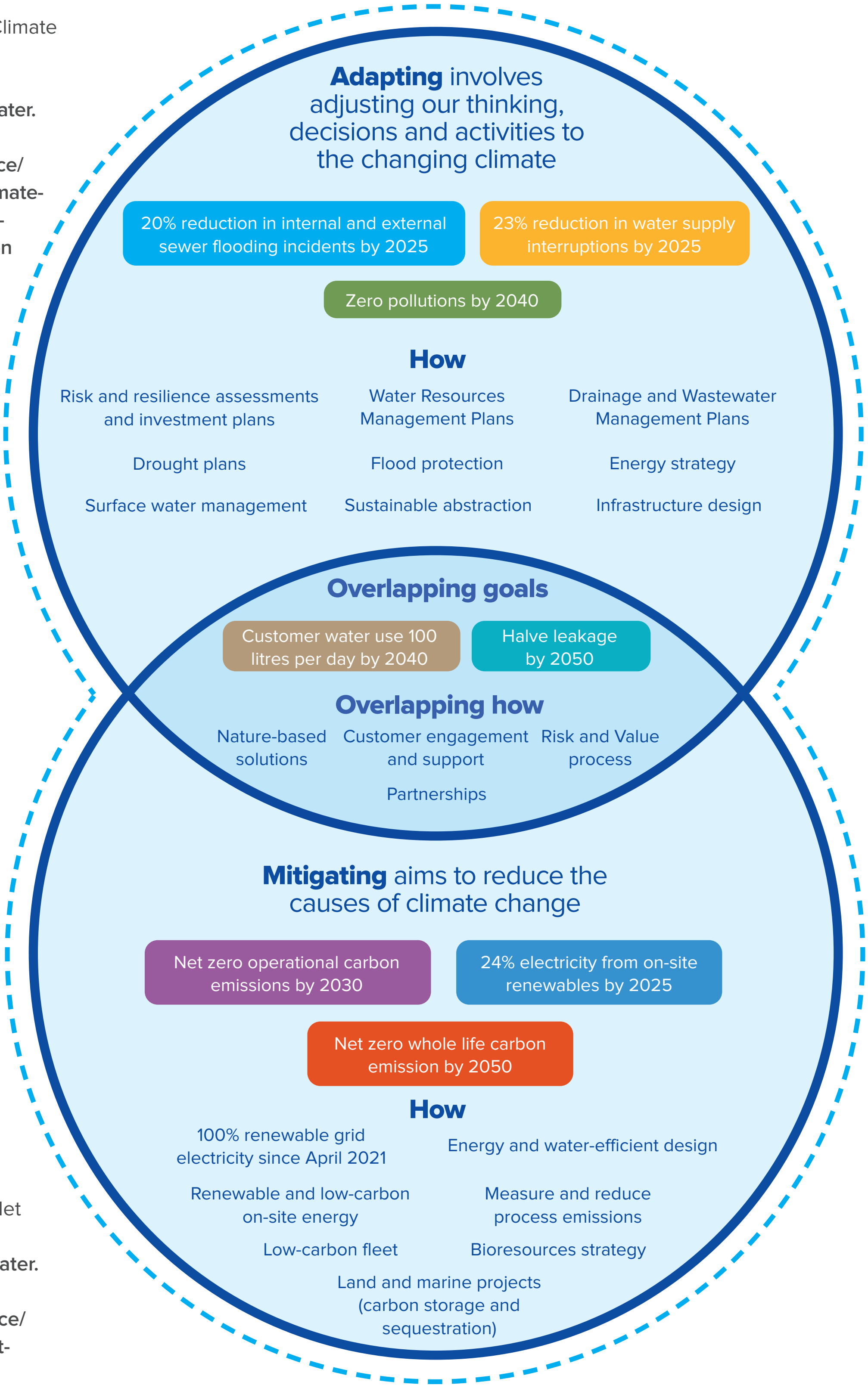
We are reviewing the prototype framework and will continue to follow its development with a view to disclose how we manage nature-related risks and opportunities in alignment with its recommendations.

Sustainability continued

Climate change strategy

Our climate change strategy is about **adaptation and mitigation**

Read our Climate Adaptation Report: **southernwater.co.uk/our-performance/reports/climate-adaptation-consultation**



Read our Net Zero Plan: **southernwater.co.uk/our-performance/reports/net-zero-plan**

CASE STUDY

Protecting and improving the environment

We're measuring embedded carbon emissions for the first time

"We've been reporting on our operational carbon emissions for some time now, but we're going a step further to include embedded carbon (also called capital carbon). It's vital that we do this going forward if we're to achieve our long-term net zero targets and fully build carbon reduction into our decision-making processes.

"These new carbon accounting measurements will mean that we can better understand the positive or negative impact on carbon emissions of our investment schemes. This will allow us to better manage our impact on the environment and seize opportunities to be part of a lower-carbon future. By looking at operational and embedded emissions, along with natural habitat-based carbon emissions, we're getting closer to considering whole-life carbon impacts, which will help us make decisions based on best value. We're also driving for more lower carbon-catchment and nature-based solutions alongside traditional engineering solutions (that typically involve the use of large amounts of concrete, energy or chemicals – all highly carbon emitting).

"By 2030 we aim to be carbon neutral in terms of our operational emissions, and completely carbon neutral by 2050. We'll continue to review our levels of emissions annually while also making sure that this thinking is embedded in our plans for the next price review (PR24). Over time, the level of detail in our reporting will increase as will our understanding of carbon management and how we can provide better options for the future."

Cigolene Nguyen
Head of Asset Systems and Processes

Stakeholders impacted

Net zero
operational emissions by 2030.

Carbon neutral
by 2050.

Sustainability continued

Engaging and empowering our people

Equality and diversity in an inclusive company – our five-year vision

Read more about our **culture** on pages 150 to 160

Promoting equality and broadening diversity across all levels

We promote a culture of inclusivity and want everyone working in our company to feel that they can bring their best selves to work every day, and work in a place where they belong. We were pleased to again have been included in the Top 50 UK Employers, with our ranking improving to 46th position (2020–21: 49). Our new five-year vision for an inclusive company sets out a number of initiatives and our new HR system will enable us to monitor trends.

In March 2022, we launched our Equality, Diversity and Inclusion intranet. This space on the intranet is available for everyone working in our company to access a variety of tools and information, including the programme of campaigns that we are planning in this area over the next five years and employee resource groups.

Our employee resource groups are evolving. We now have four and they are open to all employees, these are BE YOU (formerly LGBTQ+), Neurodiverse, Working Parents and the Women's Network.

We have also been working with other organisations and initiatives to benefit from the increased opportunities that collaboration brings. Our CEO spoke at the Water UK Forum 'Black Voices in the Water Industry: From Talk to Action'.

We enabled 10 women to be mentored as part of the 30% club which promotes inclusion and diversity through cross-company mentoring. As part of this scheme, we also provided 10 mentors.

There are many ways that we are promoting equality and diversity:

- Joining the Women's Utility Network in March 2022.
- Celebrating National Inclusion Week.
- Monitoring career progression and engagement with training/development to ensure that there is equal opportunity for our people.
- Working with our employee resource group to signpost the diversity days to celebrate and raise awareness.
- Developing a steering group and a working group to drive positive action in this area.
- Signing up to the Menopause Workplace Pledge in March 2022 and making guidance materials available on our ED&I intranet pages.
- Working collaboratively with industry partners, including EU Skills, Water UK, BITC.

Our recruitment processes ensure that blind CV screening is used to remove any bias at the recruitment stage. We also monitor ethnicity recruitment statistics at each stage of the recruitment process – application, interview and hire – ensuring that we are creating a fair process for all applicants. We have seen an increase in the diversity of candidates applying for roles following our move to blind CV screening and the use of gender-neutral language.

Gender pay reporting

We publish a Gender Pay Gap Report each year. Our 2021 report stated that our median pay gap is -0.2% in favour of women, showing our pay is almost equal between men and women, and our employee group is made up of 25% women and 75% men. The report highlights the three areas of continued focus as: leadership and accountability; knowledge and understanding; and interventions to empower diversity and inclusion. The number of women on our Board has decreased over the past year and we will look to address this in the future.

Being able to bring our best selves to work

LGBTQ+

The BE YOU group helps us to focus our activities in this area.

In 2021, we were pleased to welcome Gareth Thomas as a guest speaker during Pride Month. Employees across the company were able to join the online call to see and hear this inspirational talk. We made the talk available afterwards on the company intranet to enable us to reach out to even more of our people.

To raise awareness of LGBT+ History Month in February, each week new content about how the company was celebrating was posted online and on our social media. We also flew the pride flags at our offices during the month as a visible sign of our inclusivity.

It is important to us that we show support in our community, as well as among our employees. We supported the Worthing Pride event in September 2021 and we have assisted some LGBTQ+ focused charities. For example, on the Isle of Wight, we gave a community grant of £8,000 to the 'Out on an Island – Together as One' project, which organises pop-up befriender cafes in accessible venues, providing a safe space for the LGBTQ+ elderly community to get out and about and share stories, helping reduce stigma and social isolation.

Disability

We aim to support colleagues in a variety of ways across a range of disabilities. For example, we use technology to provide the JAWS reading software to help people who are visually impaired.

The most recent addition to our work in this area is the Neurodiversity group. We invited colleagues to join the group to help raise awareness about neurodiversity and provide support for current employees and new recruits, as well as providing the right tools and support for managers. One of the objectives is also to help support employees who have neurodiverse family members and friends, all with the goal of enabling people to be their best selves.

Young people

The profile of people working in our company has shown an increase in young people (aged 16 to 24) over the past year rising to 4.7% (2020–21: 3.9%).

We support young people working with us in different ways. The apprenticeships we offer give them the opportunity to work in our industry and gain experience. We also helped celebrate Apprenticeship Week by showcasing stories by apprentices on our social media. We also offer mentorship schemes.

Social mobility

We are pleased to support the government's Kickstart Scheme. The scheme supports 16-24 year olds who are on Universal Credit by providing funding to employers for targeted job creation. The funding lasts for six months and covers an initial set-up payment, the minimum wage and contributions for pension and national insurance.

Read more about **apprenticeship schemes** on pages 64 to 65

Sustainability continued

Engaging and empowering our people continued

Read more on pages 174 to 175

Health, safety, security and wellbeing

We take health and safety very seriously. Extreme weather events, such as Storm Eunice, test our incident management processes to the full and show the benefits of including health and safety at the highest strategic levels.

Health and safety is a daily consideration for everyone who works with us, whether they are on the frontline or office-based.

Following a review of health and safety training in 2021, we have committed to training operational managers to achieve their NEBOSH General Certificate at practitioner level and non-operational managers to be trained to IOSH standards.

During 2022, we also conducted an independent health and safety assessment lasting three months. This broad and deep assessment looked at the effectiveness of our controls. The resulting series of findings and recommendations will be translated into a plan to be developed both by – and for – the operational team. Enabling the operational team to develop the plan that they will implement increases ownership and accountability.

Looking after our employees' wellbeing

The COVID-19 pandemic has affected many of us and we have put in place a variety of tools to assist our employees with their wellbeing and make sure that everyone feels supported.

Read about our **work in the community** on pages 66 to 67

Our approach to wellbeing is called 'Balance' and it focuses on five pillars. These are financial, mental, physical, career and social. From April 2022, the Balance Roadshow went on tour, visiting 12 of our sites with information aimed at people working on sites.

Understanding the need to support mental health, we made the Unmind app available to all our employees. It is an easy way to access daily mindfulness tips or short, tailor-made programmes straight from mobile devices. In the first half of 2022, we partnered with the Brighton-based Grassroots charity to roll out mental health training courses. We also have over one hundred people now qualified as mental health first aiders.

We have an Employee Assistance Programme (EAP) through BUPA that can help colleagues with all aspects of their wellbeing. This is available to all employees and their partners and dependants (over 16 years old) to provide help and guidance in the form of counselling, money management, consumer rights, parenting, divorce, family and relationship advice and landlord disputes.

Additional support was provided to help people to manage issues relating to COVID-19, such as sleep, self-isolation and bereavement.

Other tools and benefits are available to help our people to find a wellbeing balance, for example, Perkbox – an online app – offering useful discounts on goods and services; and a Cycle to Work scheme to enable colleagues to source tax-free bikes. We also provide a Health Cash Plan available to all colleagues that supports them with day-to-day health expenses such as dentist charges and optical health.

During wellbeing week, our Executive Leadership Team took to the company intranet to tell their own stories and we continue to look at how we can make 'Balance' part of our culture.

Developing talent

We encourage all employees to keep learning and develop their knowledge and skills. Our Talent and Development team provides support to do this in a range of ways, whether that means connecting people to mentors, providing coaching or team development support, directing people towards apprenticeships or external learning providers, or our in-house blended training offerings. Our in-house training covers a mixture of courses, eLearning, social learning and experiential learning. Our experiential learning includes site visits, job shadowing and company lunch-and-learn sessions.

A total of 18% of our people are being supported to undertake formal learning (this includes apprenticeships, degrees and qualifications) and informal learning (courses and certifications). Over the past year, we spent £1.4 million on training and development and the average number of learning days is 3.16 per full-time employee.

Our apprenticeship programme has seen 8% of our people starting or completing an apprenticeship in the past 12 months. We featured highlights of our apprenticeship scheme on social media during Apprenticeship Week in February. In January, our Company Conversations monthly call focused on this subject, to help employees understand the opportunities available.

Regarding learning and development for managers, new managers are supported with a structured development programme to ensure they start off their management career with the right skills to enable them to deliver through their teams. Our line managers are supported in achieving qualifications through the Level 3 and Level 5 management apprenticeships and our high potential senior managers have the

Challenge 24 programme where they can network and support other organisations in solving business problems.

We have launched a new recruitment brand – Dive Right In – to bring a more dynamic and inviting recruitment offering to the job market. This has already been displayed at recruitment fairs to engage new apprentices and military personnel, and we expect it to improve our company diversity.

A great place to work

Our culture dashboard helps us to monitor how we are progressing towards our vision of creating a workforce where all of our people feel that they belong. We measure this through our engagement surveys which have shown a slight improvement with an increase in engagement of 0.04 making our score 3.94 out of 5 for 2022.

We saw an increase of 2% in our overall active engagement improvement. Our belonging index improved by 0.09 to 4.12 (out of 5) and manager engagement improved by 6%.

Being an inclusive employer is important to us. We try to make sure all employees have access to information and are kept informed. One example of this took place during our response to Storm Eunice, where we kept all our employees updated on the work and progress of our incident teams throughout this disruptive storm.

Read our **Culture Dashboard** on pages 156 to 157

Sustainability continued

Supporting our communities

Working in partnership with local charities and schools

Read more about our **Hardship Fund** on page 17

Over the past year, we have supported our communities with our Community Grants Scheme, outreach activities and employee volunteering. We have worked in partnership with stakeholders to make sure our community programmes are supportive and responsive to the changing needs of the communities we serve.

Helping charities

Our Community Grants scheme supported projects across Kent, Hampshire, West Sussex and the Isle of Wight. A Community Action Group made up of employees, customers and young people assessed over 200 applications received, to fund schemes across a variety of charities and community groups of all sizes operating in our region. The Group approved 80 projects. Projects and charities supported include the Mountbatten Hospice in the Isle of Wight, the South Downs National Park, Sheppey Matters, the Waterlooville Action Group, Adur Community Café and the Trussel Trust.

Volunteering

All our employees have the opportunity to use two of their workdays per year to volunteer in the local community. Our volunteer teams have been supporting a range of activities including building bike tracks for schools, beach cleaning, mock interviews, mentoring and community garden activities.

Supporting events

We also support events and, this year, we once again supported The Brighton Festival that took place in May. The festival brought people back together in a safe way, enabling the community to celebrate arts and culture together at many different events.

Engaging with schools

While we were not able to carry out our usual number of educational talks due to the pandemic, we still managed to give some face-to-face and online talks to schools, as well as to adults and non-school groups. The talks cover topics including the water cycle, water saving, three 3Ps, how wastewater is cleaned, protecting our rivers, unflushable items and climate change. Online resources and activities were increased and three new films were created and trialled.

We are part of We Are UK Water, which is made up of education teams from 12 collaborating UK water companies. We all came together to host live events and create activity packs for World Toilet Day and World Water Day over the past 12 months. For the World Toilet Day event, 16 schools in our area registered to take part, and 40 schools registered for World Water Day in March 2022.

We are working in partnership with The South East Rivers Trust (SERT) and Wessex Rivers Trust to spread the vital message that we all need to save water to protect our precious environment and ensure life can thrive in and around our rivers. The South East Rivers Trust (SERT) and Wessex Rivers Trust are piloting educational sessions to support the curriculum, these include river dipping and outdoor learning activities, initially taking place at three river sites in Kent and Hampshire.

Trial sessions are booked for June 2022, where primary school children will be invited to experience the river environment, to encourage long-term river-friendly behaviour and learn about saving water too. A full launch is planned for September 2022, when we want to reach a further 5,000+ children, alongside our investment into our ongoing schools engagement programme and plans to open sites for school visits.

CASE STUDY

Enabling and empowering our people

Helping young adults in hospice care

£20k
donation to Mountbatten Hospice.

"Our Community Action Group – made up of employees, customers and young people – selected the Mountbatten Hospice to receive a £20k community grant to fund a project to support young adults, with life-shortening conditions, to manage their transition from paediatric to adult health services.

"This project was set up in 2017 for young adults, aged 14 to 25 years, and offers a personalised mix of clinical, social and psychological care and support. It also includes a social group that meets at the hospice every week and offers a range of activities including music and art lessons. In fact, since the social group was formed, two patients have met and fallen in love and were married in front of family and friends at the hospice in June this year.

"The money we've awarded will help to fund a nurse, three days a week, to support the young adults visiting the hospice. There were no social, art and support groups for young people needing hospice care on the island prior to our funding, which meant they had to travel to the mainland for treatment and couldn't access any social activities appropriate for their age group or specialist young adult treatment without travelling to the mainland. They were extremely isolated. By funding young person-specific support on the island, we have made a huge difference."

Nigel Harley, CEO at Mountbatten, said: "We are so pleased Southern Water's youth panel has chosen to award this money to Mountbatten.

"We offer advice and support from a specialist nurse who is available for the young adults who are referred. We also offer activities including creative therapies and relaxation, but more importantly, it brings people together, giving the chance to make new friends and grow in confidence and self-esteem.

"This funding will directly benefit young people living on the island needing the support of our specialist services."

Alex Willumsen
Community and Partnerships Programme Manager

Stakeholders impacted

CASE STUDY

Ensuring a high-quality supply of water for the future

Always improving water quality

"We're always looking for ways to improve our water treatment processes. The number of people our treatment sites serve is growing all the time so we need to make sure that we can treat the raw water we take from the environment as quickly as possible while maintaining strict quality standards.

"The Drinking Water Inspectorate had asked us to replace some of the filtering equipment at our Otterbourne Water Treatment site with a more resilient long-term solution, so I have been leading a pilot trial of two new ceramic membrane filtering processes.

"The design and installation is being done at small scale, in a live environment, to allow the testing of this new technology across all aspects of the cycle, from the quality of the filtration it provides to the potential future costs of installing this equipment at scale.

"This improved filtration technology means that the quality and quantity of the water processed through the site is greatly improved, which means we can more quickly and effectively supply our customers in the area with the essential, high-quality water they need as demand continues to grow."

Chris Hall
Project Manager

Stakeholders impacted

2
pilot schemes will improve water quality.

CASE STUDY

Enabling and empowering our people

Diving right into our new employer brand

"It's been a really exciting year for our team as we've finally launched our new employee value proposition. It took months from start to finish, working with our Communications team and colleagues from across the business to trial and test the attributes that would really bring to life our Water for Life brand.

"We engaged with people from across every level of the company, from operators to executives, to find out what they wanted Southern Water to be known for, and how they wanted us to behave. The attributes that we developed from this insight have been created to enable everyone to communicate with current employees and prospective candidates in a much more joined-up and consistent way. It's all about empowering and encouraging our people to play to their unique strengths. It will help us to broaden our employee diversity, and show our commitment to ED&I.

"We've started to use some of the messaging across our recruitment and internal communications channels already. The feedback we've had so far has been fantastic, particularly from some of the candidates we've met at recruitment fairs over the past few months. It's really helping us to engage new and more diverse audiences and have different conversations with our colleagues."

Simon Dickinson
Recruitment Manager

Stakeholders impacted

Engage

Our new employer brand is helping us to reach new audiences.

Enable

New brand tools are enabling different conversations with existing and new employees.

Sustainability continued

Delivering value for suppliers

Meeting our suppliers' needs in a rapidly changing economic environment

Read more on page 10

The evolving nature of the COVID-19 pandemic, BREXIT and rising costs have combined to bring into sharp focus the need to work collaboratively with our partners to create increasingly transparent multi-tier supply chains. It is also vital that we manage those relationships to create a culture of excellence, which drives engagement, reinforces our values, and nurtures trust. This is particularly relevant to those supply partners critical to the delivery of our business outcomes.

A further area of key focus has been around our energy supply chain to ensure we continue to review carbon savings in support of our Net Zero Plan published in 2021.

We have continued our proactive and collaborative procurement strategy, delivering a total £14.9 million in-year efficiency. We have held more than 233 sourcing events to deliver the right partners to help us achieve our business outcomes.

We have started to develop our strategy to 2030 to create a resilient, sustainable, outcome-based supply chain able to adapt to shocks, contribute to business performance and enable us to achieve our environmental and customer ambitions. We want to create a collaborative, diverse, sustainable, robust and inclusive supply chain that is invested in our long-term strategy and supports innovation.

We have re-imagined our contract management approach, ensuring that we more effectively manage, monitor and control supply chain risks through the development and launch of a Contract Management Centre of Excellence. We have developed a best practice contract management framework and are now working in partnership with colleagues to reduce risk, generate financial benefit and better reflect our core values.

We are embedding a coordinated and standardised source-to-pay approach through improvements to current systems and streamlining of our purchase-to-pay process to ensure best practice purchasing and improve financial governance.

We have continued to evolve our critical partner Supplier Development programme, evaluating current programmes to promote open collaboration and information sharing across partners. Through an open collaboration forum, the Integrated Supply Chain Group (ISCG), key deliverables and metrics are tracked to understand programme delivery risk and ensure actions are shared.

Construction costs have increased over the past six months, and more recently cost pressures have been increased due to the war in Ukraine. We continue to work with our partners to consider collaborative ways to maintain the affordability of schemes and the continuity of services for our customers.

We have continued to optimise our energy supply chain to achieve our net zero ambitions. Since April 2021 all electricity purchased has been green and we have procured Renewable Energy Guarantees of Origin for each year beginning in April 2021 through to April 2024. These actions have contributed to a reduction in our carbon footprint.

We remain committed to driving sustainability within our supply chain to minimise our environmental impact. Mandatory training has been introduced for all Procurement and Commercial employees, specifically CIPS Ethical Procurement and Supply module. We will continue to invest in a wider programme of training and education. Also, following the launch of our Supplier Code of Conduct, we are in the process of attesting compliance using best practice validated sources.

s172(1) Statement

In order to make effective decisions, the Board needs to take into account the interests of our stakeholders.

Read more on pages 46 to 47

How the Board is kept informed of stakeholders' interests

Customers

- Regular reporting on customer metrics and performance.

The Environment

- Reports from management covering: environmental stakeholders; briefings from Chief Environment and Sustainability Officer; and dedicated internal Catchment Risk Management team.

Communities

- Reports of participation in local community groups.

Employees

- 'Workforce engagement' director
- Employee panel
- Speak Up (independent whistleblowing service)
- Regular reports on employee health and safety and wellbeing
- Employee engagement results
- Culture plan and dashboard.

Regulators

- Regular meetings between Chair and CEO and the senior leadership of our regulators
- Reports from management
- Regulator annual reports and key correspondence.

Suppliers

- Regular reports on supplier performance and matters, including health and safety performance.

Ensuring effective stakeholder engagement

Under section 172 of the Companies Act 2006, directors need to consider the interests of the company's key stakeholders as well as the need to take into account the impact on the environment and the outcomes over the long term. Southern Water and its Board engage with a variety of stakeholders through various mechanisms, including membership of stakeholder panels, regular meetings with stakeholders, public meetings as well as speaking to people and visiting operational sites.

Delivery for our customers is one of our key priorities. The Board receives regular reports from management regarding customer performance and attitudes. The introduction of performance metrics that take into account the wider customer experience has also led to an increased need for awareness of customer views.

The needs of our customers are a top concern of the Board, particularly where they may face significant challenges, whether these be financial, physical or mental health-related, as a result of the COVID-19 pandemic and current economic situation in particular. The Board receives regular updates from our Vulnerability team which has been working directly with third-party support organisations in the community. Dame Gillian Guy, the former Chief Executive of Citizens Advice, who serves as an independent non-executive director, has further improved awareness of the needs and concerns of customers.

Our Board receive regular updates on environmental matters, including legislative changes, key areas of concern such as climate change, biodiversity and water resources. Our CEO has also appeared in front of the UK Parliament's Environmental Audit Committee and gave evidence in support of the committee's investigation into water quality in rivers. The company's Chief Environment and Sustainability Officer ensures that appropriate focus is given to this important area.

The Board receives regular updates on compliance and regulatory matters, regulators' reports and enterprise risk throughout the year. The Board is also updated on our culture, employee engagement and ethical business, including the annual review and approval of the Code of Ethics.

Kevin McCullough, an independent non-executive director, has the remit of engaging with the company's workforce and ensuring that their views are communicated to the Board. As mentioned last year, since the start of the COVID-19 pandemic, our CEO has held fortnightly 'Company Conversations' with the company's workforce which address a variety of topics, including Southern Water's performance.

These forms of engagement are supported by regular Gallup all-employee surveys.

The CEO, Ian McAulay, is a member of the Greater Brighton Infrastructure Panel, which focuses on capital infrastructure in the sub-region.

Regular meetings between senior representatives of our key regulators – Ofwat, the EA and the DWI – and our senior executives and Chair take place, in order to discuss our performance and compliance, as well as our plans for the future.

Since the major investment by a fund managed by Macquarie Asset Management in the company, the three shareholder-nominated directors ensure that the views of the company's major shareholder are communicated. In addition, the Board and executives have engaged extensively with the new investor, including through various 'deep-dives' into aspects of the company and in terms of developing the company's strategy.

Sustainability continued

s172(1) Statement

Overview

Section 172(1) of the Companies Act 2006 sets out several factors which the Southern Water Board takes into account in its activities and decisions.

Section 172 considerations key:

- Likely consequences of decisions in the long term
- The interests of the company's workforce
- The need to foster relationships with suppliers, customers and others
- Impact of operations on the community and environment
- Maintaining high standards of business conduct
- The need to act fairly between members of the company

For more information on how we take into account the interests of our employees, please refer to pages 62-65, 158-159.

Pollutions performance

Link to Section 172 considerations

Long-term impact

Investing for the long term, with focus on the impacts of climate change.

Community and the environment

Ensuring that the company's environmental impact is minimised, enabling water resources and the natural environment to be enjoyed long into the future.

Maintaining high standards of business conduct

Minimising the number of pollution incidents, or mitigating their impact where they do occur, and acting as a good 'corporate citizen'.

Outcomes and actions:

Investing £145 million as part of our Pollution Incident Reduction Programme to reduce the number of pollution incidents by over half (compared to 2019) by 2025.

Adopting a more proactive approach to maintenance of our sites, including identifying those sites at greatest risk of a pollution incident and taking steps to address the underlying causes. In particular, the Board focused on improvements to pumping stations and installation of improved sensors to both increase resilience of our network and to provide earlier warning of when a pollution incident may occur, thereby improving our response time.

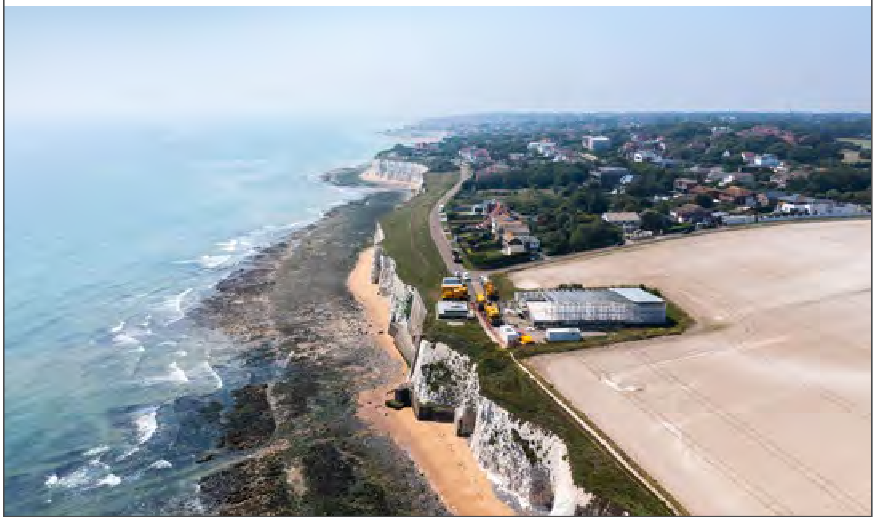
Creation of pathfinder projects to cut storm overflows, and maintaining active engagement with the UK Government and regulators on this matter.

Additional investment in our network to improve resilience and creation of an in-house tankering capability.

Link to risks:
Customer; Wastewater; Compliance; Corporate Affairs; Health and Safety; Financial

Link to strategy:
Deliver great service; Protect and improve the environment; Fit for the future

Read more on page 84



Investing for the future

Link to Section 172 considerations

Long-term impact

Invest for the long term to ensure continued supply of essential services.

Ensure that the company remains financially and operationally resilient.

Community and the environment

The need to address climate change and population growth in the South East.

Customers and suppliers

The need to ensure that our teams and contractors continue to deliver essential services for our customers.

Shareholders

Engaging with our shareholders and obtaining their support for our investment plans.

Outcomes and actions:

In September 2021, a fund managed by Macquarie Asset Management became the group's majority shareholder with an investment of £1 billion, enabling the company to invest further in its network and accelerate its transformation programmes.

Minimising the impact of the storms in late 2021 and early 2022 in order to maintain supply of essential services to customers. This was done through a combination of proactive measures to improve resilience and emergency response to ensure that customers can continue to access our services in the event of loss of supply.

Major investments in our network, including £18 million in Budds Farm Wastewater Treatment Works.

Supporting 140,445 customers in need of some form of financial assistance and assisting our customers in reducing their water consumption.

Investing a record amount while reducing our bills by 1.3%.

Link to risks:
Water; Wastewater; Financial; Resources; Climate Change; Delivery; Compliance; Customer

Link to strategy:
Deliver great service; Use water wisely; Protect and improve the environment; Fit for the future

Read more on pages 88 to 91

Protecting the environment

Link to Section 172 considerations

Long-term impact

Invest in environmental improvements to create a resilient water future for our customers in the South East.

Take steps to mitigate and adapt to climate change.

Community and the environment

The need to maintain and improve water quality in rivers and beaches so that they can continue to be enjoyed.

Outcomes and actions:

Launching of the Save Our Harbours initiative to protect Chichester and Langstone harbours from nitrates and phosphates and investment of £72 million to meet new phosphorus limits.

Creation of our Storm Overflow Task Force, working with partners in five communities across our region.

Increasing the size of our leakage team and employing new tools and techniques to find and fix leaks as part of our commitment to halve leakage by 2050.

Moving to a 100% renewable energy tariff as part of our commitment to being net zero by 2030.

Actively engaging with the UK Government and regulators as part of initiatives to improve the quality of the UK's rivers.

Link to risks:
Delivery; Resources; Corporate Affairs; Climate Change; Compliance; Water; Wastewater; Financial

Link to strategy:
Use water wisely; Protect and improve the environment; Fit for the future

Read more on pages 83 to 87

Sustainability continued

Sustainable finance

Sustainable finance is **helping us provide water for life for generations** to come

£1,125
million raised in sustainable bonds

Overview

Sustainable financing opportunities are increasingly being used by businesses to deliver projects as part of their overall business strategy. Our purpose as a business to provide water for life, exists against a backdrop of impacts from climate change and a rising population. Serving our customers long into the future means we need to drive improvements across key areas of the business, while protecting and enhancing the environment that we live in. Sustainable financing is helping us on our journey to a water resilient future.

Our sustainable financing framework

Our Sustainable Finance framework was published in 2020. Under the framework, we can raise green or social bonds, or both. The framework supports the financing and refinancing of our water, wastewater and waste management investments and activities across our region. These activities must demonstrate environmentally sustainable outcomes.

The framework was developed according to the ICMA (International Capital Market Association) principles for green bonds, social bonds and sustainability bonds and the Loan Market Association's Green Loan Principles, Sustainability Linked Loan Principles and KPIs.

Our sustainable bond investment

We have raised £1,125 billion in gross proceeds from sustainable bonds across two issuances:

- £825 million in May 2020
- £300 million in March 2021.

A total of £350 million was used to refinance projects completed during the previous business plan period (2015–20). The remainder is to support the funding of projects in the current five-year business plan to 2025.

Projects included need to meet a minimum number of social and environmental criteria, as well as having a capex addition value of above £500,000 in the year.

Social criteria:

- Affordable basic infrastructure
- Access to essential services
- Food security
- Socio-economic advancement and empowerment.

Green criteria:

- Renewable energy
- Energy efficiency
- Pollution prevention and control
- Sustainable water and wastewater management
- Environmentally sustainable management of living natural resources and land use
- Climate change adaptation
- Eco-efficient and/or circular economy, adapted productions, production technologies and processes.

Sustainable bond schemes

Our sustainable bonds support projects in both water and wastewater. The projects funded have been grouped into three areas: pollution reduction, compliance and leakage.

Examples of projects where we have used sustainable bond investment are:

- Compact treatment works underground
- Reservoir works
- New connections work
- Breaking down the run-offs from farms
- Replacement of failed linings in antiquated sewers
- Improving the quality of sewers.

The impact of our sustainable investments

Our sustainable investments across pollution reduction, compliance and leakage have a number of positive impacts in each of these areas.

Pollution reduction: Investment in this area means reduced pollutions, investment in greater operational efficiencies, pollution prevention and flooding control and compliance.

Compliance: Our projects in this area promote improved drinking water quality and greater operational efficiency.

Leakage: Projects in this area achieve improved water efficiency and increased capacity for population growth.

Governance

Projects are assessed for their eligibility to the portfolio by a committee consisting of members from our Treasury, Strategy and ESG teams.

The full capital programme of investment is overseen by our water and wastewater strategy groups and projects are monitored throughout their life cycle. Business cases are used to propose asset investments with different boards or ‘gateways’ giving approval as the proposal progresses through the approvals process. This process includes identification of risk, solution selection, and cost and benefit analysis. Eligible projects are reviewed and approved by our Investment Committee and, where required, by our board.

Read more: **southernwater.co.uk/our-story/investors**

Our operational performance

How we measure our progress

Our Water for Life Business Plan 2020–25 is broad and ambitious and includes 47 clear customer commitments.

Ofwat checks our compliance with our performance commitments for delivery of our services and our Section 19 undertakings. Several of our performance commitments have financial rewards and penalties associated with them. This means if we failed to meet our commitments to customers, we pay a penalty. And if we beat our targets, we earned a financial reward. Our performance during year two of this five-year period has earned us rewards of £2.4 million and penalties of £42.5 million.

Performance dashboard

Deliver great service

Read more on pages 77 to 80

Key outcome	Why it is important	Associated ODI	Performance (RAG) 2021–22	Performance (RAG) 2020–21	Link to remuneration
Water quality	It is essential to always provide clean, safe drinking water. This is seen as a basic service from a water company and the most important of the services we provide. Our customers' preference is for water to be as natural as possible.	• DWI Compliance Risk Index (CRI)	○	–	Indirect
		• Drinking water appearance	–	–	
		• Drinking water taste and odour	✓	–	
		• Replace lead pipes	–	–	
Supply interruption	Customers want us to be able to deal with problems, such as interruptions, quickly and efficiently. Any interruptions require clear communication, as they can cause inconvenience and distress to customers.	• Water supply interruption	–	○	Indirect
Customer experience	Customers want to see us improve our customer service performance. They want us to minimise the impact of issues and disruptions to their daily life. When shown comparative information, they expect us to do better.	• C-MeX	–	–	Direct
		• Void properties	–	–	
		• Gap sites	–	–	
Sewer flooding prevention	It is essential that our network stops homes being flooded with waste from sewers. There is strong support to ensure we continue to improve sewer flooding prevention.	• Internal sewer flooding	○	–	Indirect
		• External sewer flooding	✓	✓	
Water pressure	Customers expect a standard of water pressure to be part of the basic service we provide.	• Properties at risk of receiving low pressure	✓	○	Indirect
Supporting the vulnerable	Customers find the concept of the social tariff acceptable. They want us to protect the most vulnerable in society, and find it acceptable to pay a little extra on their bill to help those in genuine need. They want us to partner and provide support by understanding and acting on customers' individual circumstances.	• Customer satisfaction with vulnerability support	–	–	Indirect
		• Effectiveness of financial assistance	–	–	
		• Priority services for customers in vulnerable circumstances	–	–	
		• Value for Money	○	–	

Direct – there is a specific performance measure included within the bonus scheme that is linked to the performance commitment.
Indirect – there is a link to the performance measures in the bonus scheme but that it is a component of one of the metrics used for assessing performance rather than a specific/individual metric.

Deliver great service

Key:

Ofwat target met or exceeded

Ofwat target missed but performance improved in relation to prior year outcome

Ofwat target missed and performance worse than prior year outcome.

We serve a community of 2.6 million water and 4.6 million wastewater customers. All our customers rightly expect high-quality service delivery with customer-friendly access when needed, and minimal disruption to their daily lives.

Water quality

Our customers expect a constant supply of high-quality drinking water with little or no taste or odour.

The Compliance Risk Index (CRI) measures the risk arising from treated water compliance failures. Any failures are assessed by the Drinking Water Inspectorate (DWI).

Our water quality measure CRI score has risen to 6.69 (2020–21: 4.53), as a result of an increased score at service reservoirs and consumer taps and failures at our Burham Treatment Works in November 2021. We incurred a penalty of £2.945 million. While this is better than our 2020 score of 7.7, there is still a significant gap between where we are and where we need to be.

We continue to deliver against our established compliance improvement plan, agreed with the DWI. Our HazRev programme to identify water service risk, is making improvements to water supply works, and we are using Hazard Reviews as part of our Water First initiative. We are investing in site improvement and improving our people and process capability.

The quality of our drinking water is extremely important and, during the year, 99.97% of samples met all the necessary standards. We have a DWI notice which requires us to meet a minimum 10-year inspection frequency for all water service reservoirs, water towers and break pressure tanks by March 2025, to ensure these water storage facilities meet the required health standards.

For drinking water taste and odour, we ended the year by meeting our target of 0.23 contacts per 1,000 population. This means that less than 1 in 4,000 people got in touch with us about drinking water taste and odour. We finished the year on a total of 0.87 contacts per 1,000 population for drinking water appearance (1 in 1,150). This was outside our performance target of 0.74 contacts (1 in 1,333). We are working on improvements such as a mains cleaning (flushing) programme, started in early September focused on specific areas. We have flushed 590km of pipes during 2021–22, which represents 4.3% of our water network.

We are quite prepared to bring prosecutions when our water supply network might be compromised. In May 2021, we successfully prosecuted a company for interfering with hydrants and illegally connecting to the network. The company was conditionally discharged for 24 months and ordered to pay costs. We also successfully prosecuted someone following a discovery in August 2021 that new water supply pipework had been illegally installed to serve some newly developed residential properties at a location in Petworth. He pleaded guilty to two offences and was fined £350 for each offence and was ordered to pay our costs.

The replacement of lead pipes is currently in a pilot phase. We are running a trial scheme in the Deal area, which will help shape the strategy for other lead replacement schemes across our region.

Supply interruption

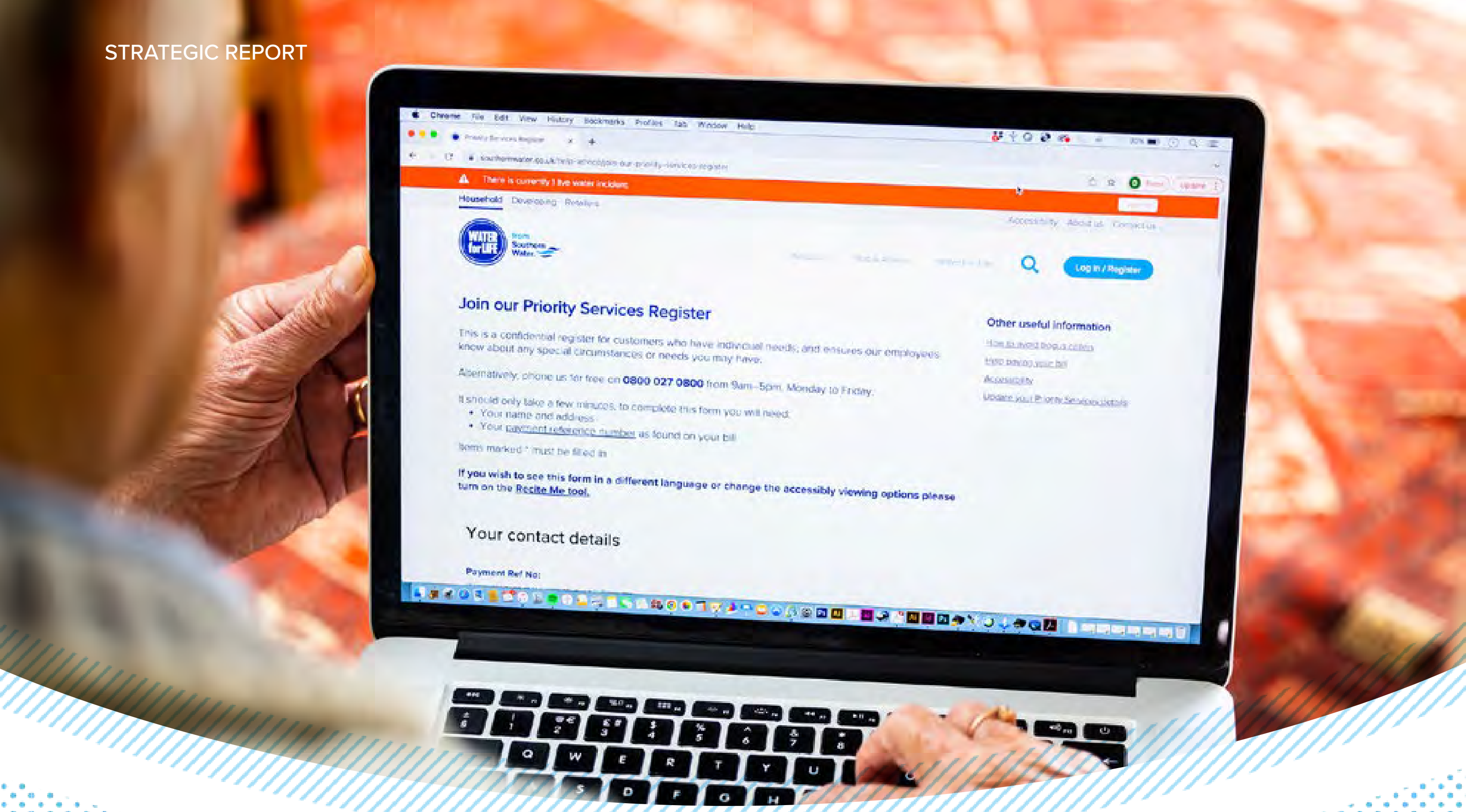
Although we have improved the average number of minutes customers are without water during a loss of supply incident by achieving an average of nine minutes 22 seconds (2021: 12 minutes, 43 seconds), we did not meet Ofwat's target of six minutes, eight seconds. This was mainly due to two major incidents, which should not occur in the future after changes in infrastructure and find-and-fix services.

Improvements have largely been due to the measures put in place under the Calm Network programme. The resulting reduction in outages protects water quality and reduces inconvenience to the customer, as well as driving down leakage. We have also increased our find-and-fix teams, carrying out checks seven days a week to stabilise network performance and repair leaks as quickly as we can.

Looking ahead, asset enhancements are expected to create increased resilience and the work done to forecast and plan ahead should help us to be more aware of where interruptions may occur.

99.97%
of our water samples met the standards

590km
of pipes flushed in our water network to clean the mains



Customer experience

We are disappointed to remain 16th out of 17 water companies in the UK in terms of our customer satisfaction metric C-MeX (2020–21: 16th). As a result, we incurred a penalty of £4.5 million. We are taking steps to improve our service in a variety of ways, and over the past year we have introduced:

- Customer billing improvements, helping customers who have a high debit or credit on their account to receive a more consistent bill.
- Tailored collections, to recognise how and when a customer prefers to be contacted about money owed. This has resulted in lower collection costs for our company. The method works better for the customer, as well as saving us money.
- Increased use of technology in our contact centre, enabling customers to get the information they want more quickly.
- A new Smart Agent, providing a knowledge base for our advisers, so that they can help respond to customer enquiries more quickly. This may be developed in the future by integrating it with the screen the agent sees, so that the customer would be automatically be guided through the information.

Helping customers achieve a quick and effective resolution to their contact with us is important, so we want to drive more customers to self-serve using our digital channels. Our web chat service has seen an increase of 500% in the average number of chats per month compared to the end of 2019. Digital billing transactions have increased 46% year on year since 2019–20 and in the past 12 months they have increased a further 14%. We can see that customers often prefer to use digital methods to contact us, as call volumes have reduced by 25% year on year since 2019–20. This year they reduced by a further 2%. To improve our digital customer experience still further, we plan to refresh our website by the end of 2022.

Two notable increases in complaint volumes were seen in the year as a result of the Environment Agency prosecution and fine, and increased media interest in storm overflows. The number of written complaints we received in 2021-22 was 9,131. We always aim to reduce complaints and in 2021, we delivered a new handling system to help resolve more complex complaints. Our number of escalated complaints has gone down since its introduction. We have also introduced the new Stage Zero process, where we try to understand expressions of dissatisfaction earlier in the process, so that customers do not reach the point where they feel they need to complain.

500%
increase in average number of web chats.

Deliver great service continued

56%
increase in the number of customers on our Priority Services Register.

We did not meet our Ofwat target of no more than 2.28% of our properties classified as void compared to the number of properties served by our company. We achieved 3.12% (2020–21: 3.47%), incurring a penalty of £600,000. We are looking to improve our position through data cleansing, with property owner processes also being targeted to reduce void levels. Our new occupier ID service is now live, reporting significant numbers of void properties in its first collection of data.

We did not reach our target for gap sites of 65 properties connected to the water supply but not registered for use. We identified 33 through our joint billing contract with South East Water.

Sewer flooding prevention

We had an exceptionally high number of internal sewer flooding incidents recorded in July and August 2021. This was due to intense rainfall over the summer, including a one in one-hundred-and-fifty-year rainstorm which caused flooding in Herne Bay – this represented a 254% increase in average rainfall.

Internal flooding incidents can be very distressing for residents who are affected, and we work hard to put the damage right. Our 21-point tactical action plan aims to improve our performance in this area, with proactive approaches to improving resilience during weather events, and our 'first time fix' teams working on the frontline to deliver solutions for customers. We recorded 614 internal flooding incidents (2020–21: 393) and incurred a penalty of £7.835 million as a result.

This year, we had fewer external flooding sewer incidents, reporting a total of 3,944 against a target of 4,141. This earned us a reward from Ofwat of £948,000. We still want to make further improvements in this area.

We are using local area catchment surveys, and blockage clearance in our worst performing areas. Our Pollution and Flooding Resilience team works to deliver best practice in this area and our Zero Flooding project continues to aim to eliminate sewer flooding incidents in key hotspots across our regions. Blockages and weather events can all put pressure on our networks, so we are continuing our fat, oil and grease (FOG) and Unflushables campaign to explain to customers what can go down the toilet or the sink, as well as improving our incident response.

Supporting the vulnerable

As a result of the impacts of COVID-19, the rising cost of living and increases in energy prices, we know that many of our customers have been put under enormous financial pressure. We have increased the number of customers on the Priority Services Register by 56%, and provided 140,445 customers with financial support. We have made it a priority to offer support where we can, and we are reducing our bills over the next five years by 18%. Our survey of customer satisfaction for vulnerability support scored 73%, which is higher than our score of 70% last year but below our target for this year of 81%. We will be reaching out to our vulnerable customers to understand how we can improve our performance.

In terms of effectiveness of financial assistance, this is measured by the percentage of customers that pay their bills in the immediate 12 months following the receipt of support. For customers who were accepted onto a financial assistance scheme in 2020–21, we reached 67% which is consistent with the 68% for customers who secured financial assistance in 2019–20. We have a number of financial assistance schemes in place to support our customers:

- Watersure – can cap bills.
- Water Direct – Jobcentre Plus may pay us directly from a customer's benefits.
- NewStart – we match additional payments towards your debt.
- Essentials – provides a discount on future bills.

We also secured funding from Kent and Hampshire County Councils at the end of March to support customers struggling financially.

According to our annual survey measuring customer satisfaction regarding the cost of their water and wastewater services, we scored 67% in 2021 compared to 71% in 2020. We aim to reach a level of at least 75% of our customers being satisfied.

Legacy issues and media attention have damaged our reputation with some of our customers over the past year, however, improvements to our service and a focus on rebuilding trust is helping maintain satisfaction with perceptions of value for money. Our combined water and wastewater bills have also decreased.

Water pressure

We reduced the number of properties at risk of receiving low pressure, ending the financial year on 210 (2020 –21: 310). This means we outperformed our Ofwat target of 227.

Deliver great service continued

Looking to the future

We want to improve our CRI score significantly and we are working to:

- Reduce our CRI score by over half from 6.69 down to a score of under 2 by the end of the current business plan period (2020–25)
- Increase the level of investment significantly in this period
- Deliver one of our most ambitious capital maintenance programmes to date, with a focus on: strategic surface works; reservoir cleaning/replacement; targeted mains replacement; driving improvements in laboratory performance through process and training enhancements; improved site hygiene, the sampling environment, dynamic risk management, grounds maintenance and chemical dosing.

We want to prevent sewer flooding, so over the coming year we are planning the following key initiatives to:

- Carry out sewer capacity surveys in targeted areas, to ensure we identify and address any loss in capacity in areas where flooding is an issue
- Conduct proactive surveys on sewers which are known to suffer with issues and lining sewers where issues are found, to prevent re-growth
- Build on our successful flooding hotspot customer engagement, working with customers to reduce flushing of wipes and fat, oil and grease.

Our operational performance continued

How we measure our progress continued

Key:

- Ofwat target met or exceeded
- Ofwat target missed but performance improved in relation to prior year outcome
- Ofwat target missed and performance worse than prior year outcome.

Use water wisely

Read more on page 82

Key outcome	Why it is important	Associated ODI	Performance (RAG) 2021–22	Performance (RAG) 2020–21	Link to remuneration
Leakage	Customers say it is essential to reduce the amount of water lost through leaks from our network. They believe water is a precious, natural resource and expect us to look after and use it wisely.	• Leakage	Ofwat target missed but performance improved	Ofwat target missed but performance improved	Indirect
Water consumption	Customers are interested in understanding more about their water usage. They see saving water as a partnership issue and are looking for us to help them save more.	• Per capita consumption	Ofwat target missed and performance worse	Ofwat target missed and performance worse	Indirect
		• Target 100	Ofwat target missed but performance improved	Ofwat target missed but performance improved	
		• Water saved from water efficiency visits	Ofwat target missed but performance improved	Ofwat target missed but performance improved	
		• Access to daily water consumption data	Ofwat target missed and performance worse	Ofwat target missed and performance worse	

Direct – there is a specific performance measure included within the bonus scheme that is linked to the performance commitment.
Indirect – there is a link to the performance measures in the bonus scheme but that it is a component of one of the metrics used for assessing performance rather than a specific/individual metric.

Water is a precious resource that we need to protect. We are working to improve leakage and help our customers save water.

15% reduction in leakage by 2025 is our aim

Leakage

This year, we recorded a three-year rolling average leakage rate of 94.9 Ml/d (2020–21: 98.5 Ml/d) and while this was outside the target set for us by our regulator of 93.9 Ml/d, we have made improvements in a number of areas.

In February, the second phase of our advanced pressure management began as part of our Water Network Digitalisation project. Recruitment of additional detection resource is in progress and a number of mains replacement schemes began in May, to continue to drive down leakage.

Water consumption

Due to the COVID-19 pandemic and people being at home more, domestic water usage continues to be high. The three-year rolling average is above our target of 125.4 litres per person, per day at 133.6 litres per person, per day (2020–21: 137.6 litres). We have been working with Ofwat and the wider water industry to understand the long-term effects of the pandemic on water usage. An independent study called COVID-19 Impact, Extra Hours Model (published July 2021) shows that on average usage increased by around 8% during 2020.

Target 100 is our commitment to, and agreement with, our customers. We will advise, support, incentivise and educate on how to reduce water use to 100 litres per person, per day by 2040.

Through a combination of 'Always On' and targeted engagement, we are focusing on a series of behaviour change communications campaigns in our 'stressed' water resource zones, divided into East, Central and West for tracking purposes.

Use water wisely

6,000
registrations to the GetWaterFit online water calculator

8%
increase in domestic water use

Our most recent campaign throughout the summer of 2021, has spread our #ItAllMakesADifference messaging across both our 'Always On' channels and targeted streams in our most-water stressed areas, covering print, radio, digital, outdoor (bus, rail and billboard sheets), as well as a number of face-to-face events in the central area. In a first for us, we also created our own water-saving TV ad which we broadcast with Sky over August and September in two of our most water-stressed areas.

In total we have delivered more than 64 million impressions and 1.6 million direct communications in the form of emails and door drops. This has resulted in estimated campaign awareness levels of: West 56%; Central 39%; East 47%, which we estimate amounts to more than 858,000 customers and around 338,000 households who have taken active steps to reduce consumption as a result.

We recorded a figure of 35% of households at Target 100, whereas the target set by our regulator was 51% of households.

Customers can benefit from our Water-Saving Home Visits. The visits provide an opportunity to give information and assistance to customers about using water more wisely and saving money.

We also promote home visits and water saving through our projects with local councils, including Kent County Council and Southampton City Council. Since January 2022, customers have been able to have water butts fitted at their properties. A total of 81 water butts were installed in the first two months of the scheme, saving an estimated 775 litres of water per year.

As customers have told us that they find the information from these visits helpful, we have started using digital methods to reach out to more customers. The GetWaterFit online water calculator, invites customers to find out about their water usage and then 'take control' by suggesting small steps to save water. The online platform has had over 6,000 registrations since it launched in May 2021.

Water saved from water efficiency visits is recorded as a cumulative saving in cubic metres per day (m3/d). The ongoing COVID-19 pandemic has meant we were not able to meet our 2021–22 target of 1,000 m3/d, however, we have managed to increase our visits to reach 359 m3/d (2020–21: 105 m3/d). We are on track to complete our target of 2,500 by 2024–25.

Reducing consumption is a priority and we are currently reviewing how we can progress enabling access to daily water consumption data.

As well as reducing consumption, new water sources are necessary to keep local taps and rivers flowing today and in the future. Our Water for Life – Hampshire programme will protect the county's precious chalk streams while maintaining supplies for customers, especially in a drought. Read more: **southernwater.co.uk/our-story/water-for-life-hampshire**.

Looking to the future

We want to halve our leakage by 2050 and over the coming year we:

- Aim to continue to bring leakage down from our baseline of 99.9Ml/d by more than 5%, keeping us on track to reduce leakage by 15% by 2025.
- Carry on the use of advanced pressure management, leading to a calmer network, better targeting of leakage areas and replacement of frequently bursting mains.

Our operational performance continued

How we measure our progress continued

Key:

✓ Ofwat target met or exceeded

– Ofwat target missed but performance improved in relation to prior year outcome

○ Ofwat target missed and performance worse than prior year outcome.

Performance dashboard continued

Protect and improve the environment

Read more on pages 84 to 87

Key outcome	Why it is important	Associated ODI	Performance (RAG) 2021–22	Performance (RAG) 2020–21	Link to remuneration
Pollution	Customers want us to treat and dispose of wastewater in a way that does not harm the environment. They rightly believe we have a duty to protect and improve the environment in which we operate, and ensuring we do no harm through pollution incidents is the minimum they expect.	• Pollution incidents	–	–	Indirect
		• Thanet sewers	✓	✓	
High-quality bathing and river waters	Our customers want to see us do more to deliver excellent bathing and river water quality. They want us to recognise the importance of this to tourism.	• Delivery of water industry national environment programme requirements	–	–	Direct and Indirect
		• River water quality	✓	✓	
		• Maintaining bathing waters at 'excellent'	✓	✓	
		• Improve the number of bathing waters to 'good'	✓	✓	
		• Improve the number of bathing waters to 'excellent'	✓	✓	
		• Treatment works compliance	–	○	
		• Combined Sewer Overflows (CSO) monitoring	–	○	
Water resource abstraction	Customers want us to use a range of sources to provide reliable services in the future and expect removal of water from the environment to be done in a sustainable way.	• Distribution input	–	○	Indirect
		• Abstraction incentive mechanism	✓	✓	
		• Effluent re-use	✓	✓	
Renewables	We should be increasing the amount of renewable energy we use in our operations. There is a growing expectation that we should be using our own wastewater services to generate more energy as well.	• Renewable generation	○	–	Indirect
		• Natural capital	✓	✓	
		• Satisfactory bio-resources recycling	✓	✓	

Direct – there is a specific performance measure included within the bonus scheme that is linked to the performance commitment.
Indirect – there is a link to the performance measures in the bonus scheme but that it is a component of one of the metrics used for assessing performance rather than a specific/individual metric.

Protect and improve the environment

60
out of 83 bathing waters classified as excellent

27%
fewer operational pollution incidents

To deliver water for life and ensure a resilient water future, we need to protect our environment from harm and improve it where we can.

Pollution

To keep our bathing waters, rivers and reservoirs clean, we need to significantly reduce pollution incidents. We have set ourselves an ambitious target for reducing pollution incidents to zero by 2040.

During 2021 we set up a dedicated Storm Overflow Task Force to lead work that will drive a reduction in flooding and the use of storm overflows in our region, thereby reducing pollutions. Our task force is looking at ways to reduce the amount of water entering our sewerage system. A range of nature-based solutions such as ponds, wetlands and soakaways can be used and we are launching projects in five catchments.

We publish our annual pollution figures on our website. We recorded 372 Category 1-3 pollution incidents, a 7.5% reduction from 2020. We still have significant improvements to make to reach our Ofwat target in this area, which was a maximum of 94 incidents.

Our work specifically targeting operational pollutions has resulted in a 27% reduction compared to 2020. However, these were offset by a higher number of pollutions related to spills due to the atypical weather seen, particularly over the summer months of 2021 with some very intense and heavy summer storms. Pumping stations are the largest contributor to our pollution incidents and together with treatment works, they will be the focus attention to improve this area.

During 2021, we have been implementing a variety of actions to reduce pollution incidents by:

- Improving asset resilience – this includes carrying out health checks on water pumping stations and water treatment works
- Trusted monitoring and analysis – our spills reporting system, ASPIRE, is an example of this
- Customer participation and network – such as targeted campaigns for blockage reduction
- Human error reduction – our Clever Nelly training-needs analysis tool checks knowledge and identifies gaps for training opportunities.

The three strategic programmes that are driving improvements are the digitisation of our network, updates to our control room and planned preventative maintenance.

A number of business-as-usual initiatives, including pollution awareness training programmes and the introduction of an operator framework aligned to external NVQ standards, have also driven improvements. Our Pollutions team has also recruited a 'human factors' investigator, to review processes and reporting.

The next phase of our work, described in the third iteration of our Pollution and Incident Reduction Plan (PIRP), has five programme areas:

- Wastewater pumping station upgrades
- Wastewater pumping station/wastewater treatment works asset availability
- Wastewater pumping station and network cleansing and escape prevention
- Pollution from spills reduction programme
- Strategic projects.

Our Beachbuoy programme, which provides the public with data on the quality of our bathing waters, was enhanced. The programme makes bathing water quality information available on our website in near real time. A pilot was undertaken in spring 2022 to assess the feasibility of providing real-time data in the future.

All new starters that come into the business will have to complete pollutions awareness training from 2022, through a blended programme using eLearning and a virtual session. All current wastewater employees have gone through this training. We also have a new virtual reality in creation for the practical element, this will complement it.

Our Thanet sewer enhancement scheme is entering its third and final phase. The wastewater network rehabilitation works are being undertaken to protect groundwater. We undertook site surveys in spring 2022 to help us confirm the scope of works for Phase 3. During the survey phase, approximately 1,700 manholes were surveyed and a programme of circa 100km of CCTV surveying began in March 2022. The conclusions of the surveys will inform the rehabilitation scope. Construction activities are due to commence on site towards the end of 2023. We are planning to complete Phase 3 by 2025.

High-quality bathing and river waters

We did not meet our performance commitment for delivery of the Water Industry National Environment Programme's (WINEP) requirements. This was due to our failure to deliver two schemes according to the plan – one was delivered but outside the agreed timeframe, the other is being delivered in collaboration with South East Water and has been delayed until next year.

The programme has a set of actions that all water companies in England are required to complete between 2020–25. The actions aim to make improvements to the natural environment, ensuring that there is no negative impact on the environment when taking water from rivers, reservoirs and groundwater sources.

As part of our WINEP delivery, we are working to deliver one of the largest-ever environmental improvement programmes to improve the water quality in 537km of rivers. During 2021–22, we reached our target to complete a total of 82.5km of rivers over the year.

All 84 of our bathing waters meet strict European standards and the Environment Agency confirmed that in 2021, 60 of these were classified as 'Excellent'. This was an increase on the 58 bathing waters classified as 'Excellent' in 2019–20. The Environment Agency based the 2021 bathing water classifications on samples collected over 2017, 2018, 2019 and 2021, as due to the impacts of COVID-19, no classifications for bathing water were published in 2020. The 2021 results showed that six of our bathing waters had improved from 'Good' to 'Excellent' and four had gone from 'Excellent' to 'Good'. Three of our bathing waters are classified as 'Sufficient' and none are in the 'Poor' category.

Our bathing water enhancement programme has continued with data being gathered at nine bathing waters by June 2022 to understand any sources of contamination. We also drew up plans to engage with a variety of stakeholders to look at possible improvements to be gained after:

- Misconnection investigations.
- Liaising with local councils to get specific local knowledge to devise plans to tackle litter, seabirds and controls on dogs.
- FOG (fat, oil and grease) team discussions and the network protection team to understand how we can collaborate to reduce releases to the environment from sewer blockages.
- Investigation of potentially defective sewers close to bathing water sites.
- Discussions with farmers to reduce pollution from grazing livestock.
- Liaising with holiday park owners to understand the integrity of their private sewerage, assets and treatment methods and disposal.
- Discussions with the Environment Agency and local Environmental Health Officers about properties which are not connected to the main sewerage system.

We monitor bathing water sampling at all sites carried out by the Environment Agency throughout each bathing season. This allows us to understand if any high concentration samples are related to releases from assets, rainfall or particular tidal conditions. By monitoring in this way, we can identify any problems rapidly and, in some cases, resolve any issues within a relatively short period of time.

Our record for treatment works compliance is slightly higher than last year at 97.94% compared to 97.06% in 2020, this represents seven failing sites in 2021 compared to 10 in 2020. This performance commitment aims for 100% compliance with Environment Agency standards to maintain and improve our wastewater treatment works. Due to falling short of our target, we earned a penalty of £10.6 million. We have improved our 'intensive care'

97.94%
treatment works compliance for 2020–21.

Protect and improve the environment continued

24%
of the energy we use will come from renewable sources by 2025.

processes to enhance the management of these sites and we continue to focus on the areas that we know need improvement.

To relieve the pressure on the network and avoid any flooding to properties or businesses in the community, Combined Sewer Overflows (CSOs) can be used. These storm overflow releases are classified as pollutions when they do not meet the permit conditions for a 'consented discharge' and environmental\amenity impact occurs or can be classed as a pollution incident if permit conditions are met, but environmental\amenity impact occurs. Over the past year, we have reported a lower number of releases from storm overflow releases than the previous year (19,782 releases in 2020 and 19,077 releases in 2021). In 2021 this meant an average of 20.2 releases per outfall - this is the lowest of all the water companies.

Event duration monitors (EDMs) have been installed at a total of 959 of the 974 storm overflows helping to keep track of this area. Our performance commitment is to achieve effective spill monitoring at 97% of our combined sewer overflows (CSOs). We currently have fully effective monitoring for 87.8%, with coverage of 98% of CSOs and plan to continue our focus in this area.

Water resource abstraction

Over the past year, due to demand we exceeded our target of 520 Ml/d for the amount of clean drinking water available in our water distribution network. We supplied our customers with 556 Ml/d (2020–21: 563 Ml/d). Domestic water use has continued to be higher than it was before the pandemic, requiring more water to be available in the system. However, we have benefited from a lack of a significant 'freeze' in the first few months of 2022, which often requires extra water due to bursts or leaks.

We outperformed our target to reduce water abstraction from the Otterbourne and Twyford rivers during the month of September. During this month of the year, following the summer's hotter weather, the river is at its lowest so the impact of abstraction on the environment is the greatest. Our abstraction was well within our legal limit of 2,280 Ml/d for the month – we abstracted 16 Ml/d less, which is better than our target of 15 Ml/d. We have therefore received a reward of £510,000 from our regulator. The aim of the performance measure is to protect the important chalk streams in Hampshire.

This year, we made 127 m3 of effluent available for direct re-use (2020–21: 273 m3). This year's reduction in volume is due to a lower number of effluent requests being received. The treated effluent is re-used by local authorities, businesses, farmers and communities, reducing the overall demand for fresh water.

Renewable generation

In our Net Zero Plan we made a commitment to achieve the production of 24% of the energy we use from renewable sources by 2025. This year's performance commitment set by our regulator for renewable generation was to generate 21.3% of the company's total electricity consumption. Ofwat's target has not been met, as we achieved 15.85%.

Although our target for renewables has not been reached, we are constantly reviewing our work in this area to make the best carbon-saving decisions available to us at the present time and into the future. A new programme to implement solar third-party funded Power Purchase Agreements (PPA) is being planned from June 2022, which could produce 3% of the energy we need. Our Combined Heat and Power (CHP) programme which is currently under review, could also provide a significant part of our target amount of renewables each year, by providing energy at our Sludge Treatment Centres.

We continue to look to increasing our renewable energy production, with plans to install solar arrays at more of our sites as well as continuing to use alternative fuel by generating biogas. Energy efficiencies are also constantly being sought for our site operations. We have a small working solar array at Hardham Water Supply Works and since 2017, we have had working arrays at Testwood and Otterbourne. A further solar array is in the design phase at Peel Common, with implementation scheduled for the summer of 2022.

Our Net Zero Plan was published in July 2021, and we have committed to being carbon neutral by 2030. We have procured Renewable Energy Guarantees of Origin (REGOs) for each year beginning in April 2021 through to April 2024, moving towards the use of deep green energy. This means all the electricity we have purchased since April 2021 has been green, which has significantly reduced our carbon emissions.

We are starting to implement a natural capital approach across the business. We aim for nature-based solutions wherever possible, and our local partnerships are key to us working effectively across the region to evaluate natural capital value and opportunities.

This year we completed the first-ever natural capital baseline assessment of our land holdings. This gives us a benchmark against which we can measure any enhancements or deterioration in the natural capital value of our sites and will help us direct investment where needed. This contributes to the effort to combat biodiversity loss and mitigate climate change, as well helping to shape our natural and social capital accounting methodology, as we imbed these into our business-as-usual approach.

We continued to meet our 100% commitment for using or disposing of our sludge. We maintained our Biosolids Assurance Scheme certification for a further 12-month period in July 2021 and satisfactorily met all treatment, storage, and disposal requirements under the relevant sludge regulations.

Our commitment aligns to the Environment Agency's methodology which is defined in its Environmental Performance Assessment. Along with other members of the Water UK Biosolids Network we consulted with the Environment Agency on proposed changes to the Environmental Performance Assessment and participated in shadow reporting under a revised measure during the 2021 calendar year.

100%
of our sludge from our treatment process is recycled.

Looking to the future

Our Pollution Incident Reduction Plan (PIRP) for the coming year sets out how we plan to:

- Significantly reduce pollution incidents in 2022, from 372 to under 200, with the aim to do even better to reach 147
- Use a combination of implementing improvements to people, process and control
- Introduce new systems to improve incident detection and response, and use pollution awareness training.
- We will continue to roll out of 22,000 sensors on our wastewater network, allowing us to spot weaknesses or failures.

Our operational performance continued

How we measure our progress continued

Key:

✓ Ofwat target met or exceeded

− Ofwat target missed but performance improved in relation to prior year outcome

○ Ofwat target missed and performance worse than prior year outcome.

Fit for the future

Read more on pages 89 to 91

Key outcome	Why it is important	Associated ODI	Performance (RAG) 2021–22	2020–21	Link to remuneration
Asset health	It is essential to be investing in our sewer networks, pipes and drains. Our customers want us to upgrade where we can and use innovative and sustainable solutions.	Mains repairs	✓	○	Indirect
		Unplanned outage	✓	✓	
		Risk of sewer flooding	✓	✓	
		Sewer collapses	−	○	
Water resilience	Customers want to ensure supply for future generations. They are willing to invest now to ensure that there is no deterioration of services in the future.	Water supply resilience	✓	✓	No link
		Long-term supply and demand schemes	○	✓	
		Risk of severe restrictions in drought	✓	✓	
		Impounding reservoirs	✓	✓	
Growth	Businesses think it is important to work with councils and developers on infrastructure. Customers recognise the challenge of new homes drawing on our network and expect us to ensure it is fit for the future.	D-MeX	−	−	Direct
		Surface water management	−	○	
Community engagement	Keen for us to focus on our role in the community, our customers want us to collaborate with local groups on important issues, support community outreach programmes and educate the next generation in schools.	Community engagement	○	−	No link
		Schools visited and engagement with children	−	✓	

Direct – there is a specific performance measure included within the bonus scheme that is linked to the performance commitment.
Indirect – there is a link to the performance measures in the bonus scheme but that it is a component of one of the metrics used for assessing performance rather than a specific/individual metric.

Fit for the future

We need to ensure our assets are fit for purpose so we can create a resilient water future for our customers, the environment and our communities.

Asset health

Over the past year, we have significantly improved our mains repairs performance, achieving 101.5 repairs per 1,000km of our network, bringing us well within our 118.3 target, earning us a reward from our regulator of £924,000.

The percentage of production capacity lost due to unplanned maintenance work is measured in our performance commitment of unplanned outage. We outperformed our target of 9.11% by achieving 7.19% (2020–21: 9.21%). Our outage recovery plan and a return to service of Falmer Water Supply Works have contributed to our improved asset health.

We outperformed our target to achieve lower than a 12.42% risk of sewer flooding achieving a score of 11.50%. This is measured in terms of the percentage of the region's population at risk from flooding from a 1-in-50-year storm, based on modelled predictions.

We will be considering the priority of the works required for three sewer flooding protection schemes, with a view to progressing them before 2025 if required: Black Rock short sea outfall in Brighton; Portobello pumping station in Brighton; and increasing resilience of our outfall at Seaford.

We understand that customers and the environment can be significantly impacted by sewer collapses. We measure our performance in this area by the number of sewer collapses, including mains bursts, per 1,000 kilometre of sewers. Our target was to not exceed 226 collapses and we did not achieve this target, with 314 in 2021–22. This resulted in a score of 7.87 and a penalty from our regulator of £4.110 million.

Water resilience

We reached our performance target this year for water resilience. In 2021–22 our target was 142,987 properties and this number has now been reduced to 131,201 (2021: 139,131). This measure records the number of residential properties in the areas of Thanet, Brighton and the Isle of Wight water supply zones at risk of long-term loss of supply (>48 hours). We are about to enter the construction phase of our resilience projects in Thanet and Brighton and are continuing our design work for the Isle of Wight. We therefore remain on target to deliver our target of 77,622 at the end of this business plan period (2025).

Networks 2030 is one of five transformational programmes, which identifies ways to modernise and rationalise our water supply networks. This includes the replacement of water mains and the use of smart water-quality sensors.

Our performance commitment in the area of long-term supply demand schemes relates to schemes to be delivered by 31 March 2027. The schemes address supply capacity and they are in the planning phase. While there have been unavoidable delays to some of the schemes, we are still committed to delivering all others by the deadline.

In the already water-stretched South East, the impact of climate change and population growth are putting our water resources under even more pressure. It is therefore vital for us to prepare for possible drought. The percentage of the customer population at risk of experiencing severe restrictions in a 1-in-200-year drought, as an average, over 25 years. In 2021–22, we met our performance commitment of zero risk to customers for drought.

Our work with Water Resources in the South East (WRSE) has enabled the production of a regional water resources plan which will secure resources for the next 75 years. To continue to improve our water resilience, we have introduced several schemes as part of our Water Resource Management Plan 2019, which aim to increase the availability of water supplies in our region and reduce our reliance on the environmentally sensitive rivers Test and Itchen. They will improve water flow in our region from East to West, connecting our Andover and Southampton resource zones and creating more connectivity between the South and North of the Western area. Three water recycling projects in Aylesford, Sandown and Ford are currently being put in place.

Our impounding reservoirs metric relates to the progress made with a programme of work enhancing the safety of four reservoirs (Bewl, Darwell, Powdermill and Weir Wood), with a target of 0% for 2020–21, rising to 48.8% completion by March 2023 and 100% completion by March 2025. The schemes in the programme of work are under review, pending updated Reservoirs Act 1975 Section 10 reports (periodic inspection reports from an independent engineer with recommendations as to measures to be taken) for Weir Wood & Darwell. We are subsequently forecasting penalties in 2022–23 and 2024–25.

5
transformational programmes

1,438
hours of community volunteering

15th
out of 17 companies in terms of Developer Satisfaction.

Growth

Our Developer Services Satisfaction score (D-MeX) put us in 15th place out of 17 water companies, the same ranking as last year. The score measures customer experience for newly connected customers through our developer services. Our Developer Services improvement programme is focused on strengthening capability in our people and launching new digital services.

The Business Channels team leads our work to improve the customer experience for all our new connections customers. A Developer Day was held on 21 October 2021 to discuss 'GetConnected' – our online developer information service. Developers and stakeholders came together under the theme of 'Water for life: Building a resilient water future'. During the day, we introduced our Future Growth team, gave an update on how we are helping support water neutrality solutions and the need to work together to overcome the effects of the climate crisis.

In terms of our surface water management metric, our Storm Overflow Task Force, set up this year, is working to reduce the amount of surface water entering our sewage system, causing flooding and subsequently going into stormwater overflows.

The issue of stormwater overflows into rivers and coastal waters is a priority for Southern Water and the local communities. Five pathfinder projects have been mobilised this year to find more innovative approaches to reduce the number of overflows, with a key focus being on the separation of storm water at source. The focus this year has been establishing these important projects in five key catchments, working closely with external stakeholders. It will lead to an increasing level of surface water reduction under this metric, but at this stage no additional separation is being reported for 2021–22.

Fit for the future continued

Community engagement

We continue to work closely with B4SI and Business in the Community to help us to evaluate and improve our social impact. Although the score is 0% for 2021–22, this represents our position measured against a small cohort of water utilities companies assessed by B4si, as set out in the Performance Commitment. Whilst we have not met out target of 75%, we recognise that the score of 0% does not demonstrate the impact our community programmes have had for our customers. We are continuing the expansion of our Community team to add value to our on-going investment in this area, and expect to see the score improve next year. Our Community Grants scheme donated £304,000 to charities across our region over the past 12 months, funding 80 projects including a food bank, a natural park and a local hospice.

Following the pandemic, we were able to resume our in-person employee volunteering activities in early October. While this meant we were not able to do as much volunteering as usual throughout the year, a total of 1,438 hours of employee volunteering took place and we are looking to increase this in the coming year.

Our performance commitment on education is to visit and engage with 250 schools per year. In 2021 we were able to resume our in-person school visits and community talks, in addition to some talks still being offered online. We delivered educational talks to 17 schools and six community groups, so together with the We Are UK Water – World Water Day and World Toilet Day online events reaching a further 56 schools, over 2,500 learner hours were delivered.

56
schools registered for events

80
projects approved for funding under our Community Grants Scheme

Looking to the future

Making sure that our water asset health is resilient long into the future means we are looking to:

- Enter the construction phase of our resilience projects in Thanet and Brighton, as well as continuing the design work for resilience projects on the Isle of Wight.
- Keep upgrading our treatment works, such as the £18 million of investment at our Budds Farm Treatment Works, which includes new storm tanks and pipework.
- Make improvements during weather events using our 21-point tactical action plan for proactive improvement approaches to weather resilience.

Financial performance

Financial performance

The financial results have been prepared in accordance with FRS 101 and the accounting policies of the company as set out in note 1 to the Financial statements.

Read more in the **Financial statements** on pages 201 to 251

Financial results

The financial results are summarised in the table below:

	Years ended 31 March	
	2022	2021*
Income statement	**£m**	£m
Revenue	**823.5**	784.2
Amortisation of regulatory settlement payments	**21.0**	35.6
Total revenue	**844.5**	819.8
Other operating income	**1.8**	1.7
Operating costs before court fine and costs and charge for bad and doubtful debts	**(384.7)**	(360.0)
Court fine and costs	**(91.5)**	0.0
Charge for bad and doubtful debts	**(29.9)**	(34.8)
Depreciation, net of amortisation	**(324.1)**	(287.9)
Operating profit	**16.1**	138.8
Profit on disposal of fixed assets	**1.5**	0.8
Profit before interest and tax	**17.6**	139.6
Net finance costs	**(196.2)**	(155.0)
Fair value losses on derivative financial instruments	**(669.0)**	(346.1)
Loss before tax	**(847.6)**	(361.5)
Tax	**86.1**	65.7
Loss for the financial year	**(761.5)**	(295.8)

*Please refer to note 1 for an explanation of prior year presentational changes

Revenue

Revenue increased to £823.5 million (2021: £784.2 million). This principally results from the changes to our inflation-linked water and wastewater tariffs, which were agreed as part of our business plan for 2020–25 and increased by £21 million because of tariff changes.

In the current year, we billed £13 million more than we estimated at March 2021 for 2020–21 household consumption and this is therefore included within our revenues for 2021–22. In addition, we experienced a recovery of non-household revenues by £8 million following the resumption of trading after the more extensive lockdown for COVID-19 in the prior year.

In 2018–19, we made provision for customer rebates, based on our regulatory settlement with Ofwat, to be provided to customers over the period from 2020–25. These customer rebates are now included within our tariffs and so part of the revenue reported in the income statement. The provision made in 2018–19 for these rebates is being released in line with the tariff adjustment over the same period.

An analysis of revenue is provided in note 5 to the financial statements.

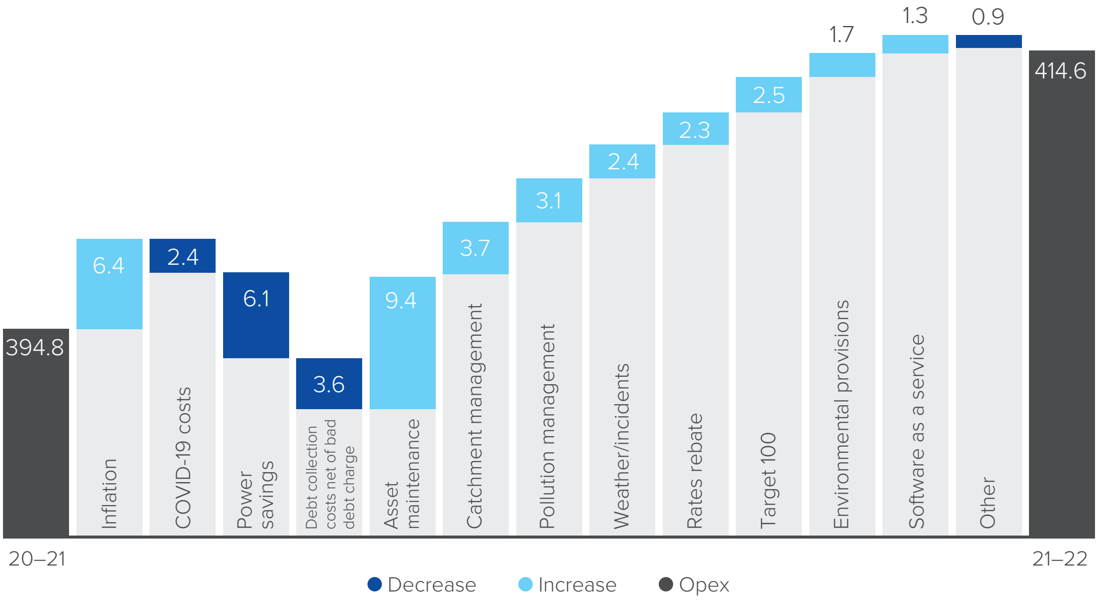
Financial performance continued

Read about our performance on pages 76 to 91

Operating costs and charge for bad and doubtful debts

Operating costs including the charge for bad and doubtful debts for the year increased by £19.8 million from £394.8 million to £414.6 million. This increase is explained in the chart below:

Movement in operating costs including charge for bad and doubtful debts £m



Over the course of the year the most significant cost reductions were:

- **COVID-19** – during 2020–21 there were additional one-off costs incurred, excluding the impact on debt collection, in relation to the pandemic.
- **Power savings** – following the successful hedging of our wholesale power costs we achieved a total cost saving of £6.1 million in 2021–22.
- **Debt collection costs** – as life has started to return to normal, following the impact of COVID-19 over the past two years, we have restarted our debt collection processes. The increased costs of debt collection activities have been offset by a reduction in our bad debt charge resulting in a net year-on-year reduction of £3.6 million in our operating costs. This reduction would have been significantly larger were it not for the pressure, currently being experienced on household budgets, from rising inflation. Our overall bad debt charge for the year was £29.9 million (2021: £34.8 million) and includes an additional £10.3 million to reflect the impact of the current economic situation on our expected future recovery of debt.

The impact of these cost reductions has been offset by a number of cost increases:

- **Asset maintenance** – we increased maintenance expenditure of our wastewater treatment assets by £9.4 million to improve our wastewater compliance and operational performance and reduce the risk of equipment failures.
- **Catchment management** – as part of the Water Industry National Environment Programme (WINEP), we are undertaking investigations and implementing schemes to improve the quality and quantity of drinking water supplies to make our catchments more resilient to our business operations, working with key stakeholders including the agricultural sector to reduce pollution risks. In addition, we started developing an approach to embed natural capital considerations into our investment decision-making process, which will enable us to assess the value of the environmental and social outcomes of projects we deliver. These activities increased our operating costs by £3.7 million this year.
- **Pollution management** – we increased the surveying, jetting and proactive maintenance of our sewerage network by £3.1 million as part of our pollution reduction programme.

- **Weather/incidents** – we incurred an additional £2.4 million compared to the prior year responding to weather related incidents, for example storm Eunice in February.
- **Rates rebate** – following a successful appeal in 2020–21, we received a one-off net reduction in our business rates charges of £2.3 million in 2020–21 as a result our charges have increased for 2021–22.
- **Target 100** – additional costs incurred in support of our water efficiency campaign to help customers reduce their personal use to 100 litres a day by 2040.
- **Environmental provisions** – in 2018–19 we made an environmental provision for ecological work to be undertaken on the Rivers Itchen and Test and the Candover Stream between 2018 and 2030. We have reviewed the likely future work required to meet these obligations and increased the provision held in respect of this work by £1.7 million in 2021–22.
- **Software as a Service (SaaS)** – during the year, the IFRS Interpretations Committee published its agenda decision regarding configuration and customisation costs in Cloud Computing Arrangements (SaaS). This has resulted in certain costs, that would have previously been capitalised as an intangible asset, being held on the Balance Sheet as a prepayment and recognised as an operating expense over the life of the contract. We had no SaaS arrangements in place in 2020–21 and the impact on our operating costs is an increase of £1.3 million in 2021–22.

Court fine and costs

As disclosed on page 38 the company was subject to a detailed investigation by the Environment Agency (EA) regarding permit breaches at some of our wastewater treatment works during the period 2010 to 2015. On 9 July 2021, the company was sentenced and fined £90.0 million plus £2.5 million of costs for these historic offences. These costs, less the provision of £1.0 million made in 2019–20 have been charged to the income statement in 2021–22.

Depreciation and amortisation

Depreciation and amortisation increased to £324.1 million (2021: £287.9 million) following the completion and commissioning of a large number of our capital investment schemes and the acceleration of depreciation in relation to assets at our Weirwood Water Supply Works where we are planning a major refurbishment. This included a number of large schemes across our wastewater treatment works network aimed at improving our wastewater asset performance together with a number of short-life IT and system-related assets.

Operating profit

As a result, operating profit decreased to £16.1 million (2021: £138.8 million), an 88% reduction, the majority of which relates to the court fine and costs described earlier.

Financing costs and profit before tax

Net finance costs increased by £45.9 million to £196.2 million (2021: £150.3 million). This increase is largely driven by higher indexation on our index-linked debt of £26.0 million and a lower level of interest capitalised during the year of £17.0 million.

The fair value loss on our derivative financial instruments amounted to £669.0 million (2021: loss £346.1 million). The primary driver for changes in the valuation are the fluctuation in UK Government bond yields, which are used to discount the future cash flows and inflation which increases the liability associated with our index-linked instruments. As government gilt yields are constantly moving and inflation has increased significantly over the past few months, the valuation of our derivative instruments is volatile. The balance sheet value represents the present value of future cash flows using financial market forecasts for inflation and interest rates. This balance sheet value does not, however, reflect the expected impact of inflation on future revenues and future Regulatory Capital Value (RCV) which is expected to more than offset the reported balance sheet value.

The loss before tax for the year amounted to £847.6 million (2021: £356.8 million loss).

Taxation

We have recognised a total tax credit to the income statement of £86.1 million (2021: £65.7 million tax credit). This differs from the credit that may be expected of £161.0 million, based on the loss before tax of £847.6 million and the current period tax rate of 19%, as described in note 10. The difference is primarily due to the disallowance of the court fine and costs from the tax calculation together with the announcement made in the government's Budget Statement in March 2021 that the rate of corporation tax would be increasing from 19% to 25%, effective from 1 April 2023. As a result of this tax rate change, a charge of £59.2 million has been recognised in the income statement for the impact of this on our deferred tax balance.

Read about Target 100 on pages 81 to 82

Financial performance continued

Cash flow statement

Overall, cash and cash equivalents decreased in 2021–22 by £182.1 million (2021: £235.2 million increase) and details of the principal movements in the cash flow are provided in the table below.

	Years ended 31 March 2022 £m	2021* £m	Movement £m	Explanation
Proceeds from share issues	**391.3**	–	391.3	In September 2021 a fund managed by Macquarie Asset Management acquired a majority stake in Southern Water's ultimate parent company Greensands Holdings. As part of this investment new equity totalling £391.3 million was issued by Southern Water Services.
Settlement of loan to SWSG	**130.0**	–	130.0	As part of the investment into the group by a fund managed by Macquarie Asset Management, the inter-company debtor issued to SWSG was repaid.
Net interest-related transactions	**(123.0)**	(201.1)	78.1	In total, the net cash outflow in relation to interest increased by £78.1 million. The principal reasons were: A payment of £46.9 million was made in 2021–22 (2021: £194.5 million) in relation to accrued indexation on our index-linked loans. An increase in the value of our inter-company loan with SWSF, which is used to pay the interest on our bonds of £18.1 million (2021: £39.4 million reduction).
Net movement on borrowings	**(16.9)**	411.0	(427.9)	During the year, we made loan and credit facility repayments totalling £16.9 million (2021: £696.2 million); no new bonds were issued during the year (2021: £1,107.2 million).
Movements in short-term investments	**(285.0)**	25.0	(310.0)	Funds held on deposit for periods greater than three months increased by £285.0 million in the year following the equity injection by a fund managed by Macquarie Asset Management.
Settlement of court fine and costs	**(92.5)**	–	(92.5)	Payment of the court fine and costs relating to the Environment Agency prosecution as disclosed on page 38.
Equity dividends paid	**–**	(4.0)	4.0	No dividends were paid during 2021–22. In FY21 a dividend of £4.0 million was made to SWSG to enable SWSG to make interest payments back to SWS. These historic dividend payments will no longer be required following the repayment of the loan by SWSG.
Other	**(186.0)**	4.3	(190.3)	The net cash movement from operating activities and our capital investment programme. Largely driven by the increase in our capital investment programme during the year which increased cash expenditure by £130.8 million and additional lump sum deficit payments made into our final salary pension scheme of £59.8 million.
	(182.1)	235.2		

*The prior year has been restated to reflect cash held on short-term deposit at 31 March 2020.

Statement of financial position

	31 March 2022 £m	31 March 2021 £m (Restated*)
Non-current assets	**6,887.2**	6,731.0
Current assets (excluding cash)	**539.2**	227.0
Cash and cash equivalents	**157.4**	339.5
Total assets	**7,583.8**	7,297.5
Current liabilities	**(735.2)**	(349.7)
Non-current liabilities	**(6,259.6)**	(5,983.4)
Total liabilities	**(6,994.8)**	(6,333.1)
Total net assets	**589.0**	964.4
Total equity	**589.0**	964.4

*For details of the prior year restatement see note 1 to the accounts.

At the end of the year to 31 March 2022, we had non-current assets of £6,887.2 million (2021: £6,731.0 million), an increase of £156.2 million from March 2021. This increase results from our ongoing capital investment programme, which – after depreciation – increased the value of property, plant and equipment and intangible assets by £308.8 million.

Overall, during 2021–22 our capital investment in property, plant and equipment was £569.7 million (2021: £393.5 million). This step-up in expenditure was targeted at making refurbishments to our assets to improve operational performance as well as schemes to enhance the level of wastewater treatment we undertake, for example to reduce phosphorus levels.

The increase in asset values was offset by a decrease in the value of our non-current financial derivative assets of £22.6 million and the settlement of a long-term inter-company debtor of £130.0 million as part of the investment into the group by a fund managed by Macquarie Asset Management.

Current assets increased to £539.2 million (2021: £227.0 million). Most of this increase resulted from £285.0 million held in short-term investments at March 2022 (2021: £nil). In addition, following the relaxation of COVID-19 restrictions during 2022, the value of the accrual for non-household revenue increased by £2.7 million at March 2022. This increase in accrued debtors, together with an increase in the balance on our inter-company debtor with Southern Water Services (Finance) Limited of £18.1 million, which is used to pay the interest on our loans, were the main reasons for the remaining growth in the value of current assets.

Current liabilities increased to £735.2 million (2021: £349.7 million). This was mainly caused by loans of £274.9 million, which are due to be repaid during 2022–23 and have therefore been re-classified within current liabilities at March 2022, together with an increase in the level of creditor accruals of £109.7 million. The higher level of accruals was largely the result of the acceleration of our capital investment programme which increased capital accruals by £88.7 million.

At 31 March 2022, non-current liabilities totalled £6,259.6 million (2021: £5,983.4 million). This increase of £276.2 million was principally the result of the following:

- A reduction in borrowings of £242.0 million largely resulting from the re-classification to short-term creditors of loans totalling £274.9 million which are due for repayment in 2022–23 and the repayment of loans of £16.9 million, offset by indexation on our inflation-linked bonds of £46.5 million.
- An increase in the derivative financial instrument liability of £688.3 million.
- A decrease in the deferred tax liability of £99.4 million as a result of the fair value loss on derivatives recorded for the year offset by the change in corporation tax rate effective from 1 April 2023.
- A reduction in retirement benefit obligations of £56.6 million. The final salary pension scheme was closed to future accrual on 31 March 2020. During the year, lump sum deficit payments totalling £77.3 million were made into the scheme, but these were offset by the movement in market conditions at 31 March 2022, which increased the deficit by £18.4 million, together with past service and financing costs of £2.3 million.
- The transfer of £21.6 million of the Ofwat regulatory settlement provision to short-term liabilities for rebates that will be applied through customers' bills during 2022–23.

Overall, net assets decreased from £964.4 million to £589.0 million.

Financial performance continued

Read more on page 105

Dividend policy

Our dividend policy is formulated to ensure a fair balance of reward between customers and investors. To enable the successful delivery of our business plan for 2020–25, all stakeholders must share in success: customers benefiting through enhanced service and lower bills, and shareholders earning a fair return on the 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 all aspects of our performance. This would reflect our overall financial performance as compared to the final business plan 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 out-performance should be reinvested to benefit customers. This consideration will 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 (in the Annual Report) and highlight any changes.

No dividends were declared or paid in 2021–22 (2021: £4.0 million).

Historically, the tests described above were not applied to the interim dividends of £4.0 million paid in 2020–21 to Southern Water Services Group (SWSG) as this dividend payment was instantly offset by a corresponding interest receipt from SWSG and therefore immediately repaid to the company in a 'dividend loop', resulting in no net cash outflow for the company. As part of the investment by a fund managed by Macquarie Asset Management into the group in September 2021, the inter-company loan of £130.0 million has been repaid by SWSG, removing the requirement for these dividend loop payments.

The Board has not approved the payment of preference share dividends for 2021–22 (2021: £nil). Preference share dividends are disclosed as interest in the financial statements and an accrual totalling £12.2 million in relation to the cumulative liability is included within the financial statements as an inter-company creditor.

Tax strategy and policies

Southern Water and all group companies adopt the tax strategy and policies outlined below.

Our approach to the management of tax affairs is driven by our core values of succeeding together, always improving and doing the right thing, alongside the corporate strategy of the company. We have a low-risk tax appetite and this is reflected in our management of tax.

The foundation of our tax strategy is to comply fully with tax legislation and to focus upon maintaining a strong tax compliance culture.

To enable this, we undertake regular compliance reviews both internally and externally to ensure our tax policies are consistently applied. 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. The very nature of our business means we always take a long-term view on all the activities we undertake. We therefore ensure our tax strategy, and approach to tax, is sustainable, ethical, considers both social and corporate responsibilities and can stand up to external scrutiny. When faced with a decision or business case, the ongoing tax impact is always considered as part of that decision-making process.

Our approach to tax management and governance

We ensure we are fully compliant with tax laws, rules, regulations and reporting requirements in all operations. This extends to following both the letter of the law as well as the spirit of the law. A culture of doing the right thing is embedded in our core values and our approach to tax embodies this by ensuring we pay the right amount of tax, in the right place, at the right time. We also use the expertise of professional tax advisers to ensure we maintain best practice in our approach to compliance and in circumstances when additional advice is deemed appropriate.

The day-to-day management of the tax affairs of Southern Water and all companies in the group is the responsibility of the Tax team. Roles and responsibilities within the Tax team are clearly defined. The Tax team reports to the Group Treasurer, who in turn reports to the Chief Financial Officer (CFO). The CFO is the Senior Accounting Officer (SAO) and has ultimate responsibility for the tax affairs for Southern Water and the Southern Water Group companies.

Our management of tax risk

As indicated above, we adopt a conservative approach to tax risk. Our tax management focus is on compliance, systems and governance and our tax planning is always aligned with our commercial and economic activity. All companies within the 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 and management 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 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 requirements. 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 & 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 shares our view of our low-risk approach to the management of our tax affairs with the last HMRC assessment being that we were deemed to be a 'low-risk' company.

Maintaining public trust

As previously stated, we are committed to complying fully with tax legislation, maintaining a strong culture of compliance and having open and constructive relationships with tax authorities. We do not use tax avoidance schemes or take an aggressive approach on tax planning when interpreting tax legislation.

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 through reduced bills.

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 107 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. The closure process is now substantively completed after receiving all the requisite approvals for the removal of this entity. It is anticipated that the final part of the removal process will be completed in 2022–23.

Read more on page 107

Financial performance continued

The full amount of the court fine and the associated costs awarded to the Environment Agency (EA) that were incurred and recorded in the accounts for 2021–22 has been fully disallowed for tax, i.e. Southern Water does not receive any tax benefit for this deduction.

Although our tax strategy is reviewed and updated each year, it is not expected to significantly change from year to year.

We regard this publication as complying with our duty under paragraph 16(2) of Finance Act 2016 for the financial year ended 31 March 2022.

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** – capital allowances are a way of obtaining tax relief on certain types of capital expenditure. These are treated as a business expense and so reduce our taxable profit. Depreciation represents how much of an asset's value has been used up and reduces accounting profit. Capital allowances are applied at different rates than used for depreciation. As a result, there is a difference between capital allowance deductions made against our taxable profits and depreciation made against our accounting profits. The annual variance between capital allowances and depreciation results in a difference between our taxable profit and our accounting profit. Due to the large scale of our capital expenditure programme and the level of capital allowances available and 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, reducing profit and the amount of tax we pay. However, there are 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 treated as an expense when calculating our taxable profits.
- **Group relief** – Southern Water is part of the Greensands Holdings group of companies as set out on page 106. All of these companies are taxable as UK companies and profits or losses of the companies within the group can be set off against one another in the financial year. Group relief can be claimed by Southern Water Services Ltd where the standard rate of tax for the losses claimed is paid. For 2021–22, no tax for these losses was paid, therefore there was no group relief claimed.
- **Deferred tax** – the cumulative difference between taxable profits and accounting profits, which are expected to be temporary and reverse in future years, is presented as deferred tax 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 2020 to March 2025.

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 202.

Our other tax contributions

Our other contributions to the Exchequer amounted to £76.4 million. These are explained below:

- Business rates of £27.8 million paid to local authorities (2021: £25.2 million) and payments to the Environment Agency of £8.0 million (2021: £8.3 million) for abstraction licences and discharge consents, which reduce profits chargeable to corporation tax.
- Employment taxes of £40.6 million (2021: £36.5 million) paid to the Exchequer under PAYE (Pay As You Earn) and National Insurance contributions.

No payments have been made to other group companies for tax losses surrendered to the company. As a result of capital allowances and interest charges, no corporation tax was paid by the company to HMRC in 2021–22.

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.

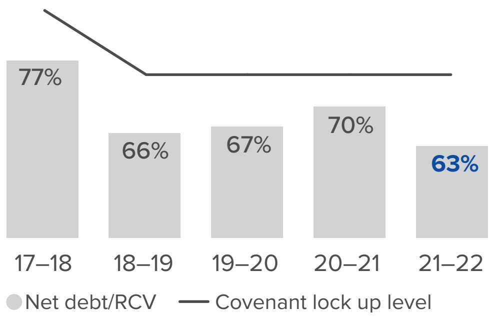
The net debt to RCV ratio is calculated as short- and long-term senior borrowings less cash and short-term deposits to the RCV (all values taken from our Regulatory Accounts). The RCV is set by Ofwat at each five-year review and reflects our initial market value plus subsequent capital investment and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

The adjusted cash interest cover is measured as the ratio of net cash inflow from operating activities less RCV depreciation to net cash interest expense.

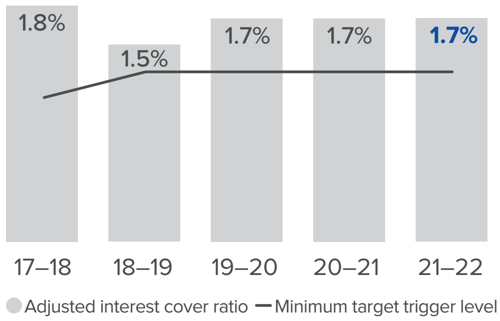
The credit ratings shown here were updated in the summer/autumn of 2021 in response to our 2021 results, the outcome of the EA prosecution and the new equity investment by a fund managed by Macquarie Asset Management. The outlook for Standard and Poor's improved from Negative to Stable Outlook, the outlook for Fitch moved from Ratings Watch Negative to Negative, and the outlook for Moody's remained Stable.

Debt covenant

Net debt/RCV



Adjusted cash interest cover ratio



The covenanted lock-up level/trigger level refers to debt covenants where payment of dividends by Southern Water is 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

Standard & Poor's

Class A debt:

BBB+

Fitch

Class A debt:

BBB+

Moody's

Class A debt:

Baa3

Read more on page 107

Notes: A further credit rating downgrade by one or more Rating Agencies would result in a Trigger Event under our Common Terms Agreement which would restrict the payment of dividends and require the preparation of a remedial plan for our lenders. Southern Water has obtained a waiver from its lenders to continue to access permitted financial indebtedness to refinance the business in the event of a downgrade Trigger Event.

A further credit rating downgrade, or the assignment of a negative outlook, by Moody's would lead to a restriction on the payment of dividends under the terms of our Licence.

Under our Common Terms Agreement, a Trigger Event would occur if any two of the credit ratings fall to BBB (Standard & Poor's), BBB (Fitch) or Baa2 (Moody's) or below; and a Default would occur if any two of the credit ratings are less than the minimum rating required for the status of investment grade.

Capital structure

Read about our capital investment on page 97

Why Southern Water raises finance

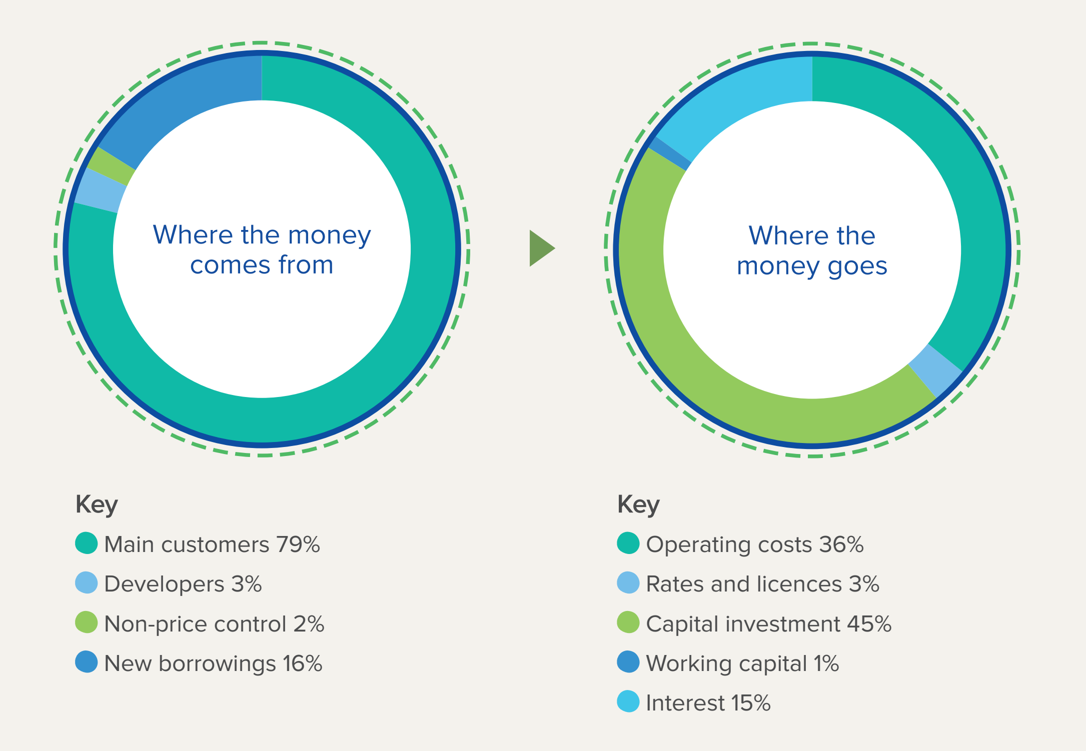
Significant capital investment has been a feature of our business since privatisation in 1989. We have invested in both maintaining our existing asset base and constructing new assets to improve the environmental quality of wastewater, improve the quality of drinking water and accommodate population 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 our £100 million construction project at Woolston, which has improved the quality of effluent discharged into the River Itchen and reduced odours.

We raise finance to pay for the construction of new assets and to repay loans taken out in previous years. We cannot rely wholly on raising new finance to pay for the construction of new assets and our shareholders contribute approximately 30% of the funds we require and to also provide the financial buffer we need to absorb financial risk.

Revenues from our customers are used to meet the costs of running the business (our operating expenditure), the cost of maintaining our assets, and to pay for the interest on the finance we raise and a return on the equity provided by our shareholders, to finance the capital investment programme. Our economic regulator, Ofwat, ensures that we can only charge our customers for an efficient level of cost, which is benchmarked against our peers.

The charts opposite illustrate the sources and uses of expected cash flows for the business plan 2020–25 and demonstrate our requirement to raise finance to fund our capital investment programme. The data is based upon the regulatory price determination for 2020–25, which sets out both our performance obligations and the limits on customer bills for this five-year price period.



Where the money comes from

Main customers – income for the provision of our core water and wastewater services.

Developers – income from the provision of services to developers for the provision of infrastructure and new connections to our network.

Non-price control – income from non-appointed activities.

New borrowings – additional financing raised to support delivery of our capital investment programme.

Where the money goes

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

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

Capital investment – includes investment to maintain our pipework and treatment works as well as the construction of new assets to enhance treatment standards and cater for growth.

Rates and licences – business rates on buildings, wastewater treatment and water supply works and Environment Agency licences.

Working capital – the timing and growth of the difference between expenditure and receipts.

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

Capital structure continued

Read more on pages 140 to 141

GSH ownership

MSCIF Wight Bidco Ltd
Funds managed by Macquarie Asset Management on behalf of long-term investors including pension funds and insurance companies.

IIF Int'l SW UK ParentCo Ltd
A constituent entity of the Infrastructure Investments Fund, a fund advised by JP Morgan Asset Management (JPMAM), a large-scale global asset manager advising institutional investors.

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

Hermes Infrastructure funds
Hermes Infrastructure is part of Federal Hermes International and is a specialist infrastructure manager operating a diversified, well-established, UK-focused shared investment platform.

Other
Minor shareholdings held by infrastructure investment companies.

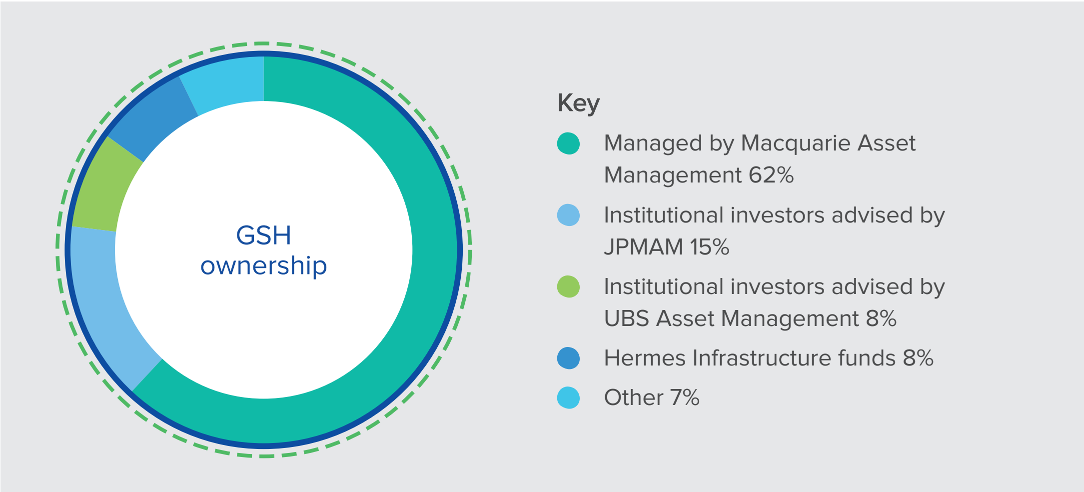
Ownership and structure

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.

In September 2021, a fund managed by Macquarie Asset Management acquired a majority stake in GSH, with an investment of over £1 billion of new equity into the group. This new equity was used to recapitalise the ownership structure and improve the financial resilience of Southern Water. None of the proceeds were paid to the existing shareholders of GSH.



GSH Board

The GSH Board comprises three directors, appointed by GSH's majority shareholder.

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. While certain matters are reserved to the GSH Board and/or shareholders in GSH, they do not impact the day-to-day operations of Southern Water and nor do they materially affect Southern Water's ability to function as a company in providing an essential public service.

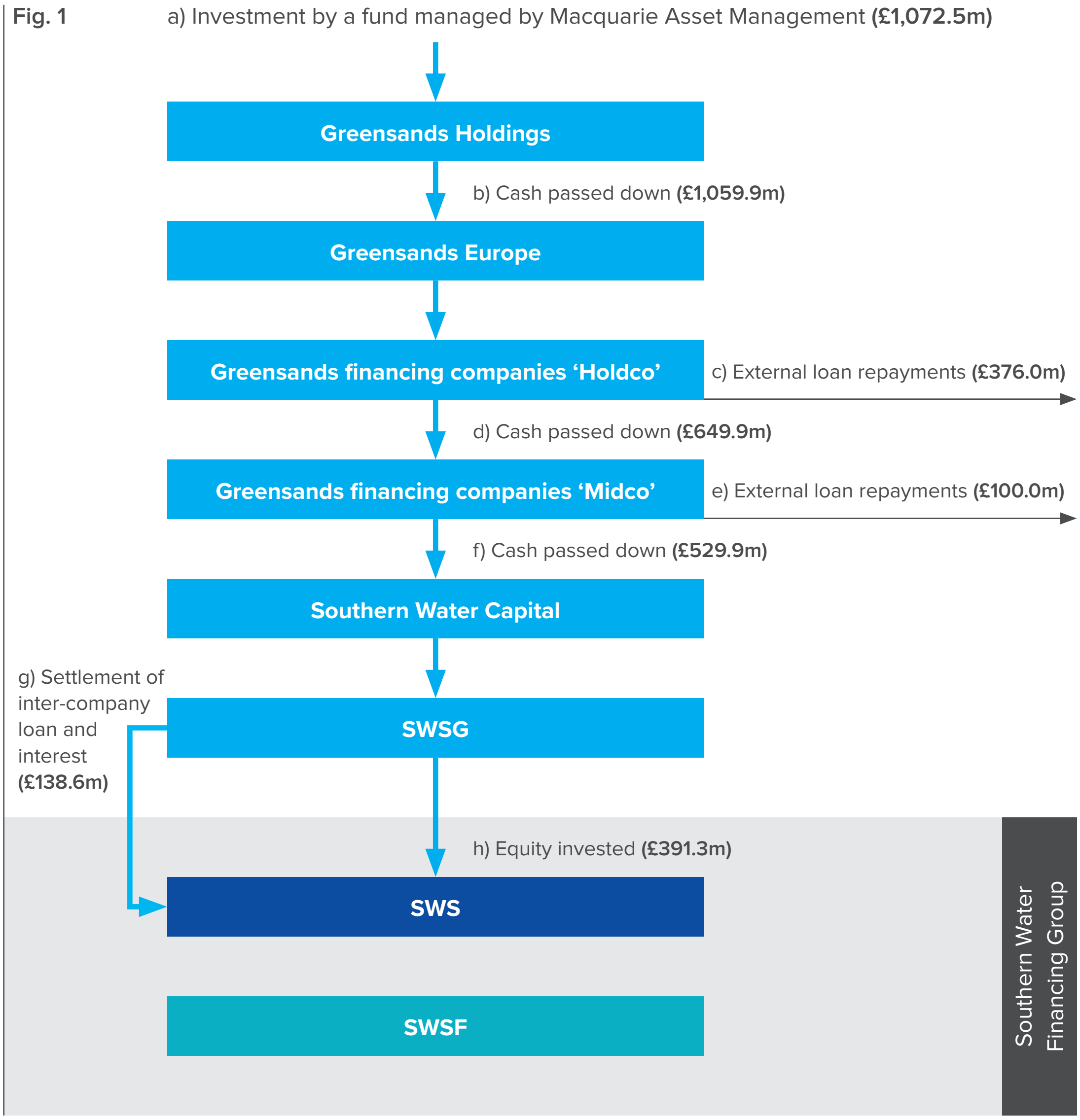
Group structure

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 five-year price review period starting April 2020.

As mentioned above, a fund managed by Macquarie Asset Management acquired a majority stake in the Greensands group in September 2021. This investment was used by the group to repay external debt totalling £476.0 million and make a cash injection into Southern Water Services totalling £529.9 million from the settlement of an inter-company loan and the issue of new equity. A summarised group structure, together with details of the funds flow from the investment by a fund managed by Macquarie Asset Management are shown in figure 1 below.

Fig. 1



Footnote:

a. Investment made into the Group by a fund managed by Macquarie Asset Management to acquire 62% of the shares in GSH
b. Cash passed down the group by GSH in the form of investments and redemption of inter-company loans
c. Repayment of external debt held at SWGF
d. Cash passed down the group by 'Holdco' in the form of investments and redemption of inter-company loans
e. Repayment of external debt held at GSF Ltd
f. Cash passed down the group by 'Midco' in the form of investments and redemption of inter-company loans
g. Repayment of inter-company debtor of £130.0m to SWS together with interest to the date of redemption of £8.6m
h. Equity invested into SWS

Capital structure continued

Read more on pages 140 to 141

Corporate Level	Companies	Description
Greensands Holdings	Greensands Holdings Ltd (GSH)	The ultimate parent company for the group.
Greensands Europe	Greensands Europe (GSE)	Intermediate holding company. Listed (Jersey) Eurobonds held by shareholders in proportion to their equity were converted to an inter-company loan with GSH in June 2021.
Greensands financing companies 'Holdco'	Greensands UK Limited (GSUK) Greensands Junior Finance Limited (GSJF) Southern Water (Greensands) Financing plc (SWGF) Greensands Senior Finance Limited (GSSF) Greensands Investments Limited (GSI)	A group of companies established to provide additional external financing for the acquisition of the Southern Water Capital group of companies in 2007 plus a further £250 million of additional finance raised in 2019, the proceeds of which were invested into SWS. The security granted to the lenders of this financing is limited to the share capital of GSH. 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'	Greensands Finance Holdings Limited (GSFH) Greensands Finance Limited (GSF Ltd) Greensands Financing plc (GSF plc)	A group of companies incorporated in 2018 as part of a financial restructuring exercise to improve the financial resilience of Southern Water. The objective of the restructuring was to reduce the total leverage within the Southern Water Financing Group. 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.
Southern Water Capital	Southern Water Capital (SWC) Southern Water Investments Limited	Intermediate holding companies established 2002 as part of a previous ownership structure.
Southern Water Services Group	Southern Water Services Group (SWSG)	Intermediate holding company established as part of a previous ownership structure.
Southern Water Financing Group	SWS Group Holdings SWS Holdings **Southern Water Services Limited (SWS)** Southern Water Services (Finance) (SWSF) SW (Finance) I plc (SWFI) SW (Finance) II Limited (SWFII)	SWS is the regulated water and wastewater company. It is the company that this Annual Report and financial statements relates to. SWSF was incorporated to raise finance on behalf of SWS. SWFI and SWFII have been incorporated to replace SWSF. The Southern Water Financing Group was established in 2003 and comprises a legal framework where each company guarantees the obligations of others within the group. Security granted to the lenders within this group is limited to the share capital of SWS Group Holdings Ltd. This structure ensures that SWS can continue to operate as a regulated water and wastewater company in the event of a default by any group company.

All companies are UK tax resident and therefore subject to UK taxes.

Most companies within the group are incorporated in the UK. The exceptions are:

- Greensands Holdings Ltd is incorporated in Jersey, but UK tax resident. The company was incorporated there because Jersey law allowed greater choice than the UK about the way distributions can be made to shareholders while treating UK and non-UK investors equally.
- Southern Water Services (Finance) Ltd is incorporated in the Cayman Islands, but is UK tax resident. SWSF was established for the express purpose of raising debt finance on behalf of SWS. Due to administrative reasons applicable at the time of forming the Southern Water Financing Group, it was necessary for SWSF to be registered in the Cayman Islands to raise debt listed on bond markets. This original requirement is no longer necessary, and we are in the process of replacing SWSF with two new UK incorporated companies, SW (Finance) I plc and SW (Finance) II Limited.

How we finance the business

In note 20 to the financial statements, we provide an analysis of our outstanding debt at 31 March 2022 and 31 March 2021. 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), which is 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 have large cash balances at times. 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 had in issue, at March 2021, a loan with SWSG, which was put in place as part of the refinancing in 2003 (note 15). The outstanding balance of this loan, £130.0 million, was repaid as part of the investment by a fund managed by Macquarie Asset Management into the group.

The Greensands companies also have their own loans:

- Loans issued by Greensands Finance Limited and Greensands Financing Plc, represented in the diagram above as part of the 'Midco' financing companies.
- Eurobonds issued by Greensands Europe, which were converted to an inter-company loan with GSH in June 2021.
- The Greensands financing companies also maintain liquidity facilities (£100 million at Greensands Midco financing companies and £40 million at Greensands Holdco financing companies to January 2021), which can provide a source of finance to pay interest on loans.

Risk management approach

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

Read more on our principal risks on pages 114 to 120

Risk management is a core component of our governance and internal control framework, which provides the structure through which we conduct business.

Risk is inherent in our business and we face a diverse range of risk and uncertainties that cannot be completely eliminated. The purpose of our approach to risk management is to support better decisions through an improved understanding of risk. Those risks that have the potential to have a material impact on our company and our ability to deliver on our strategic objectives are our Principal Risks. Our risk governance model ensures that we can manage, monitor and report on our Principal Risks to maintain a resilient business. These risks are described on pages 115 to 120.

Managing risk

Our approach to risk management is designed to provide a clear and consistent framework for managing and reporting risks associated with our operations, to executive management and to the Board.

Our risk management framework is the totality of systems, structures, policies, processes and people that identify, measure, monitor, report and control or mitigate internal and external sources of risk.

The framework seeks to promote better decision-making, avoid incidents and encourage the best outcome for the company and our customers by allowing us to:

1. **Risk identification and ownership:** understand the risk environment, identify the specific risks we face and assess potential exposure.
2. **Risk assessment:** determine how best to manage identified risks to balance exposure.
3. **Risk response:** take action to manage the risks we do not want to be exposed to, ensuring our resources are effectively and efficiently prioritised and used.
4. **Risk monitoring, reporting and escalation:** report to the Audit Committee, the Health and Safety and Operational Risk Committee and to the Board on a periodic basis on how significant risks are being managed, monitored, assured and the improvements that are being made.
5. **Risk appetite and communication:** use our analysis to support the Board's determination of risk appetite and to monitor and report against it.

Across the company our risk management approach is embedded within the business units and their business processes. We have established a risk management approach that provides a consistent basis for measuring risk to:

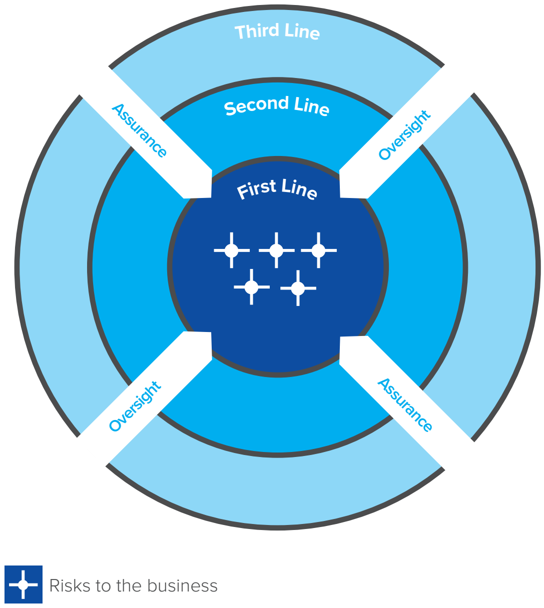
- establish a common understanding of risks on a like-for-like basis, taking into account potential impact and likelihood,
- report risks and their management to the appropriate levels of the company,
- inform prioritisation of specific risk management activities and resource allocation.

All areas of the company review significant risks and business processes to help inform and enable risk-based decision-making. As part of Southern Water's annual planning process, the Executive Leadership Team and Board review the company's Principal and Emerging Risks.

Three lines of defence

Our approach to risk management adopts the 'three lines of defence' model in which risk ownership responsibilities are functionally independent from oversight and assurance:

- Primary responsibility for risk management lies with the business. The risk owner is the first line of defence. An important part of the role of all employees is to ensure they manage risks appropriately.
- The Risk Management function forms the second line of defence and provides independent and objective review and challenge, oversight, monitoring and reporting in relation to material risks.
- Independent External Assurance and the Internal Audit function act as the third line and provide independent assurance on the business control environment and the effectiveness of the wider system of internal control.



First Line

– The functions that own and manage risk.

Second Line

– The internal functions that oversee risk and regulatory compliance activities.

– Provide guidance, direction and oversight.

– Develop the related assurance frameworks.

Third Line

– Provides independent assurance on the business control environment, and the effectiveness of the wider System of Internal Control.

Always improving

The Board continues to recognise the importance of effective risk and resilience management. Collaborating across the company helps us to better understand the needs of the key stakeholders and identify any gaps and inconsistencies in the existing framework.

As part of our regulatory commitments, we are continuing to improve and enhance our approach to risk and resilience management. Our key milestones include:

March 2021
Redefined enterprise risk Management and Resilience Framework aligned to industry best practice ISO 31000- Risk Management

November 2021
New risk management policy approved by the Board Risk Committee

December 2021
GRC solution procurement to strengthen our risk, assurance and control environments

March 2022
Continued to embed our risk management framework and approach across our Business Partnering Model

July 2022
Risk consultation preparation for the next business plan period

November 2022
GRC implementation, training with teams across the company

March 2023
Advanced analytics, data and insights to enhance risk-based decision-making and drive business intelligence reporting

May 2023
Refresh Board and executive risk reporting

The next 12 months

The coming year will see continued integration of our refined risk management framework and approach. This will see risk management efforts focused on maturing our activities in a number of areas, including:

- Continued training across the company to embed our business partnering model and to develop their enterprise risk profiles and support risk-based decision-making.
- Refreshed approach to reporting of risk to the Board, Board Committees and Executive Leadership Team.
- Lead the risk assessment of the business plan in preparation for the business plan submission to Ofwat.
- Delivering on our regulatory commitments to Ofwat through the implementation of our newly implemented Governance, Risk and Control (GRC) system to integrate and support assurance and control work across our risk and compliance teams.
- Driving continuous improvement through our systems of risk-data capture, analysis, and training work with our business partners across the company.
- Strengthening our analytical risk management capabilities to utilise enhanced risk management data and insights to facilitate risk-based decision-making and deliver business intelligence reporting.
- Running interactive risk sessions with the Executive Leadership Team.

The improvements we are making to our risk management approach are setting the company up for future success. As we further embed these improvements, we will be able to demonstrate to our customers and external stakeholders that the decisions we make are considered, well thought through, and demonstrate continued commitment to our values.

Risk oversight and governance

Read more about the **Board's role in mitigating risks** on pages 174 to 175

Risk oversight and governance

To successfully embed risk management, the process is supported by a governance structure that defines roles and responsibilities at each level of the company. The Board has overall accountability for risk management but discharges this role through the Audit Committee. It oversees and advises on enterprise and corporate risks, while the restructured Health and Safety and Operational Risk Committee oversees and advises on operational risk.

Role of the Board

The role of the Board is to promote the long-term sustainability of Southern Water and its responsibilities to its shareholders, customers, employees, and the communities in which it operates. It has overall responsibility for risk management within the company.

The Board is responsible for maintaining an effective risk culture and is committed to:

- reviewing, endorsing and monitoring our approach to risk culture and conduct
- forming a view on our risk culture and the extent to which it supports our ability to operate consistently within our risk appetite.

The Board defines our risk appetite, enabling the company, in both quantitative and qualitative terms, to judge the level of risk it is prepared to take in achieving its overall objectives.

Our risk appetite is directly aligned to our principal risks. The risk appetite for each of these underpins our governance and reporting framework and is subject to regular review by the Board. The alignment of our principal risks with risk appetite allows for an informed analysis and discussion of our risk position and provides the Board with the insight to make key-decisions.

As a company we are tolerating a level of risk which is outside our current risk appetite and is reflected in the review of our principal risks in the coming pages. This can result in more focus on short-term issues than longer-term resilience.

The Board ensures the oversight and monitoring of our risk culture, risk appetite and risk management activities through the Audit Committee.

Role of the Audit Committee

The Audit Committee is responsible for the review of the company's internal financial controls systems that identify, assess, manage and monitor financial risks, and other internal control and risk management systems. It advises the Board on the company's overall risk appetite, tolerance culture and strategy, taking into account the current and prospective regulatory, legal, political, macroeconomic and financial environment with the Board retaining overall ownership and approval.

The Audit Committee oversees and advises the Board on current risk exposure and longer-term strategic risks to determine our future risk strategy. It also has a key role in risk assessment:

- reviewing the company's overall risk assessment processes for enterprise and corporate risks that inform the Board's decision-making, ensuring qualitative and quantitative metrics are used;
- reviewing regularly and approving the parameters used in these measures and the methodology adopted; and
- setting a standard for the accurate and timely monitoring of large exposures and corporate risk types of critical importance.

In addition, the Audit Committee reviews the company's capability to identify and manage new and emerging risk types and reviews reports on any material breaches of risk limits and the adequacy of proposed action.

Role of the Health and Safety and Operational Risk Committee

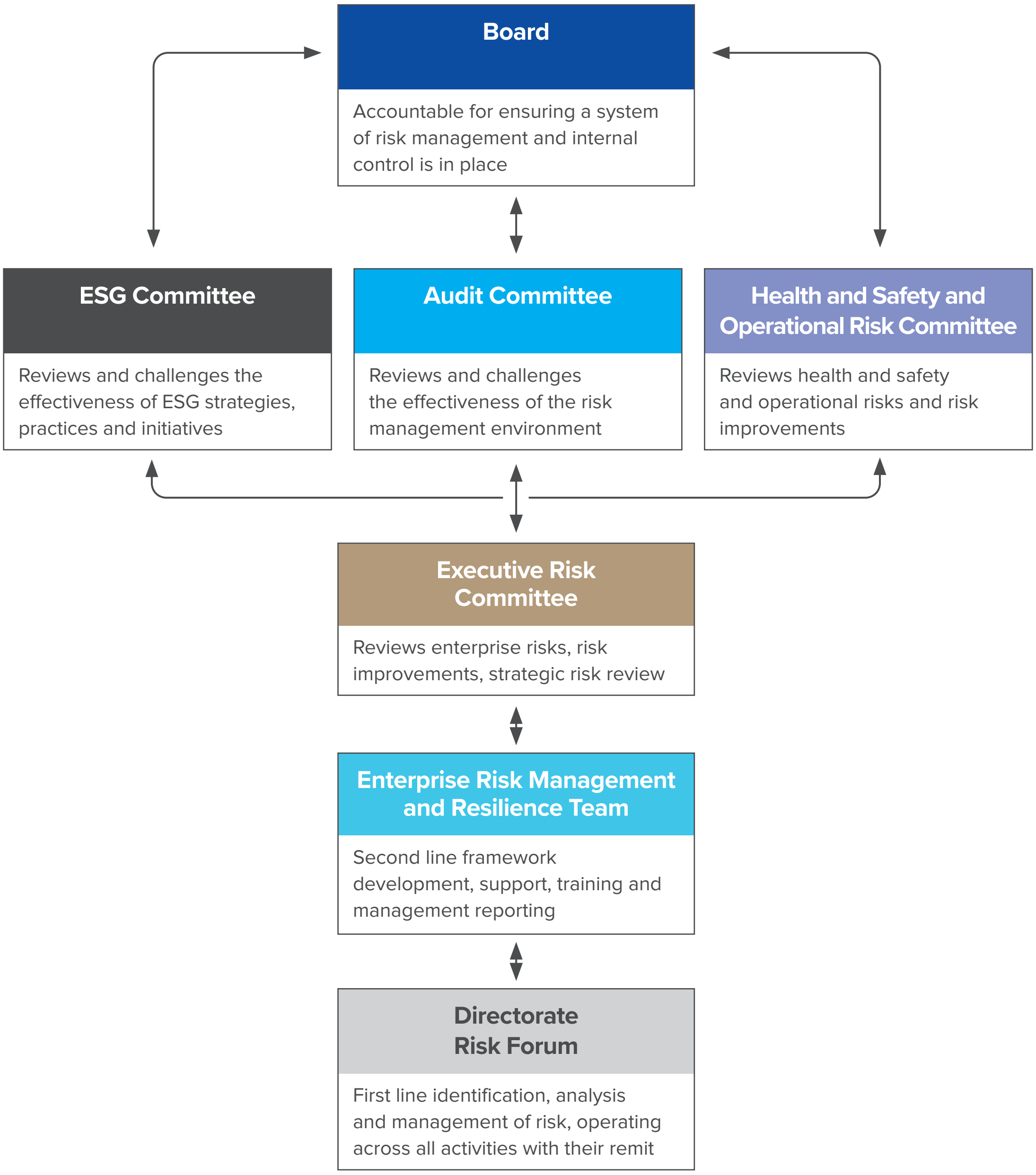
The Health and Safety and Operational Risk Committee is responsible for the oversight and assessment of the overall adequacy and effectiveness, of the health, safety and wellbeing policies, strategies; processes and controls; operational risk management and compliance with relevant legal and regulatory requirements, with the Board retaining overall ownership and approval.

The Health and Safety and Operational Risk Committee has a key role in:

- reviewing the areas of significant corporate and individual health, safety, wellbeing and operational risk whether the executive is managing these risks effectively, including via the supply chain;
- reviewing the company's health, safety, security and wellbeing performance;
- reviewing operational risk and risk management of information security, information governance, water, wastewater and customer services;
- reviewing of the scope, and results, of any: health, safety, wellbeing, information security, information governance, water, wastewater and customer operational risk audits; and
- considering the findings of internal and external investigations and executives' response.

For the upcoming financial year, the Board has approved the formation of an Environmental, Social and Governance ("ESG") Committee. This committee will be tasked with supporting the Board in defining the company's strategy relating to ESG matters and in reviewing practices and initiatives relating to ESG matters, ensuring that they remain effective and up to date.

Key risk and governance responsibilities include:



During the year, to enhance our organisational risk governance, the Board decided to change the terms of reference of the Audit and Risk Committees and create two risk-focused committees. The reformed Audit Committee was tasked with focusing on enterprise and corporate risks and the renamed Health and Safety and Operational Risk Committee with a focus on operational risks.

Prior to the change, the Audit and Risk Committees each met three times during the year. Thereafter, the new committees each met once. Going forward each committee will meet a at least four times a year. The reports of the Audit Committee and the Health and Safety and Operational Risk Committee are included on pages 169 and 175.

Emerging and principal risks

Read more on our principal risks on pages 114 to 120

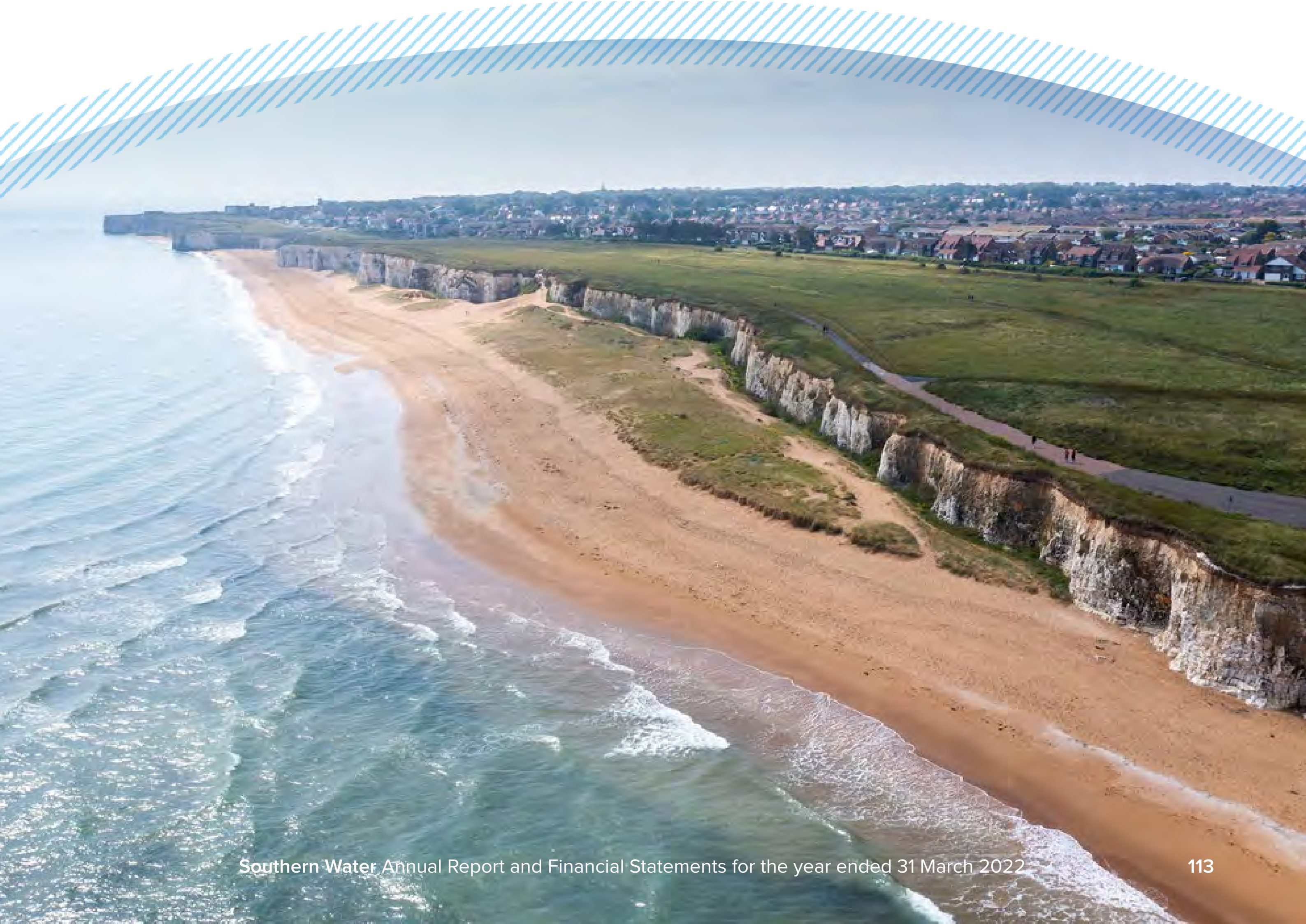
Southern Water regularly considers new, changing, or emerging risks that could affect its ability to achieve long-term objectives. Our risk assessment process monitors management information from a wide variety of internal and external sources when considering emerging risks and analyses potential causes, impacts, likelihood, and the time frame over which a risk could occur. The company considers its emerging risks as:

Emerging risk	Description	Relevant activity
DWI enforcement regime	In early 2021, the DWI began work to change its method of regulatory enforcement to consider a new approach to include a punitive financial penalty regime within its regulatory framework. The company is currently subject to a number of DWI notices; this could lead to a risk of additional financial penalties.	The company continues to work closely with the DWI to respond and resolve our open notices in a timely manner. The company is committed to reform and improve our performance related to our business operations and our provision of a sufficient supply of high-quality drinking water.
Environmental	Environmental stakeholders are increasing pressure on water companies to limit impact on the environment. This has emerged as a national debate on the future use of Combined Sewer Overflows and their impact on the environment.	The company continues to reform and implement business practices to reduce pollution incidents and to comply with our licence conditions for abstraction, wastewater discharge and biowaste treatment to improve biodiversity and ecosystems resilience.
Prolonged supply chain disruptions	The risk that the company will experience prolonged supplier risk events due to supply chain disruption caused by labour issues, extreme weather events, Russian-Ukraine conflict, Brexit trade disputes, recovery from the COVID-19 pandemic and cyberattacks or other factors	The company is taking action to boost resilience through negotiations with our suppliers, strengthening our contract management, the use of localised supply chains where possible, refreshing our outsourcing policy, conducting regular supply chain resilience assessments to define strategy and capability build-out to anticipate and mitigate future disruption.
Prolonged macro-economic downturn and accelerated inflation	The risk that a sustained macroeconomic downturn and inflationary pressures will continue to increase the prices of goods and services and significantly raise the cost of doing business, reduce customer/employee buying power and negatively impact our revenues, debt financing and ability to raise future capital.	The company has implemented measures that can help mitigate the adverse impact including the supply chain strategy, budgetary management processes, vulnerable customer support services and enhanced financial performance measures and metrics to assess cashflows and liquidity.

Those risks that have the potential to have a material impact on our company are our Principal Risks. Southern Water manages, monitors and reports on the principal risks that can impact our ability to deliver our objectives. As part of Southern Water's annual planning process, the Executive Leadership Team and the Board review the business's Principal Risks. These may be updated during the year in response to changes in internal and external circumstances.

We currently have 12 Principal Risks. These are a key feature of our Risk Taxonomy and risk appetite. Our principal risks reflect our commitment to our values: doing the right thing. succeeding together. always improving. We review our principal risks and their risk components on an annual basis, ensuring emerging risks are reflected and that the current structure adequately reflects the risk context in Southern Water.

In March 2022 we recommended to the Board to include "People" as a new Principal Risk to reflect the rising people and skills risk being faced by the company. The "People" risk replaced the former "Transformation" risk, with relevant sub-components from the 2021 "Transformation" risk being split between "Delivery" and "People" in 2022. This appropriately reflects the company's development of our risk management framework and risk management approach.

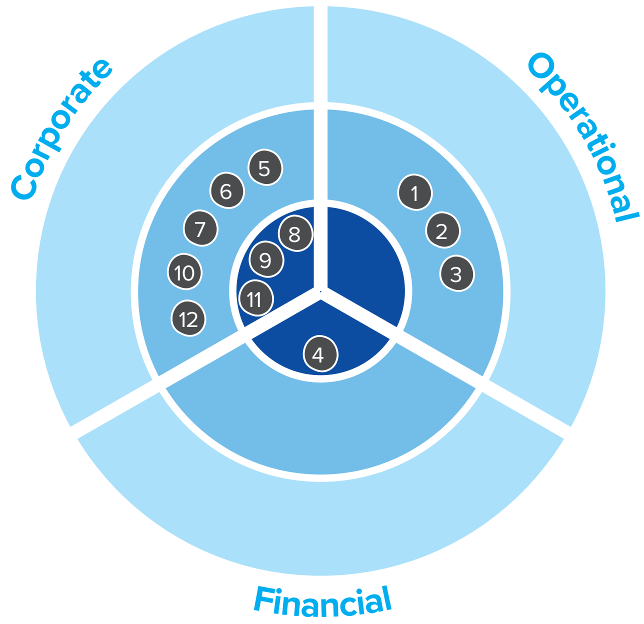


Principal risks

Principal Risk radar

The Principal Risk radar provides an indicative view of the current risk position of each of the Principal Risks, relative to each other.

Improving
Stable
Deteriorating



Risk		Category	Risk climate	Commentary
1	Water	Operational	Stable	We are challenged to manage our water resources through a below average rainfall winter while complying with our regulatory abstraction limits.
2	Wastewater	Operational	Stable	We are challenged to manage an increase in capacity demand and extreme weather events while meeting our regulatory targets.
3	Customer	Operational	Stable	We are managing a tight funding regime with the scale of customer service improvement required to deliver our business plan.
4	Financial	Financial	Deteriorating	We are being impacted by external factors affecting the availability and cost of capital.
5	Compliance	Corporate	Stable	We remain under continued scrutiny by our regulators as we transform the business and deliver on our business plan.
6	Climate Change	Corporate	Stable	We are managing various work programmes for both aspects of climate change, Mitigation and Adaptation.
7	Delivery	Corporate	Stable	We are managing the delivery of TotEX projects which includes our extensive capital investment delivery programme and significant Opex funded strategic projects.
8	Information Technology (IT)	Corporate	Deteriorating	The global heightened cyber security risk arising from the Russia/Ukraine conflict and the underlying risk associated with the Network and Information Systems (NIS) Regulation has increased risk in this area.
9	Resources	Corporate	Deteriorating	The impact of Brexit and prolonged uncertainty in the global markets in post-COVID operations has increased risk in this area.
10	Health, Safety	Corporate	Stable	Work is underway across the business to embed and enhance our Health, Safety, Security and Wellbeing improvement plan.
11	Corporate Affairs	Corporate	Deteriorating	The ongoing debate on the future of Combined Sewer Overflows (CSOs) which could lead to a significant change in our operating environment.
12	People	Corporate	Stable	We are adapting our ways of working to the longer-term impact of the COVID-19 pandemic.

Risk climate ▲ Improving ▶◀ Stable ▼ Deteriorating

Principal risks and uncertainties

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Operational risk

1 Water

We must ensure we can supply enough good quality drinking water to cater for a growing population of more than 2.6 million people across the region. Should operational water treatment processes or control systems 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,
- customers could find their water supply becomes cut off,
- harmful chemicals could be released to the environment.

Executive accountability:

Managing Director – Water

Risk climate: ⧓

Our risk profile has remained static from last year but is still in a challenging position. This has been caused by a below average rainfall winter alongside the amendment of regulatory limits on the amount of water that can be abstracted for water supply in our Western region. Increased demand from our customers, continues to place additional stress on our asset infrastructure. We are also dealing with significant levels of asset risk on some of our key operational sites and this is reflected in key performance metrics including Interruptions to Supply, Compliance Risk Index (CRI), Event Risk Index (ERI) Supply Demand Balance Index (SDBI) and Leakage. Much of this risk position has been mitigated by strong event management and incident management processes, which have helped maintain service levels (most notably during the Storm Eunice event).

Risk driver(s):

- Ageing infrastructure increasing the frequency and severity of asset failure
- Challenge of new asset integration while sites in operation
- Non-adherence to established processes and procedures when under pressure of operational incidents
- Challenges of power resilience on operational sites
- Fluctuation and severity of weather events.

Mitigating strategy:

- Water for Life – Hampshire – programme of significant capital and asset improvements to provide long-term resilience.
- Water First, our improvement programme strengthening internal processes and asset performance.
- Creation of new logistics team that will manage the inventory of materials and equipment in the field including in-sourcing of water tankering capability.
- Implementation of new control centre initiative that will enhance operational response to adverse conditions by boosting control shift resource and out of hours management.

Forecasted business impact:

Medium term

Cross reference:

Read more about how we Deliver great service on pages 76 to 80

Read more about how we Use water wisely on pages 81 to 82

Operational risk

2 Wastewater

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.

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. This could lead to prosecution and fines by the Environment Agency and a reduction in stakeholder and customer confidence.

Executive accountability:

Managing Director – Wastewater

Risk climate: ⧓

The level of risk remains steady but at a high level. Our performance has been challenging, specifically in light of increased capacity demand, fluctuations in extreme weather events and challenging regulatory targets that are becoming increasingly onerous. A national debate on the use of storm overflows has intensified over the last year. We are also under significant scrutiny from the general public and stakeholders with respect to our impact on the environment; with a key focus on spills to the environment in rivers, chalk steams and bathing waters.

Risk driver(s):

- Asset capability performance due to ageing infrastructure
- Increase in regional power outages
- Investment requirements to support growth schemes for new housing developments
- Meeting the required standards of wastewater treatment and asset management to protect the environment and/or public health from pollution and/or sewer flooding
- Non-adherence to established processes and procedures when under pressure of operational incidents.

Mitigating strategy:

- Over £1.5 billion investment to 2025 to improve the capacity and capability of our wastewater network across the region.
- Storm Overflow Task Force to reduce the harm from storm overflows.
- Ongoing Pollution Incident Reduction Plan.
- Wholesale strategic programme of projects to support key capability including asset maintenance, digitalisation and improvements to the control centre, and a new approach to logistics.

Forecasted business impact:

Medium term

Cross reference:

Read more about how we Protect and improve the environment on pages 83 to 87

Read more about how we plan to ensure our services are Fit for the future on pages 88 to 91

Principal risks and uncertainties continued

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Operational risk

3 Customer

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 reliant on us providing the level of service expected by our customers and our regulators. 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.

Executive accountability:

Chief Customer Officer

Risk climate: ⧓

The scale of the challenge is significant if the business plan for 2020–25 is to be delivered; we face a tight funding regime and the level of customer service improvement required to deliver our plans is significant. Our performance on key metrics is improving although we remain in the bottom third of companies for both our customer satisfaction (C-MeX) and developer satisfaction (D-MeX) scores. There has been no significant change in our risk profile during 2021–22. We continue to deliver improvements through our Customer Transformation programme (Velocity). Improvements to how we run our developer services channels continue to be implemented strengthening performance in this area.

Risk driver(s):

- Customer and wholesale business impact on our C-MeX and D-MeX performance
- Manual processes, which may lead to errors that require automating
- Transformation project (Velocity) does not deliver an improvement to cost to serve.

Mitigating strategy:

- The customer transformation project (Velocity) continues to develop the processes and technology that underpin our customer service
- Contractual targets in place for customer service provided by third-party suppliers
- Cross functional C-MeX working group established to ensure appropriate accountability and management focus across all relevant parts of the business
- Dedicated team in place to proactively engage with local authorities and new-build developers, to ensure the appropriateness of supply planning and connection
- Specific incident management process and procedures for customers in the event of service impacts
- Process in place to support vulnerable customers affected by operational incidents.

Forecasted business impact:

Medium term

Cross reference:

Read more about how we Deliver great service on pages 76 to 80

Read more about how we plan to ensure our services are Fit for the future on pages 88 to 91

Financial risk

4 Financial

Exposure to financial markets and other macro-economic factors, given our requirement to raise finance to fund the capital investment programme and to refinance debt maturities, results in Southern Water being impacted by external factors affecting the availability and cost of capital. A failure to maintain certain credit ratings could lead to an increase in interest cost and reduced availability of capital. This could put pressure on our ability to finance our capital investment programme or refinance our existing debt maturities. We enter into treasury transactions to manage inherent risk and support prudent funding, and not to speculate. We also manage our internal financial resilience and ability to manage budget overspends and other pressures on our financial position.

Executive accountability:

Chief Financial Officer

Risk climate:

Our risk profile has deteriorated over the year. We have seen an improving position in relation to the investment from our new shareholders, a fund managed by Macquarie Asset Management. This has injected new capital into the business strengthening the balance sheet, and providing funds for investment, which has resulted in an improved outlook for our credit ratings. However, we have experienced pressure on operating budgets and budget overspends. We continue to be at risk of a credit rating downgrade as a result of our poor operational performance versus our peers and the 2019 Price Review Final Determination. We continue to invest in improving performance. Our credit ratings are provided on page 101.

Risk driver(s):

- Accuracy of forecasts to meet long-term liabilities and obligations.
- Ability to access cost effective capital through maintaining an appropriate credit rating.
- Ability to manage internal cost challenges and pressures.

Mitigating strategy

- Liquidity testing and reporting is carried out on a regular basis, forming part of the 'going concern' assessment
- Sufficient cash and facilities are maintained to mitigate such risks as bond market closures
- Flexible dividend policy supports management of financial risk
- Detailed budgetary scrutiny of operational spend
- Improved operational performance, such as the pollution reduction plan – see page 27
- Continued use of a Sustainable ESG Framework during the year with the issue of dual tranche sustainable bonds.

Cross reference:

Read more about our financial performance on pages 92 to 101

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Corporate risk

5 Compliance

We are a highly regulated business and high standards of compliance are expected. Inadequate resources, processes, structure, capability, culture, 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 licence to operate as a water and wastewater company. As with all companies we are also required to comply with corporate legislation (for example Competition Law and the Bribery Act). Existing and changing legal and regulatory requirements encourage the business to operate in an agile way to ensure continued compliance with our obligations.

Executive accountability:

Director of Risk and Compliance

Risk climate: ⧓

Our risk posture for compliance is complex and has remained static over the last year, albeit at a high level. We remain under continued scrutiny by our regulators. During the year we were prosecuted by the Environment Agency (EA) for wastewater permit breaches from 2010–15. We continue to assist the EA with its ongoing investigations into legacy issues relating to wastewater sampling compliance. The Drinking Water Inspectorate (DWI) and the EA continue to monitor our delivery of regulatory schemes (outputs) and this is likely to continue in the future.

Our CRI performance continues to improve but further improvement is required. Our one-star performance on the EA's Environment Performance Assessment (EPA) has declined from 2020, with four metrics rated as 'Red'. Ofwat continue to focus on our performance and compliance with our Section 19 Undertakings. Ofwat and the EA have both begun industry wide investigations into wastewater treatment flow compliance.

Risk driver(s):

- Failure to comply with the requirements of our licence
- Failure to meet our obligations with the EA, as reflected in the Environmental Performance Assessment (EPA)
- Meeting our Water Quality obligations as reflected in key performance metrics (CRI and ERI) and DWI notices and enforcement.

Mitigating strategy:

- Delivery of key transformation and training programmes in both water and wastewater parts of the business.
- Ensuring appropriate governance through the embedding of a robust three lines of defence compliance model
- A compliance framework with internal monitoring and assurance and an ethical business framework
- Compliance with company procedures is reviewed through self-assessment every six months.

Forecasted business impact:

Short term

Cross reference:

Read more about our three lines of defence on page 109

Read more about the EA investigation on page 38

Corporate risk

6 Climate change

The impacts of climate change continue to increase our related risks, such as impacts on our water resources, increased drought and flooding, and extreme weather events. We supply drinking water to a growing population in areas already classified as under 'severe water stress'.

If we are unable to improve our resilience to the extreme weather events predicted by the physical impacts of climate change:

- we will find it increasingly difficult to supply sufficient water to meet the growing demands of our customers though scarcity of water resources, heat stress or contamination by saline intrusion of existing water reserves
- the assets on our sites, or our sewer system network, could more easily be overwhelmed by storm events, leading to flooding or pollution in our region; and
- our coastal sites may become inundated from rising sea levels or at risk of coastal erosion and subsidence.

Executive accountability:

Chief Environment and Sustainability Officer

Risk climate: ⧓

We are working on both aspects of climate change. Mitigation to reduce our contribution and adaptation to ensure our resilience to the existing and future impact of climate change.

Our risk profile remains stable. Extreme weather events such as flooding, and storms are becoming more frequent and impact our ability to supply sufficient water to meet the growing demands of our customers.

While stringent abstraction licences continue to challenge our ability to meet customer demand while also protecting the sustainability of our natural resources and the environment.

Risk driver(s):

- Failure to adapt to the long-term effects of climate change
- Challenging regulatory and societal targets
- Increased customer demand
- Fluctuation, severity and frequency of weather events.

Mitigating strategy:

- Climate Change Adaptation Report (published December 2021)
- Net Zero Plan
- 50-year Water Resources Management Plan
- Target 100 water efficiency programme
- Drought Plan
- Investment in new infrastructure
- Drainage Wastewater Management Plans.

Forecasted business impact:

Medium term

Cross reference:

Read more about our approach to tackling climate change on pages 56 to 60

Read our Climate Adaptation Report: **southernwater.co.uk/our-performance/reports/climate-adaptation-consultation**

Principal risks and uncertainties continued

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Corporate risk

7 Delivery

We have a planned totex investment programme of £2.1 billion between 2020 and 2025. 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.

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 or prevent us from fulfilling the promises that we have made in our business plan and commitments to our regulators.

Executive accountability:

Chief Operating Officer

Risk climate: ⧓

The scale of the requirements of the capital investment delivery programme combined with a tight financial settlement in the period 2020 to 2025 has maintained risk in this area.

The size and scale of the requirements of the investment delivery programme, plus stringent requirements from regulators to deliver extensive programmes of work continues to exert pressure in this area. Managing changes to the programme delivery within established financial envelopes and contractual relationships is a challenge.

In addition we have significant Opex funded strategic projects which will help the performance of the business; we are also delivering the planning and production of our next business plan.

Risk driver(s):

- Tight Financial Determination from Ofwat has put pressure on capital delivery budgets.
- Challenging delivery efficiencies that are required to deliver value for the wider business.

Mitigating strategy:

- We have brought significant investment capability in house including:
  - An embedded in-house engineering and capital delivery function
  - An established long-term delivery partner supply chain
- Risk and value are considered at each step of the investment cycle to provide best value for money to our customers
- Monitoring the delivery of our Final Determination obligations, continually assessing our financing status.

Forecasted business impact:

Medium term

Cross reference:

Read more about our five-year delivery strategy to 2030 on page 51

Read more about our Long-Term Priorities on page 50

Corporate risk

8 Information Technology (IT)

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.

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.

Executive accountability:

Chief Information Officer

Risk climate: ▼

There has been an increase in the risk climate. The conflict in Ukraine has heightened the overall cyber security risk, in addition to underlying risk associated with the NIS directive. We continue to rebuild our IT capability. This transformation has been ongoing for the past five years and seen an improvement in our IT estate.

Risk driver(s):

- Insufficient cyber security controls and monitoring in place for business systems to avoid malicious attacks
- Technology failure through the use of and dependency on legacy systems
- Mishandling or deliberate sabotage of data
- Inability to monitor and manage operational functions (telemetry and control) or to provide IT supported customer services, including billing or new service provision.
- Weakness in the security of SW's telemetry OT network, where physical access to the network can be obtained.

Mitigating strategy:

- Business continuity processes reducing impact on IT systems
- Active programme for migration of services off heritage infrastructure and onto new fully-managed infrastructure
- Migration of existing critical and core service applications into the new data centres
- Enhanced suite of IT general controls identified following alignment to the Network and Information System (NIS) – Cyber Assessment Framework
- Continued investment in cyber threat mitigation strategies in response to the ever-changing risk landscape.

Forecasted business impact:

Long term

Areas impacted:

Customer experience, Business disruption, Brand and Reputation, Legal and Regulatory, Financial.

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Corporate risk

9 Resources

The nature of our business model includes the use of long-term contracts for the provision of critical goods, services and works, as well as some outsourced activities. Some of our most critical resources include the supply of chemicals, fuel, and spare parts to ensure continuity of service, as well as the energy required to power our operational equipment on a continuous basis, at a commercially viable price.

Inflationary pressures and disruption in production capacity and the global supply chain has reduced availability, delayed supply and driven protracted prices hikes to increase the risk in this area.

There is a risk that a failure to have the required external market capability and capacity, would lead to Southern Water being unable to deliver its commitments to our customers, stakeholders, and shareholders.

Executive accountability:

Chief Operating Officer

Risk climate: ▼

As we enter the post-COVID-19 period, respond to the impact of BREXIT and the uncertainty in global markets our risk climate has deteriorated.

Risk driver(s):

- Russia being one of Europe's largest providers of oil and gas, and sanctions hitting exports, energy prices have subsequently soared to record highs.
- Periods of global disruption can completely transform the sourcing landscape, turning items once considered low-risk commodities into business-critical inputs overnight and impacts on the value of the commodities.

Mitigating strategy:

- Hedging strategy is in place for energy cost fluctuations/ increases to manage impact to end customers.
- The Contract Management framework is in place to effectively work with suppliers to mitigate risks of supply and impacts of inflationary issues, with no material impacts occurring.

Forecasted business impact:

Short term

Areas impacted:

Business Disruption, Brand and Reputation, Financial.

Cross reference:

Read more about our suppliers on pages 10 and 70

Corporate risk

10 Health and safety

The health, safety, security and wellbeing of our employees and the public 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.

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.

Executive accountability:

Chief Executive Officer

Risk climate: ⧓

Our risk profile remained stable in 2021–22. During the year we formed a Health and Safety and Operational Risk Committee. We also undertook a complete review of our processes and procedures and are working on an enhanced improvement plan to reduce our existing risks.

Risk driver(s):

- Incident occurrence from deteriorating assets, trips and hazards, and poor behaviours impact asset security and personal safety
- Failure to adopt standardised approach and guidelines within the business
- Asset damage, disturbance and nuisance from our external operating environment.

Mitigating strategy:

- Significant review of our health and safety approach, processes, procedures and capabilities
- Enhancements to our safety communications and reporting,
- Continued improvement of training and development programmes.
- A renewed focus at board level with a health safety and operational risk committee.
- Clearly defined strategy, safety protocols and standards in line with legislation and industry best practice
- Front-line team accountability
- Site safety inspections and audits
- Suppliers and delivery partner standards
- Enhanced incident reporting and investigation including near misses and lost time incidents
- Mandatory health, safety and wellbeing training.

Forecasted business impact:

Short term

Areas impacted:

Business Disruption, Brand and Reputation, Legal and Regulatory, Financial.

Cross reference:

Read more about employee safety on page 64

Read more about our new Health and Safety and Operational Risk Committee on pages 174 to 175

Principal risks and uncertainties continued

Risk Climate Key:
▼ Deteriorating
▲ Improving
⧓ Stable

Corporate risk

11 Corporate affairs

Failure to effectively monitor and adapt to any changes in our political and regulatory frameworks, or a failure to influence change to the political or regulatory landscape, may lead to potential un-forecasted increases in administrative costs, reduced revenue, and ultimately non-compliance.

Our current business plan and approved pricing structure runs until 2025. We are under stringent financial constraints, performance incentives and targets, making longer term resilience more challenging.

There is a risk that changes in the political landscape, new legislation and Ofwat's approach to the 2025–30 price review may cause costly consequential impacts on the water sector to which we will have to adapt.

Executive accountability:

Chief Environment and Sustainability Officer

Risk climate: ▼

Our risk profile has deteriorated during 2021–22 in relation to the debate on the future of Combined Sewer Overflows (CSOs) which could lead to a significant change in our operating environment.

Risk driver(s):

- Inability to meet assumed performance as reflected in Operational Delivery Incentive (ODI) performance
- Ineffective regulatory change horizon scanning
- Lack of influence in shaping the outcomes of change, including in relation to the price review for the period 2025–30
- Ability to adapt and transform the business to meet the changing environments in which we operate
- Inability to influence the perception of the business following past events.

Mitigating strategy:

- Monitor developments in the requirements from all of our regulators on key issues
- Maintain close dialogue with Government, Ofwat and other regulators on key issues
- Work with our customers to understand their perception of our delivery, and future ambitions
- Continue to engage constructively with all of our regulators in regards to the water scarcity challenges
- Work with our regulators on how we better understand and address our customers' needs to enable successful outcomes in the next price review period 2025–30.

Forecasted business impact:

Long term

Areas impacted:

Customer Experience, Brand and Reputation, Legal and Regulatory

Cross reference:

Read more about our Long-Term Priorities and five-year delivery strategy on pages 50 to 51

Corporate risk

12 People

The attraction, retention, and succession of the right people, with the right skills for the role, is a central part of our long-term strategy and our ability to ensure the company is agile and adaptable to change.

We have designed our people risk framework to support a diverse and inclusive culture that promotes employee engagement and demonstrates the desired conduct and behaviours that align with our values. It includes building and retaining an industry-leading workforce and managing our people to upskill and develop our talent. This means we can ensure that we have the right resources to support our operations while implementing HR processes and procedures that support, protect and manage our people, and provide a fair and transparent reward and recognition programme.

Executive accountability:

Director of HR

Risk climate: ⧓

Our risk profile during 2021–22 has remained consistent – our execution plans are comprehensive, however we continue to face challenges, especially in relation to talent attraction. We continue to adapt to the longer-term impact of the post-COVID pandemic in relation to employees, contractors and our ways of working.

Risk driver(s):

- Ability to attract and retain the right skills (Technical and STEM) to perform and deliver on our strategic priorities
- Regional challenges related to location and reward packages
- Negative impact on employee morale and fatigue through continued change.

Mitigating strategy:

- Ongoing workforce planning analysis and high-level strategic talent reviews take place across the business to assess capability and capacity needs
- Launched employer brand
- Our Management Academy supports in-role development and career progression
- Our recruitment strategy streamlines out best route to market
- Our annual engagement surveys assess our employee satisfaction to develop action plans
- Inclusion and diversity action plan.

Forecasted business impact:

Medium term

Areas impacted:

Customer Experience, Business Disruption, Legal & Regulatory, People, Financial

Cross reference:

Read more on our people on pages 62 to 65

Viability statement

Southern Water Services (SWS) is a regulated utility which is characterised by a long-term investment horizon, over multiple-price control periods with stable revenues. Ofwat sets price controls for five-year periods, which reduces the potential for variability in revenues from the regulated business. The company benefits from a rolling 25-year operating licence.

Ofwat regulates the water industry in England and Wales and has a statutory obligation to ensure that water and wastewater companies can finance their functions. In addition, the regulator has a primary duty (under the Water Act 2014) to ensure that water and waste companies have the long-term resilience to meet the needs of customers.

In preparing the long-term viability statement (LTVS), Southern Water has conducted an assessment covering the period up to March 2030. The analysis has taken into account current performance, planned performance improvements, funding of the defined benefit pension scheme and the principal risks that affect the business as documented in the Strategic Report on pages 108 to 120. Scenarios were developed with reference to a quantification of financial risk relating to specific risks underpinning the principal risks faced by the business, as well as consideration of the gearing sharing mechanism. These risk scenarios were then tested both individual and in combined scenarios. Additional detail on this analysis is provided below. Mitigating actions to reduce the impact on financial flexibility of these risks and the effectiveness of these actions were also considered.

Financial resilience benefits from the £529.9 million equity injected into SWS in September 2021, as part of £1.1 billion of new equity injected into the Greensands group of companies. The purpose of the equity was to pay for the EA prosecution fine of £92.5m received July 2021, to finance the additional wholesale totex expenditure of £230 million in the current five-year regulatory period to March 2025, and the remainder used to support the balance sheet. Settlement of the EA prosecution fine also removed a risk considered in previous viability statements.

The analysis has also taken into account the long-term financing needs of the business, including the maturity profile of existing debt, which extends to 2056, and the restructuring activity conducted in recent years to support long-term financial viability.

New finance of £1,125 million was raised during 2020–21 under our financing sustainability framework. The framework ensures proceeds are used for environmental and social purposes, including the repayment of debt issued for the same purpose. Future financing plans assumed for the long-term viability statement includes £2.5 billion of projected new finance used for the capital investment programme and the scheduled repayment of debt maturities during this period.

Assessment period

For the LTVS, the Board continues with a forward-looking term up to 31 March 2030:

- The period to 2025 is reasonably certain, given SWS has accepted the commitments and customer promises in the Final Determination for 2020–25 and the SWS Board has agreed a business plan for the period to March 2025.
- The Board, however, notes that analysis of resilience over the period 2025–30 is highly uncertain. A high-level plan was produced for the period from 2025–30 as part of the business plan submission to Ofwat in 2019. The main purpose of this plan was to provide an indication of future customer bills and also to provide a reasonable basis for an assessment, albeit recognising that the period to 2030 is inherently uncertain, given the likelihood of further evolution of the regulatory framework and the potential impact from, as yet, unknown factors which may affect the shape of the plan. Moreover, cost allowances, performance challenges and returns are yet to be set, implying a wide range of potential outcomes. The risk scenarios include two PR24 WACC scenarios.

Stress tests

- It is not considered practicable to extend the period beyond 2030 given the inherent uncertainties already present in the forecasts used to 2030.

The ‘principal risks’ identified (pages 108 to 120) are recognised as the key risks facing SWS and those that will have the potential greatest impact on the business. These are regularly reviewed by the Board. Based on the principal risks, the following risk factors are considered to have the potential for a negative impact on the financial position of SWS.

Viability statement continued

- **Outcome Delivery Incentive (ODI) penalties:** These may materialise as a result of under-performing on performance commitment targets set by Ofwat, which are significantly more challenging compared to the previous price control.
- **Totex overspend:** Totex overspend has been considered carefully in light of the more challenging cost allowances set in the PR19 Final Determination as well as unexpected costs from incidents such as severe weather, cyber security events, pension deficit contributions and major operational events.
- **Retail:** Companies may underperform due to factors such as bad debts, which has increasingly been an issue recently, given the cost of living environment, and COVID-19.
- **Outturn inflation is different to forecast:** SWS's financial projections are sensitive to inflation scenarios given the index-linked nature of business cash flows and a number of credit metrics which include inflation adjustments. Southern Water has in place inflation linked debt and derivatives to mitigate some of this risk.
- **Financial penalties:** This captures the risk of SWS receiving (non ODI) fines.
- The likely financial impact of these risks has been estimated and used in the construction of severe, but plausible, downside scenarios. In developing these scenarios, we have considered combinations of risk factors and taken into account potential correlations between risk factors.

Stress test	Link to principal risks	Specification of stress test
ODI penalty	Operational risks	ODI penalties resulting from failing to deliver on performance commitments due to operational failures. (RORE -2.3% to 2025 and -0.6% to 2030).
Totex underperformance	Operational risks Corporate risks	Additional Totex resulting from the principal risks (see pages 108 to 120) over and above the costs already in the plan which are c. £270 million in excess of the PR19 FD). (sensitivity +3.6% of each year to 2030).
Macroeconomic shock – low inflation	Financial	Inflation forecasts to 2030 -1%.
Macroeconomic shock – high inflation	Financial	Inflation forecasts to 2030 +1%.
Combined operational scenario	Operational risks Corporate risks	50% of totex underspend to 2030 combined with the ODI penalties, and high inflation.
Severe scenario (high inflation) Severe scenario (low inflation)	Operational risks Corporate risks	The full amount of totex overspend plus ODI penalties combined with high and low inflation.

Assessment of results and mitigating actions

There is limited financial flexibility within the current credit ratings for Southern Water in the current five-year period, principally the result of weak performance against operational metrics in the PR19 determination and a reduction in customer cash as a result an annual refunds to customers, a total of £135 million over the period 2020 to 2025, as reparation agreed with Ofwat in 209 regarding wastewater misreporting. Significant resource has been invested in a turnaround plan for SWS, which is expected to achieve demonstrable improvement in performance by the end of current five-year period (by 2025). This is expected to improve financial resilience for the period 2025 to 2030.

Credit ratings improved following the new equity in September 2021. There is a risk of a further downgrade if SWS is unable to deliver its planned improvement to operational performance and business efficiency for the remainder of the current regulatory period to March 2025.

There is not expected to be a Trigger Event, or a credit rating downgrade for the period 2025 to 2030, in all but the most severe scenarios tested when combined with a low PR24 WACC scenario.

A Trigger Event (under the Common Terms Agreement) would occur if there were a breach of a debt covenant ratios or if either of Standard and Poor's or Fitch downgraded the credit rating. A dividend restriction under our Licence of Appointment would occur where a credit rating negative outlook is assigned to the lowest investment grade credit rating.

A Trigger Event would result in restrictions on the payment of dividends. Southern Water obtained a waiver from its lenders in 2021 to permit continued access to financial indebtedness in order to continue to finance the business in a credit rating downgrade Trigger Event or the breach of interest cover ratio. This was granted for the current regulatory period to March 2025. A Trigger Event in the period 2025 to 2030 would result in restrictions on the payment of dividends plus require lender consent to permit continued access to financial indebtedness, which we believe would be granted.

A Default Event is considered unlikely and did not materialise in any of the scenarios tested.

For each of the scenarios tested, we have identified appropriate mitigating actions in the event that stress tests would result in projected metrics deteriorating materially. These mitigating actions are set out in the table below.

Description of risk	Scenario	Potential mitigating actions
Costs incurred are higher than allowed in the FD	Totex underperformance	Reduction, or suspension, of projected dividend.
Underperformance on ODIs and totex	Combined operational scenario	Reduction, or suspension, of projected dividend.
Severe event – totex overspend, ODI penalty and high inflation	Severe scenario (high inflation)	Reduction, or suspension, of projected dividend.
Severe event – totex overspend, ODI penalty and low inflation	Severe scenario (low inflation)	Reduction, or suspension, of projected dividend. Discuss impact with lenders and seek a waiver if necessary, when combined with low WACC scenario. Suspend discretionary expenditure and consider whether support is required from equity against implied inefficiency.

Viability statement continued

Viability

The Board has assessed the viability of SWS to the period March 2030. In doing so, it has considered SWS's current position, the principal risks facing the company and resulting stress tests, and the impact of mitigating actions.

The other companies in the wider Greensands group are principally in place to support the viability of the regulated business. The Board has taken into consideration the activities of other group companies (pages 102 to 107) as well as the overall group structure and is satisfied that it poses no additional risk to the financial flexibility of SWS.

In making their assessment, the directors have assumed capital markets will be available to provide funding for the significant ongoing capital investment programme as well as for the refinancing of debt, credit facilities and financial derivative maturities when they fall due. The directors anticipate the ability to efficiently raise new finance and a stable and supportive regulatory environment.

The Board is satisfied that it has sufficient information to judge the viability of the company and has a reasonable expectation that the company will be able to continue to operate and meet its obligations over the period to March 2030.

Governance and assurance

The Board has reviewed the medium-term plan and reviews the company's principal risks from a strategic perspective, which form the basis of the stress tests modelled.

The Audit Committee supports the Board in reviewing the results of the analysis as part of its normal procedures. To support the Board in its assessment, a third-party assurance was obtained over the calculations applied to the financial projections for the LTVS in 2021.

The Strategic Report, including the directors' Section 172(1) Statement on pages 21 to 124, was approved by the Board of Directors and signed on its behalf by:

Richard Manning
General Counsel and Company Secretary
15 July 2022

Corporate governance

Chair's overview

"The year has seen some highly significant events for Southern Water, both positive and negative, against a backdrop of the country emerging from the COVID-19 pandemic and entering into a period of economic uncertainty."

Keith Lough
Chair

There have been a number of major events during 2021–22 and some significant changes in terms of our corporate governance arrangements.

Our culture

In July 2021, the company received a £90 million fine, having pleaded guilty to the 51 charges brought by the Environment Agency. This further underlines the importance of having an ethical culture within the business, as the consequences of not having one can be significant. As a result, one of the Board's main priorities continues to be to monitor the culture of the workforce and organisation and to support and roll out initiatives to make such negative behaviours unthinkable.

A key component of this has been the development of our Culture Dashboard, which was first reported on in 2020–21. Please see pages 156 and 157 for details of our culture metrics.

In addition, the Board continues to use such tools as all-employee surveys, Company Conversations with the Chief Executive, as well as direct engagement with the workforce to monitor progress. Kevin McCullough, who acts as the director with the remit of communicating the views of the workforce to the Board, carries out much of this engagement.

Delivering for customers

Perhaps the most significant event for the company during the year was the investment by a fund managed by Macquarie Asset Management in August 2021. After a process lasting several months, a fund managed by Macquarie acquired a majority stake in Southern Water's parent company, Greensands Holdings Limited. This investment of £1 billion in the Greensands Holdings group, including £530 million into the company, strengthens Southern Water's balance sheet, enabling us to increase investment in our network and improve delivery for our customers.

During the year, the Board was also heavily focused on agreeing and developing our execution plan for 2021 and on the proposals for our business plan covering the period from 2025–30, which will be agreed with Ofwat in 2024. The Board also approved the company's Level Playing Field Investment Programme (LPIP), committing investment of £230m into our core water and wastewater assets.

Delivering for the environment

Protection of the environment and steps to reduce our impact are essential to our operations. In addition, the increased likelihood of extreme weather events, whether they be extended dry periods or serious storms, due to climate change highlights the importance of organisations ensuring that they are resilient and capable of continuing to operate under difficult circumstances.

Accordingly, the Board approved a number of material investments to upgrade our estate, including at Budds Farm Treatment Works.

The Board has paid much attention to the discussions at governmental level and new environmental legislation during the year. The issue of storm overflows and the duties and expectations set out in the Environment Act 2021 were particular areas of focus. The Board also considered the implications of the Task Force on Climate-Related Financial Disclosures.

Although the number of pollution incidents has reduced from 400 in 2021 to 372 category 1-3 incidents in 2022, the Board still considers this to be too high. The Board has therefore devoted much time to overseeing the company's Pollution Incident Reduction Plan and other measures to prevent and/or mitigate pollution incidents.

Board changes

Following the major investment by a fund managed by Macquarie, the previous shareholder-nominated non-executive directors, Sara Sulaiman and Marykay Fuller, resigned and Mark Mathieson, Will Price and Martin Bradley were appointed in their place in September 2021. Martin Bradley has since been replaced by Steve Fraser as of 1 May 2022.

In addition, both our Chief Executive Officer and Chief Financial Officer announced their intention to stand down in 2023 and 2022 respectively. We were pleased to announce that Lawrence Gosden, the previous Chief Operating Officer, would join the Board as Chief Executive Officer from 1 July 2022. In addition, Nadim Ahmad will join the Board later in July 2022 replacing Sebastiaan Boelen.

Improving corporate governance

In February 2022, it was agreed to transfer responsibility for monitoring risk appetite and enterprise risk from the Risk Committee to the Audit Committee and to reconstitute the Risk Committee as the Health and Safety and Operational Risk Committee. It is intended that this change will enable greater attention to be given to health, safety, security and wellbeing and enable steps to be undertaken to developing an enhanced safety culture within Southern Water.

In addition, in February 2022, the Board agreed to form an Environment, Social and Governance Committee to be responsible for our material environmental, social and governance matters.

Under the terms of our licence, Southern Water is required to meet the objectives set out in Ofwat's Board leadership, transparency and governance principles (the 'Ofwat Principles'). We set out our assessment of our compliance with the Ofwat Principles on pages 136 and 137.

In addition, the Board has further sought to embed more consistently its consideration of section 172(1) factors in its decision-making. Our section 172(1) Statement can be found on pages 71 to 73 of our Strategic Report.

Keith Lough
Chair

15 July 2022

Board of directors as at 30 June 2022

Keith Lough
Chairman

Non-Executive
Independent: On appointment

Committee membership:
N RE

Date of appointment:
01/08/2019

Experience:

Keith has extensive experience in the natural resources and energy sectors in both finance and leadership roles, including as finance director for British Energy plc between 2001 and 2004 during a period of major restructuring.

In addition, Keith served as non-executive chairman of Gulf Keystone Petroleum plc, following a successful debt restructuring. Immediately prior to his appointment to the Board of Southern Water, Keith was a non-executive member of the Gas and Electricity Markets Authority (Ofgem), where he was chairman of the Audit and Risk Assurance Committee, having served on the board since 2012.

Keith holds an MA in economics and MSc in finance and is a Fellow of the Association of Chartered Certified Accountants.

External appointments:

Keith holds non-executive directorships in a number of oil and gas companies, including at Rockhopper Exploration plc as non-executive Chairman, at Hunting plc as senior independent director and at Capricorn Energy plc.

Ian McAulay
Chief Executive Officer

Executive
Independent: No

Committee membership: N/A

Date of appointment:
01/02/2017

Experience:

Ian joined Southern Water as Chief Executive Officer in January 2017 and was appointed to the Board from 1 February. He is a member of the Executive Committee and the Executive Leadership Team.

Ian has more than 30 years of global water and environmental experience, operating in both publicly quoted FTSE100/250 companies and privately-held enterprises. He has managed utility, construction and consulting businesses in the UK, Belgium, India and the USA, and has enhanced his experience with executive education, notably at Harvard Business School.

Previously, he served as an executive director of the Pennon Group plc and chief executive of its subsidiary, Viridor.

In a non-executive capacity, he served as a member of Greater Manchester Authorities Low Carbon Hub Board and the Scottish Government's 2020 Climate Change Board. He has also provided expert input into government review groups and industry partnerships.

Ian holds an honours degree in Civil and Environmental Engineering and is a Chartered Member of the ICE, CIWEM.

External appointments:

Ian is chair of the Greater Brighton Infrastructure Panel and chair of trustees of Dallagio Rugbyworks.

Note:

Ian McAulay resigned from the Board on 30 June 2022. He was replaced by Lawrence Gosden from 1 July 2022.

Committee membership key

A Audit Committee
N Nomination Committee
RE Remuneration Committee
E ESG Committee
RI H&S and Operational Risk Committee
Committee Chair

Sebastiaan Boelen
Chief Financial Officer

Executive
Independent: No

Committee membership: N/A

Date of appointment:
14/12/2018

Experience:

Sebastiaan started his career with 10 years in the Royal Navy, followed by management consulting (McKinsey; C&L – now PwC) and senior finance roles in telecoms (infrastructure), consumer goods, business services and financial services, for listed and private equity portfolio companies.

He also worked with Electricity North West and has been Chief Financial Officer and Board member of Southern Water since December 2018. He is a member of the Executive Committee and the Executive Leadership Team.

Sebastiaan has worked and lived in the Netherlands, France, Switzerland, Belgium, Luxembourg and the UK.

External appointments:

None.

Note:

Sebastiaan Boelen will step down from the Board later in July 2022. He will be replaced by Nadim Ahmad as interim Chief Financial Officer.

Paul Sheffield
Senior Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:
N RE

Date of appointment:
01/06/2014

Experience:

Paul joined the Board in June 2014 and was appointed as senior independent non-executive director in July 2015. Between 1 April and 31 July 2019, Paul served as acting Chairman while he led the search for a new Chairman.

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 board for 10 years and served as chief executive officer between 2010 and 2014. Between 2014 and 2017, he headed up the construction operations for the European and Middle Eastern businesses for Laing O'Rouke 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.

External appointments:

Paul is a member of the Supervisory Board of BAM Group in the Netherlands. He is also a Fellow and former president of the Institution of Civil Engineers.

Board of directors continued

Rosemary Boot
Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:
A E

Date of appointment:
01/03/2015

Experience:

Rosemary joined the Board in March 2015.

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 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, Rosemary 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 acquisitions.

External appointments:

Rosemary is Senior Independent Director of Impact Healthcare REIT plc and Triple Point Energy Efficiency Infrastructure Company plc. She is a non-executive director of Urban&Civic plc. She is also a trustee of Green Alliance, and a founder and director of Chapter Zero Limited.

Mike Putnam
Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:
RI

Date of appointment:
26/09/2017

Experience:

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. He has since transitioned to a plural career with a portfolio of non-executive directorships.

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 as working across the group as a non-executive director on some of the international boards. Throughout his career he has been closely involved with the successful delivery of many high-profile projects and programmes.

Mike is a member of the Acceleration Unit Expert Panel, part of the Department of Transport. He has also been a member of the Construction Leadership Council and chair of the Green Construction Board, a member of the CBI Construction Council, and a non-executive director of the Association of Consulting Engineers.

A Chartered Engineer, Mike is a Fellow of the Institution of Civil Engineers and Royal Institution of Chartered Surveyors.

External appointments:

Mike currently serves on the boards of Network Rail, Arcadis NV and Bazalgette (Tideway) Tunnel Ltd. He is also a member of the 'Acceleration Unit Expert Panel' within the Department for Transport.

Committee membership key

- A Audit Committee
- N Nomination Committee
- RE Remuneration Committee
- E ESG Committee
- RI H&S and Operational Risk Committee
- Committee Chair

Dame Gillian Guy DBE
Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:
E

Date of appointment:
12/11/2018

Experience:

Gillian joined the Board in November 2018.

Gillian served as a non-executive board member and chair of the Audit Committee of the National Audit Office and as 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 and was awarded a Damehood in the 2020 New Year's Honours List for services to public and voluntary sectors.

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.

External appointments:

Gillian was formerly 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.

Kevin McCullough
Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:
E RI

Date of appointment:
18/07/2019

Experience:

Kevin joined the Board in July 2019 and was appointed as the non-executive director with the remit for communicating the views of the workforce to the Board in February 2020.

Kevin has over 35 years of experience in the utility sector. He has developed a strong reputation for delivering results in the most arduous of business environments, having held significant executive positions with RWE Innogy and npower, Horizon Nuclear Power and UK Coal Production Ltd.

He has been responsible for the development and construction of some of the UK's largest power plants, including large-scale offshore wind and high-efficiency combined cycle gas turbine. Kevin's career has seen him take key roles interfacing with, and in some cases advising, government directly on all aspects of UK energy generation.

As chairman of Horizon Nuclear Power, he helped nurture the opportunity for new nuclear capability in the UK.

Kevin is a Chartered Engineer and a Fellow of both the Institute of Mechanical Engineers and the Energy Institute.

External appointments:

Kevin is an Executive Advisor to PA Holdings Ltd, a member of the PA Consulting Group.

Board of directors continued

Malcolm Cooper
Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:
A

Date of appointment:
23/12/2019

Experience:

Malcolm joined the Board in December 2019 and was appointed as Chair of the Audit Committee.

Malcolm has extensive experience in the regulated utility sector, having worked for around 30 years at National Grid plc, British Gas plc and other companies. He was a member of the board of both National Grid Gas plc and National Grid Electricity Transmission plc.

Malcolm was previously a non-executive director of St William. He is also a past president of the Association of Corporate Treasurers and was a member of the Listing Authority Advisory Panel of the FCA.

Malcolm has a degree in Pure Mathematics and is both a Fellow of the Association of Chartered Certified Accountants and the Association of Corporate Treasurers.

External appointments:

Malcolm is a non-executive director at: Morgan Sindall plc where he chairs the audit and the responsible business committee; MORhomes plc where he is Senior Independent Director and chairs the credit committee; and at Custodian REIT plc as audit committee chair designate. He was also a non-executive director at CLS Holdings plc, where he was senior independent director and audit committee chair. He is a non-executive director and chairs of the audit and risk committee of Local Pensions Partnership Ltd.

Mark Mathieson
Non-Executive Director

Non-Executive
Independent: No

Committee membership:
E RI

Date of appointment:
08/09/2021

Experience:

Mark joined the Board in September 2021.

A Chartered Engineer, and a Fellow of the Institution of Engineering and Technology, he has 33 years of experience in the energy utility sector. Mark joined Macquaire in 2018. Previously Mark was CEO at Green Highlands Renewables, the UK's leading developer of run-of-river hydro-electric schemes. Prior to that he began his career and spent 26 years at the North of Scotland Hydro Electric Board which subsequently formed part of SSE plc, where he was the MD responsible for electricity networks business. He was also recently a non-executive director at the Smart DCC company responsible for the central infrastructure of the UK smart metering roll-out. He is a past chair of both the Energy Networks Association, the trade association and EA Technology, a leading company in energy innovation.

Mark has a Bachelor of Engineering in Electrical and Electronic Engineering from Heriot Watt University, Edinburgh.

External appointments:

Mark sits on the Boards of Cadent Gas Networks, the largest gas distribution network business in the UK, Nortegas Energia Grupo, the gas distribution network business serving northern Spain and Distributie Energie Oltenia SA, an electricity distribution network in Romania.

Committee membership key

A Audit Committee
N Nomination Committee
RE Remuneration Committee
E ESG Committee
RI H&S and Operational Risk Committee
Committee Chair

Will Price
Non-Executive Director

Non-Executive
Independent: No

Committee membership:
A RE N

Date of appointment:
08/09/2021

Experience:

Will joined the Board in September 2021.

Will joined Macquarie Asset Management in 2007, and works in the Utilities team covering Europe.

Will has been involved in several utilities acquisitions including Wales & West Utilities, Thyssengas, Czech Grid Holding, EP Infrastructure, Viesgo, CEZ Romania, and Southern Water. Will currently serves as a director on the Board, EP Infrastructure, and Czech Grid Holding.

Will has been involved in key asset management initiatives including regulatory resets and refinancings for several utility assets, a consensual restructuring of National Car Parks, separation and transition of EP Infrastructure and Czech Gas Networks, and the disposal of Viesgo.

Will has a Bachelor of Science in Economics and Politics from the University of Bristol, UK. He also holds a Master of Finance from INSEAD Business School, France.

External appointments:

N/A

Steve Fraser
Non-Executive Director

Non-Executive
Independent: No

Committee membership:

N/A

Date of appointment:
01/05/2022

Experience:

Steve has over 20 years' experience of managing and transforming infrastructure businesses latterly as Chief Operating Officer and a board director of FTSE100 United Utilities.

He has a degree in Management Studies and a Master's in Engineering Management from UMIST and also holds a diploma in Advanced Management from Harvard University.

After leaving education, Steve trained in utilities operations working across water, electricity, and latterly high-pressure gas pipelines.

He became a director of Bethell Group where he worked to establish them as a leading player in the energy services sector prior to joining United Utilities in 2005 to run the global outsourcing division Energy and Contracting Services working across the UK, Europe and the Middle East.

External appointments:

Steve is the CEO at Cadent Gas.

Richard Manning
General Counsel and Company Secretary

Committee membership:

Secretary to all committees

Date of appointment:
24/07/2018

Experience:

Richard joined Southern Water in July 2018 as General Counsel and Company Secretary and now has overall responsibility for leading the Risk and Compliance directorate alongside his legal and governance roles. He is a member of the Executive Committee and the Executive Leadership Team.

He has held similar roles in a number of listed and private companies including GCap Media plc, JJB Sports plc and Waterstones, and brings a wide experience of legal and governance matters.

Richard holds a law degree and an MBA and is a qualified solicitor.

External appointments:

None.

Governance at a glance

The year has seen **significant events** for the company and its Board.

Governance highlights

3
members joined the board

Safety
survey conducted across the business at every level

3.93/5
employee engagement score

ESG
Committee established

Externally
facilitated Board evaluation

Changed
remit of Audit and Risk Committees

What was on the Board's agenda this year

Execution plan

To deliver the investment and improvements for the year based on the 2020–25 business plan.

New external investment

The acquisition of a majority stake in the group by a fund managed by Macquarie Asset Management.

The environment

Monitoring environmental impact and reviewing plans to improve performance.

Accelerating investment

Accelerating our capital programme to deliver a more resilient company.

Price review 24

Planning for the next five-year business plan period to 2030.

Committee highlights

Nomination Committee

Areas of focus this year:

- Externally facilitated Board evaluation and the actions of the previous year's evaluation.

Priorities for 2022–23

- Improving diversity.
- Succession planning.

Audit Committee

Areas of focus this year:

- Annual and interim financial statements.
- Non-financial performance reporting assurance.

Priorities for 2022–23

- Assurance of our business plan for 2025–30.
- Task Force on Climate-Related Financial Disclosures (TCFD).

Health and Safety and Operational Risk Committee

Areas of focus this year:

- Rolling out the new risk taxonomy.
- Employee health and safety.

Priorities for 2022–23

- Developing and implementing proposals to improve health, safety, security and wellbeing to generate a safety culture.
- Employee wellbeing and mental health.

Remuneration Committee

Areas of focus this year:

- Reviewing performance against 2021–22 corporate objectives.
- Designing new bonus arrangements for April 2022 onwards, which aim to deliver performance to benefit customers, the environment and stakeholders.

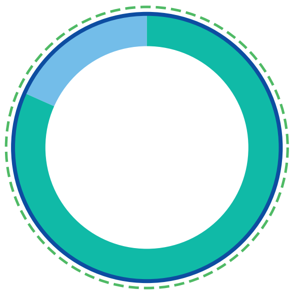
Priorities for 2022–23

- Setting stretching targets that strongly align with delivering customer and environmental outcomes.
- Ensuring the company continues to strengthen its financial position in the interests of all customers and stakeholders.

Our Board's composition

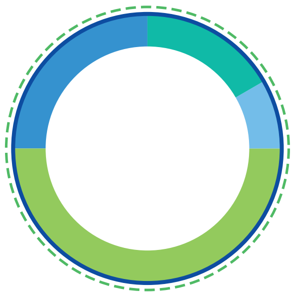
(as at 30 June 2022)

Board gender profile



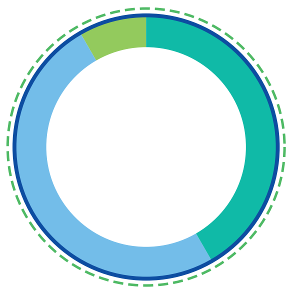
- Male (10)
- Female (2)

Board independence



- Not independent (2)
- Independent on appointment (1)
- Independent (6)
- Shareholder nominated (3)

Board background

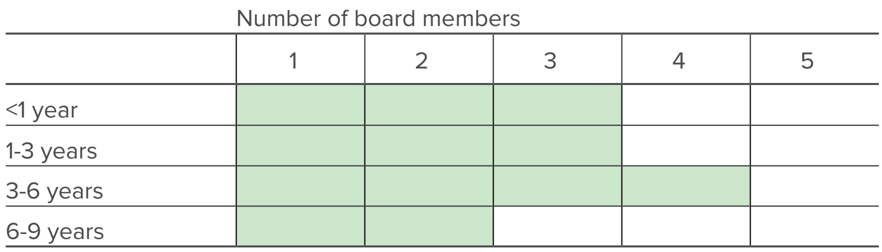


- Finance/Accounting (5)
- Engineering/Operations (6)
- Public sector/Charity (1)

Executive and Non-Executive Directors

- Executive (2)
- Non-executive (10)

Board tenure



Our approach to governance

Ofwat principles

In 2019 Ofwat published its Board leadership, transparency and governance principles and, subsequently, in July 2019, amended the licences of water and wastewater companies to require them to meet the four objectives they set out.

The Ofwat Principles are an update of those previously published in 2014 and include principles and provisions of the Financial Reporting Council's (FRC) UK Corporate Governance Code. Accordingly, Southern Water seeks to apply both the Ofwat Principles and those of the UK Corporate Governance Code in terms of its approach to governance.

1 Competence and independence

Boards and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high-quality decisions that address diverse customer and stakeholder needs.

Objective/provision	Compliant	Page(s)
Boards and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high-quality decisions addressing stakeholder needs.	Yes	135, 144-148
i. Boards and board committees have the appropriate balance of skills, experience, independence and knowledge of the company. Boards identify what customer and stakeholder expertise is needed in the boardroom and how this need is addressed.	Yes	135, 145, 148, 149, 167
ii. Independent non-executive directors are the largest single group on the board.	Yes	135, 145, 146-147
iii. The chair is independent of managers and investors on appointment and demonstrates objective judgment throughout their tenure. There is an explicit division of responsibilities between running the board and executive responsibility for running the business.	Yes	145, 146
iv. There is an annual evaluation of the performance of the board. This considers the balance of skills, experience, independence and knowledge, its diversity, how stakeholder needs are addressed and how the overarching objectives are met. The approach is reported in the annual report and any weaknesses are acted on and explained.	Yes	162-164
v. There is a formal, rigorous and transparent procedure for new appointments which is led by the Nomination Committee and supports the overarching objective.	Yes	166
vi. To ensure there is a clear understanding of the responsibilities attached to being a non-executive director in this sector, companies arrange for the proposed, final candidate for new non-executive appointments to the regulated company board to meet Ofwat ahead of a formal appointment being made.	Yes	166
vii. There is a majority of independent members on the Audit, Nomination and Remuneration Committees and the Audit and Remuneration Committees are independently led.	Yes[1]	166, 169, 179

2 Purpose, values and culture

The regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

Objective/provision	Compliant	Page(s)
The regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.	Yes	150-160
i. The board develops and promotes the company's purpose in consultation with a wide range of stakeholders and reflecting its role as a provider of an essential public service.	Yes	158-159
ii. The board makes sure that the company's strategy, values and culture are consistent with its purpose.	Yes	150-160
iii. The board monitors and assesses values and culture to satisfy itself that behaviour throughout the business is aligned with the company's purpose. Where it finds misalignment it takes corrective action.	Yes	152, 154, 156-157, 159, 160
iv. Companies' annual reporting explains the board's activities and any corrective action taken. It also includes an annual statement from the board focusing on how the company has set its aspirations and performed for all those it serves.	Yes	126-127, 142, 150, 152, 154, 160

3 Effectiveness

The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.

Objective/provision	Compliant	Page(s)
The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.	Yes	128-133, 135, 140-141, 142-148, 162-164, 165-167
i. The regulated company sets out any matters that are reserved for shareholders or parent companies (where applicable), and explains how these are consistent with the board of the regulated company having full responsibility for all aspects of the regulated company's business, including the freedom to set, and accountability for, all aspects of the company's strategy.	Yes	104, 140-141
ii. Board committees, including but not limited to Audit, Remuneration and Nomination Committees, report into the board of the regulated company, with final decisions made at the level of the regulated company.	Yes	141, 143
iii. The board of the regulated company is fully focused on the activities of the regulated company; takes action to identify and manage conflicts of interest, including those resulting from significant shareholdings; and ensures that the influence of third parties does not compromise or override independent judgment.	Yes	140-142, 148, 167

4 Transparency and accountability

The board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.

Objective/provision	Compliant	Page(s)
The board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.	Yes	140, 168-173
Regulated companies publish the following information in a form and level of detail that is accessible and clear for customers and stakeholders:		
i. An explanation of group structure;	Yes	104-106
ii. An explanation of dividend policies and dividends paid, and how these take account of delivery for customers and other obligations (including to employees);	Yes	98
iii. An explanation of the principal risks to the future success of the business, and how these risks have been considered and addressed;	Yes	108-120
iv. The annual report includes details of board and committee membership, number of times met, attendance at each meeting and where relevant, the outcome of votes cast; and	Yes	128-133, 144, 165, 169, 174, 179
v. An explanation of the company's executive pay policy and how the criteria for awarding short and long-term performance-related elements are substantially linked to stretching delivery for customers and are rigorously applied. Where directors' responsibilities are substantially focused on the regulated company and they receive remuneration for these responsibilities from elsewhere in the group, policies relating to this pay are fully disclosed at the regulated company level.	Yes	176-193

Find more information at **ofwat.gov.uk**

[1] The membership of the Nomination and Remuneration committees is: the Chair, one independent non-executive director and one non-executive director. The Chair, while not independent under the UK Corporate Governance Code is independent of management and the shareholders.

Corporate governance report

How we are becoming a **more resilient organisation** and ensuring long-term success

Read more about our long-term priorities on pages 50 to 51

Our journey of delivering better outcomes for our customers

As a provider of essential water and wastewater services to customers in the South East, the company's and the Board's focus is on improving our performance to deliver for our customers. Owing to the nature of our business and the 25-year licence to supply services, the Board and company must take a long-term view in order to ensure provision of services in the future within a challenging and changing environmental, demographic and regulatory context.

Delivering our 2020–25 business plan

The delivery of our 2020–25 business plan is a key priority for becoming a more resilient supplier of essential services to our customers. As such, the Board was heavily focused on the execution plan for the 2021–22 period and planning for 2022–23. Following the major investment by a fund managed by Macquarie Asset Management, the Board has had to consider the most appropriate use for the additional funding, focusing in particular on accelerating capital programmes and carrying out proactive maintenance activities.

Read more on pages 76 to 91

Planning for the future

Although the Board is focused on delivering the current 2020–25 business plan, the company also needs to be in a position to deliver for the next five-year period (2025–30) through taking initial steps to lay the ground work for the capital and operational programmes of the future. As such, the Board has considered and approved significant extra investment in leakage to target a 15% reduction in leakage by 2025 and a 50% reduction by 2050.

Read more on pages 81 to 82

Embedding risk management at every level of the organisation

The Board has continued to support the roll-out of the new risk taxonomy developed in 2020–21. In addition, the Board reviewed the terms of reference of the Audit and Risk committees and agreed to enhance the focus on health and safety by reconstituting the Risk Committee as a Health and Safety and Operational Risk Committee and transferring the more 'strategic' elements of risk to the Audit Committee.

Read more on pages 108 to 120

Improving our environmental performance

The company's environmental performance, including prevention and management of pollution incidents, needs to improve. Therefore the Board has approved a number of additional investments in our infrastructure – including £18m of upgrades at Budds Farm Treatment Works – in order to reduce our impact on the environment.

Read more on pages 83 to 87

CASE STUDY

Company Conversations hosted by our CEO

Created in the first lockdown, this is a regular conversation between employees and our Executive.

Following the move to many employees working from home and significant potential for reduced engagement, it was decided to introduce regular online Company Conversations hosted by the Chief Executive Officer, Ian McAulay.

Originally intended to address concerns about COVID-19 and its impact on the company and its operations, these conversations have since addressed a variety of subject areas, including health, safety, security and wellbeing, apprenticeships, 'Stars of the Year' awards and the company's ongoing operational and financial performance.

The format of the conversations enabled employees to submit questions to the Chief Executive Officer and other members of the Executive Leadership Team on any topic and is a key method of the Board and senior management obtaining insight into the current views and concerns of the workforce.

These company conversations are consistently popular with hundreds of employees joining each time.

Stakeholders impacted

100s
of employees join each conversation.

Insight
gathered from these calls helps the Executive and Board make informed decisions.

Corporate governance report continued

1

Competence and independence

Boards and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high-quality decisions that address diverse customer and stakeholder needs.

"Effective Boards must comprise of individuals with diverse skillsets and experience, who exhibit independence of thought and judgment."

Keith Lough

Overview of the Board's responsibilities

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 its purpose,
- have full responsibility for all aspects of the company's regulated business in the long term,
- ensure obligations to, and interests of, all company stakeholders 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 CEO and his team to operate, manage and develop the business appropriately, and
- ensure that appropriate and effective processes and controls are in place to assess and appropriately manage risk.

Greensands Holdings Board

The shareholders' agreement of our parent company, Greensands Holdings Limited reserves certain matters by exception to the board and shareholders of that company. This includes the group's dividend policy, which can be found on page 98. While the policy governing dividends is subject to shareholder approval, the decision whether or not to recommend payment of a dividend from Southern Water Services Limited sits with the Southern Water Board. A schedule of those matters reserved to Greensands Holdings Limited is published at **southernwater.co.uk/greensands-ownership-of-southern-water**.

During the year 2021–22 a number of matters required shareholder and/or Greensands Board approval. These included the changes in corporate structure necessary to carry out the removal of the Cayman Islands entity and the approvals required as a result of the major investment by a fund managed by Macquarie Asset Management.

Governance structure as at 30 June 2022

Shareholders

Greensands Holdings Limited Board of Directors

Certain key matters are reserved to the board of Greensands Holdings Limited and/or the Shareholders.

Southern Water Services Limited Board of Directors

The Board of Southern Water is ultimately responsible for the company.

Executive Committee (EXCOM)

Comprising the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Chief Environment and Sustainability Officer, Chief Customer Officer, Chief Information Officer, Managing Director of Water, Managing Director of Wastewater and General Counsel and Company Secretary, it meets to agree areas of strategy and other matters critical to the company.

Executive Leadership Team

The Executive Leadership Team supports the CEO in driving the implementation of strategy in the company. Comprised of the senior leaders of the functions and operational units, the ELT meets regularly to:

- Consider performance and make decisions on operational matters;
- Oversee the company's transformation programme; and
- Consider health, safety, security and wellbeing, risk and compliance.

Corporate governance report continued

1. Competence and independence continued

Read more about our Board on pages 128 to 133

The Board

The Board comprises the non-executive Chairman, two executives – the Chief Executive Officer and Chief Financial Officer – and nine non-executive directors, six of whom are independent.

It routinely determines the following matters:

- Business and financing strategy
- Business plans
- Approval of annual budgets
- Fixing of principal charges and schemes
- Approval of financial statements
- Key regulatory submissions
- Key customer and stakeholder publications
- Entering into significant contracts or commitments
- Approval of dividends
- Commencing new businesses
- Appointment or removal of the auditor, directors and company secretary
- Remuneration of independent non-executive directors.

What was on the Board's agenda during the year

- The execution plan to deliver the company's business plan for 2020–25.
- Development and approval of the company's Level Playing Field Investment Plan (LPIP), a targeted investment of £230m in core water and wastewater assets.
- Two submissions for Water for Life Hampshire.
- Risk appetite and risk monitoring.
- Preparation and planning for the next five-year business plan for 2025–30.
- The investment by a fund managed by Macquarie Asset Management and subsequent plans.
- Strategic projects to improve the company's resilience and performance.
- Reviewing the company's business operating model and other transformation programmes.
- Monitoring environmental impact and reviewing plans to improve its performance, including pollutions performance.
- Continuing to develop measures for and monitoring the company's culture, including new ethics questions in all-employee surveys.
- Reviewing and monitoring the company's progress against the undertakings given to Ofwat following the settlement in 2019–20.
- Agreeing changes to the remits of the Audit and (then) Risk committees.
- Establishing an ESG Committee.

Board committees

In line with both the Board leadership, transparency and governance principles published by Ofwat and the UK Corporate Governance Code, as well as best practice, the Board has established a number of standing committees with specific responsibilities. These committees are:

Audit
Health and Safety and Operational Risk
Nomination
Remuneration
ESG

These committees assist the Board by monitoring and reviewing performance and issues within their respective scopes. Specific responsibilities have been delegated to these committees.

Each committee has written terms of reference, which are published at **southernwater.co.uk/board-committee-terms-of-reference**. These terms of reference are reviewed at least annually.

In February 2022, the Board agreed to amend the terms of reference of the then Audit and Risk committees and reconstituted the Risk Committee as the Health and Safety and Operational Risk Committee.

Other committees are constituted if and when required for specific matters.

The Board also formed a number of working groups with non-executive and management representation to work on the preparations for the 2025–30 business plan, Water For Life Hampshire and other projects.

Southern Water Board and committee responsibilities

The Board

- Has full responsibility for the company's business over the long term.
- Establishes the company's purpose, values and culture and sets its strategy.

Read more on pages 146 to 147

Audit Committee

- Monitors the integrity of the company's financial statements by challenging the basis of preparation and the judgments made.
- Monitors the integrity of non-financial information reported by the company.
- Keeps under review the company's internal controls and risk management systems.
- Monitors the company's overall risk appetite and the effectiveness of risk controls.
- Oversees Internal Audit and the relationship with the external auditor.

Read more on pages 168 to 173

Health and Safety and Operational Risk Committee

- Monitors and advises on health, safety, security and wellbeing and makes appropriate recommendations to the Board.
- Reviews and monitors operational risks and related risk management systems.

Read more on pages 174 to 175

Nomination Committee

- Reviews the size, structure and composition of the Board.
- Evaluates the balance of independence, skills, experience and diversity on the Board.
- Leads the process for identifying and nominating candidates for approval by the Board of directors.

Read more on pages 165 to 167

Remuneration Committee

- Sets remuneration policy for all executive directors and the Chairman.
- Recommends and monitors remuneration for senior leaders.
- Approves the design of and determines targets for any performance-related pay schemes.
- Reviews the design of all long-term incentive plans.
- Oversees major changes to employee benefit structures.

Read more on pages 176 to 193

Formation of our ESG Committee

In February 2022, the Board approved the formation of an Environment, Social and Governance Committee to provide greater oversight and consideration of the material environmental, social and governance matters relevant to the company's activities. These include environmental performance programmes and plans; social performance programmes, including employee engagement, equality, diversity and inclusion and community engagement; and governance matters relating to ethical and transparent business practice.

Note: Although formed prior to the end of the reporting period the new ESG Committee did not meet until May 2022.

Corporate governance report continued

1. Competence and independence continued

Read more about Board skills and experience on pages 148 to 149

Board meetings and attendance

A total of six Board meetings were scheduled to take place during the year.

The attendance at scheduled Board meetings during the year was as follows:

	Attendance					
Member	1	2	3	4	5	6
Keith Lough						
Ian McAulay						
Sebastiaan Boelen						
Paul Sheffield						
Rosemary Boot						
Mike Putnam						
Gillian Guy						
Kevin McCullough						
Malcolm Cooper						
Sara Sulaiman[1]						
Marykay Fuller[1]						
Mark Mathieson[2]						
Will Price[2]						
Martin Bradley[2]						

1 Sara Sulaiman and Marykay Fuller resigned as shareholder-nominated directors on 8 September 2021.

2 Mark Mathieson, Will Price and Martin Bradley were appointed as shareholder-nominated directors on 8 September 2021.

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.

Ordinarily, the Board would hold its meetings at the company's head office in Worthing or in London. However, owing to the COVID-19 pandemic, the Board continued to hold some of its meetings remotely during 2021–22 using tele- and video-conferencing facilities. In a typical year, the Board also endeavours to hold one meeting 'off site' during the year coupled with a strategy day in order to provide an opportunity to discuss the company's future strategy and plans. As with previous years, the Board held a strategy day at which it focused on strategic risks and performance as well as on the LPIP and the environment.

Where a director has a concern over any unresolved matter, they are 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 Chair would bring it to the attention of the Board.

All members of the Board were and are able to allocate the necessary time to the company in order to be able to discharge their responsibilities effectively.

Board composition

There have been a number of changes in the composition of the Board during the year, largely as a result of the major investment by a fund managed by Macquarie Asset Management in 2021. This saw the two previous shareholder-nominated directors, Sara Sulaiman and Marykay Fuller resign and the appointment of three shareholder-nominated directors – Mark Mathieson, Will Price and Martin Bradley – in their place. Martin Bradley has since been replaced by Steve Fraser as of 1 May 2022. Mark, Will and Martin are also directors of the company's ultimate parent company, Greensands Holdings Limited.

In addition, both the Chief Executive Officer and Chief Financial Officer have announced that they will be retiring in 2023 and 2022 respectively.

Keith Lough has served as Chair since 1 August 2019 and Ian McAulay and Sebastiaan Boelen have served as executive directors since 2017 and 2018 respectively.

Until September 2021, Marykay Fuller was on the Board as the shareholder representative non-executive director for Greensands Holdings Limited and Sara Sulaiman was nominated by one of the company's then main shareholders. The current three shareholder representative non-executive directors were all nominated by a fund managed by Macquarie Asset Management as the company's majority shareholder.

As at 31 March 2022, women made up 16% of the Board (two out of 12 directors). The company is committed to having a diverse workforce that reflects the communities it operates in. The company publishes a Gender Pay Gap Report. Our report showed that the median pay gap has moved from being -2.0% in favour of female employees to being -0.2% in favour of female employees. In terms of the bonus gap, we have seen a reduction from 24.5% to 16.1% in favour of male employees.

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**. Please also refer to pages 165 to 167 for more on what the Board is doing to promote diversity.

In accordance with good governance practice, the roles of the Chair and Chief Executive Officer are separate.

Corporate governance report continued

1. Competence and independence continued

Board composition continued

Chair

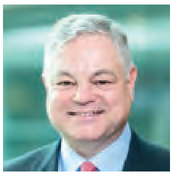
The role of the Chair is to lead the Board in its shared responsibilities, to encourage and facilitate the contributions of its members and to ensure adherence to the governance principles and processes of the Board. Keith Lough has served as the company's Chair since 2019. In line with the Ofwat Board leadership, transparency and governance principles as well as the UK Corporate Governance Code, Keith was viewed as independent on appointment.

The Chair 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 Chair has authority to act and speak for the Board between its meetings, which includes engaging with the Chief Executive Officer. The Chair reports to the Board, chairs of its committees and individual directors as appropriate on decisions and actions taken between Board meetings. The Chair 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 Chair is not a member of the Greensands Holdings Limited (the company's ultimate parent company) board.

Chief Executive Officer

The Chief Executive Officer is a member of the Board and has all the responsibilities of a director of the company. Ian McAulay has served as the company's Chief Executive Officer since 2017. 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 Chair, appraise his performance annually. In February 2022, Ian announced his intention to retire as Chief Executive Officer by 2023. As reported elsewhere, Lawrence Gosden has been appointed as his successor.



Chief Financial Officer

The Chief Financial Officer is a member of the Board with all the responsibilities of a director of the company. Sebastiaan Boelen was appointed as the company's interim Chief Financial Officer and member of the Board in December 2018 and this appointment was made permanent in September 2019. 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. Sebastiaan Boelen will step down later in July 2022 and will be replaced as interim Chief Financial Officer by Nadim Ahmad.

Senior independent non-executive officer

Paul Sheffield is the senior independent non-executive director. Paul chairs the Remuneration Committee and is also a member of the Nomination Committee.

As senior independent non-executive director, ordinarily Paul would chair Board meetings in the event that the Chair 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.

Read more about employee engagement on page 151.

Independent non-executive directors

The largest group on the Board are the independent non-executive directors in accordance with the Ofwat Principles and as a matter of good governance practice. The number of independent non-executive directors on the Board is also in accordance with the company's licence conditions, which require at least three.

They provide independent advice and perspectives and review and challenge decisions and reporting on behalf of all stakeholders, including customers and the workforce. 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 non-executive directors also appraise the Chair's performance.

The standard terms and conditions for the appointments of independent non-executive directors can be viewed at: **southernwater.co.uk/corporate-governance.**

Shareholder representative non-executive directors

Under the terms of the subscription and shareholders' agreement, and following the investment by a fund managed by Macquarie Asset Management, the shareholders' agreement, certain investors have a right to nominate for appointment non-executive directors to the Board of Southern Water. As a statutory director, such an individual has 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 those 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.

Prior to the investment by a fund managed by Macquarie Asset Management in September 2021, Sara Sulaiman and Marykay Fuller acted as shareholder representative non-executive directors, having been nominated by one of the company's then major shareholders and Greensands Holdings Limited respectively. Since September 2021, a fund managed by Macquarie Asset Management has nominated three directors – Mark Mathieson, Will Price and Steve Fraser (from 1 May 2022 when he replaced Martin Bradley) – to act as shareholder representative non-executive directors. Please refer to pages 128 to 133 for details of the background and experience of the shareholder representative non-executive directors.

Neither Will Price nor Mark Mathieson receive any remuneration from Southern Water.

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.

Directors are also able to obtain appropriate independent professional advice in connection with the performance of their duties.

Read more on pages 128 to 133

Board independence

In accordance with the Board leadership, transparency and governance principles published by Ofwat, the majority of non-executive directors have been independent and independent non-executive directors were the largest single group on the Board throughout the year.

Following listed company best practice, the Board takes into account those matters listed in Provision 10 of the 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 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, communities, workforce, suppliers and the environment and how these can be respected and protected.

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. During 2021–22, no director declared a material interest at any time during the year in any contract of significance with the company.

Balance of skills and experience of the Board

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 number of directors with significant and/or material skills, knowledge and experience related to the key areas necessary to deliver the company's strategy is summarised below. Details of the individual Board members' experience are on pages 128 to 133.

Moving towards creating a **resilient water future** for our customers

In order to be able to deliver for our customers and the communities we serve, the Board requires a diverse range of skills and experience. The table below shows the current Board members in terms of their primary skills and experience and how these contribute to ensuring a more resilient water future.

Ensuring Southern Water contributes to a more resilient water future	Board skills/ experience required	Board members
Succeeding together	Customer, capital programmes, operations, financing, transformation	Keith Lough, Ian McAulay, Sebastiaan Boelen, Paul Sheffield, Rosemary Boot, Mike Putnam, Gillian Guy, Kevin McCullough, Malcolm Cooper, Will Price, Steve Fraser.
Doing the right thing	Customer, environment, governance, regulation	Keith Lough, Ian McAulay, Rosemary Boot, Mike Putnam, Gillian Guy, Malcolm Cooper.
Always improving	Customer, capital programmes, operations, transformation, utilities sector	Keith Lough, Ian McAulay, Sebastiaan Boelen, Paul Sheffield, Rosemary Boot, Mike Putnam, Gillian Guy, Kevin McCullough, Mark Mathieson, Steve Fraser.

Corporate governance report

2

Purpose, values and culture

The regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

"A company can only deliver its strategy effectively if this serves the company's purpose and are delivered in accordance with the company's values."

Keith Lough

Our purpose:

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

Our vision:

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

Establishing Southern Water's purpose

The company's purpose is why it exists. Its purpose should influence all of the company's actions and the company's strategy must fulfil the company's purpose.

The Board is responsible for establishing Southern Water's purpose and for ensuring that its decisions in respect of its strategy enable it to deliver this purpose. The Board and the company must inform itself and take into account the interests of a wide array of stakeholders to ensure that its activities support the company's purpose to deliver water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy. These activities might include support for the vulnerable, infrastructure investment, measures to protect the environment and engagement with the public to reduce water consumption.

Southern Water's stakeholders include customers, employees, local communities, suppliers, government and investors.

Alignment of Southern Water's purpose with values and culture

Values dictate how a company acts when delivering its purpose. The company's culture should align with the company's values in order to ensure that the company's actions are always carried out in the way that they should be for the reason of delivering the company's purpose.

One of the key expressions of the company's values is its Code of Ethics, which sets out the expectations for the company's workforce and its partners. Southern Water's Code of Ethics makes clear the basic expectations of how Southern Water conducts its business.

The Board plays a key role in setting the tone for the business, and has consistently supported the commitment to embedding ethical business practice throughout the organisation. All Board members have signed up to the Code of Ethics, and it has been personally endorsed by the Chair and Chief Executive Officer.

To be able to take corrective action where the values and behaviours shown do not align with the company's values and purpose, it is essential that the Board monitors the company's culture. This is a priority of the Board to ensure that the unacceptable behaviours of the past never happen again. To this end the company has developed metrics for monitoring the company's culture in our culture dashboard, which can be seen on pages 156 and 157.

CASE STUDY

Succeeding together to improve engagement

Improving satisfaction among our employees is driving a steady improvement in our Gallup engagement scores

Southern Water has used the Gallup employee engagement survey, both as targeted 'pulse' surveys and as 'all-employee' surveys, for four years. The results of the 'all-employee' surveys in particular are one of the key indicators used by the Board to determine employee views and engagement with the purpose and ambition of the company.

The annual engagement survey received responses from 82% of employees.

2021–22 has seen an increase in engagement from 3.89 to 3.93 (out of 5), which beat the target of 3.91 set for the year. In addition, the results of the annual engagement survey showed an increase in the proportion of employees stating that they are 'actively engaged' as opposed to 'disengaged'. Furthermore, 66% of respondents rated their overall satisfaction as being 4 or 5 (out of 5).

The introduction of ethics-related questions in the survey has also enabled the Board to learn more about the culture within the organisation. Monitoring the organisation's culture and taking steps to address any concerns, in conjunction with the senior executives, is one of the Board's key roles.

The Board and senior management use the results and comments from the surveys to inform conversations with employees and develop engagement action plans for each team.

Stakeholders impacted

3.93
was the overall engagement score (out of 5).

66%
of staff rated their overall satisfaction at 4 or 5 (out of 5).

Corporate governance report continued

2. Purpose, value and culture continued

A key area of focus for the Board is to monitor culture

Monitoring and assessing our culture

Changing the culture of the organisation for the better is a key priority for the Board as well as a requirement of the Section 19 Undertakings given to Ofwat in order to make a repeat of the negative behaviours of the past unthinkable.

In order to be able to measure the culture of the organisation, the company has developed a number of appropriate and informative measures to inform the Board's view of the organisation's culture, but also to see what progress has been made in terms of changing culture for the better.

These measures include key metrics in terms of collaboration within the company, performance, customer focus and ethical working, and have been informed by best practice examples in other organisations. The Board regularly receives reports on these measures.

In addition, the appointment of a non-executive director with the remit of communicating the views of the workforce offers the Board an opportunity for a further view of the culture within the workforce.

Culture Change Group

Since 2019, the Culture Change Group has met monthly. It includes representation from Risk and Compliance, Human Resources, Health, Safety, Security and Wellbeing, Communications and Legal. The group's aim has been to share ideas and best practice in the area of cultural change, including reviewing the results of all-employee surveys.

Following recommendations made in 2020–21, the company continues to implement measures to coordinate activities, including in areas such as line manager training and Speak Up. In addition, the company has introduced specific ethics-related questions into the all-employee survey.

3.93
Gallup survey score out of 5

These results provide valuable insight for the Board.

Our culture journey

2017: December
Customer research and 'brand' review.

2018: January
Stakeholder mapping – what do customers think about us?

Spring to summer
Brand propositions test, 70+ colleagues/partners review.

July
Board holds a session focusing on ethics.

September
Customers review Water for Life. Behavioural expectations launch.

October
Board review. Quick Check decision-making tool released.

November
Values tested at colleague roadshow.

December
Purpose approved by Board.

2019: January
Engagement survey expanded to include culture measures.

February
Water for Life launch. Values approved by Board.

June
Code of Ethics approved by the Board and launched.

October
Values week. Dilemma scenarios released.

November
Board session on ethical business practice facilitated by the Institute of Business Ethics.

2020: January
Ethics and Speak Up training for senior and line management with Institute of Business Ethics.

2020: June – 2021: March
Publication of quarterly dashboards.

2020: July
ELT paper Culture Change Initiatives.

August/September
Code of Ethics Policy Board Sign up.

September
Board paper for Culture review including Measures of Culture Dashboard and refreshed Code of Ethics.

October
Publication of revised Code of Ethics.

2021: March/April
Board Culture review including Measures of Culture Dashboard and recommendations for revisions for 2021–22 dashboard metrics and targets.

April
Production of guidance for senior managers.

May
Draft ethics ELT embedment indications.

88% Self-reported pollutions

The majority of pollution incidents are reported by the company itself.

3.89 Gallup survey score out of 5

These results provide valuable insight for the Board.

2022: March/April
Board Culture review including Measures of Culture Dashboard and recommendations for revisions for 2022–23 dashboard metrics and targets.

3.93 Gallup pulse survey score out of 5

Introduction of Handling Concerns training for line managers

Corporate governance report continued

2. Purpose, value and culture continued

To prevent the poor behaviours of the past reoccurring, the Board is committed to ensuring that the company's culture is founded on ethics, integrity and the company's values

Read our Culture Change dashboard on pages 156 to 157

How the Board monitored culture in the past year

Reviewing the culture change dashboard	Link to culture
Throughout the year, the Board received updates on a number of measures to provide an indication of, and inform discussions with respect to, the company's culture.	The Board's plans and potential actions to intervene are informed by monitoring the culture within the organisation as well as informing the Board the extent to which the organisation's culture is changing and how.

Regular reports on Speak Up	Link to culture
The Audit Committee receives regular reports on the company's Speak Up policy, including information in respect of the number and seriousness of the reports.	Monitoring the concerns raised via Speak Up gives the Board insight into the potential ethical culture of the organisation and enables the Board to take appropriate steps.

Reviewing the results of employee engagement surveys	Link to culture
Both the all-employee GALLUP and targeted 'pulse' surveys provide valuable insight into the attitudes within the company.	The results of the all-employee and targeted surveys give the Board information about the level of engagement across the organisation. There is a positive link between engagement, values and ethics.

Examples of ways that the Board monitors and assesses culture

Board member / group	Examples
Audit Committee	The committee receives regular reports on the company's Speak Up policy, including information in respect of the number and seriousness of the reports.
Health and Safety and Operational Risk Committee	The committee receives regular reports on health and safety matters, including the number of incidents/accidents and the culture of health and safety in the company, in particular trends with regard to 'near-miss' and hazard reporting.
Workforce engagement non-executive director	The director meets regularly with employee forums and the company's HR team to enable him to understand the views within the organisation.

Corporate governance report continued

2. Purpose, value and culture continued

The Board uses a set of measurements to effectively monitor culture

Our Culture Change dashboard

Our past experiences show us it is essential to do the right thing and the importance of driving performance by behaving correctly and compliantly.

Our dashboard provides a point of focus for thought, discussion and action around the company's culture.

Our values

Fundamental beliefs that underpin everything we do.

Our three values sit at the core of our ethical decision-making framework.

Succeeding together

Doing the right thing

Always improving

Collaboration

Each other

Metrics

1 Employee Engagement
Overall company Gallup survey score out of 5.
3.93 (2020–21: 3.89)

1 Employee sickness
% of all employees
1.65% (2020–21: 1.87%)

2 Gender hourly pay
Median difference male/female salaries
-0.2% (2020–21: 2%)

2 Gender bonus pay
Median difference male/female bonuses
16.1% (2020–21: 24.5%)

4 Gender distribution
Split of male/female employees
75/25% (2020–21: 76/24%)

1 Near misses
Reports by employees and supply chain partners per 100 FTE
2.3 (2020–21: 1.2)

3 Rule of two
% of reporting of incidents compliant with timescales
78% (2020–21: 67%)

1 STAR Award nominations
Number of employee STAR nominations
1,649 (2020–21: 1,979)

* All metrics for the 12-month period ending 31 March 2022, with the exception of those under Driving Results, which are in respect of the 12-month period ending 31 December 2021.

Note: The trend indicators for non-targeted metric performance show changes to the number reported from previous period and is not a measure of performance.

Key:

1 Improving   2 Static   3 Worsening   4 No target

Driving results
Our environment and public health

Metrics

2 **Pollution incidents**
Number of Category 1-3 pollutions
372 (2020–21: 400)

1 **Self-reported pollutions**
% of total incidents self-reported
90% (2020–21: 88%)

1 **WWTW Effluent Compliance**
% permit compliance at numeric wastewater treatment works
97.9% (2020–21: 97.1%)

1 **Water quality compliance**
Calculated score using DWI Compliance Risk Index (CRI)
6.69 (2020–21: 4.62)

Customer focus
Our customer

Metrics

1 **Escalated complaints**
Number of written escalated complaints per 10k customers
0.91 (2020–21: 2.31)

3 **GSS payments**
Number of payments made
907 (2020–21: 26,613)

2 **C-MeX Satisfaction**
Overall quarterly C-MeX score out of 100
72 (2020–21: 74.77)

1 **R-MeX satisfaction**
Overall half-year R-MeX rank
7th (n/a – new measure)

3 **Appointments**
Percentage appointments attended
97.3% (n/a – new measure)

Ethical working
Our business

Metrics

1 **Values/Ethics Q15 survey scores**
Scores out of 5 in Gallup/ Pulse surveys – Q15 Confidence in company
4.07 (2020–21: 4.05)

1 **Values/Ethics Q16 survey scores**
Scores out of 5 in Gallup/ Pulse surveys – Q16 Integrity of colleagues
4.10 (–)

2 **Values/Ethics Q17 survey scores**
Scores out of 5 in Gallup/ Pulse surveys – Q17 Understand values
4.22 (2020–21: 4.26)

1 **Code of Ethics sign ups**
% of employees who have completed mandatory training to sign up to the Code of Ethics
94% (2020–21: 97%)

4 **Speak Up – cases opened**
Number of cases opened
29 (2020–21: 37)

4 **Speak Up – cases closed**
Number of cases closed
46 (2020–21: 56)

3 **Speak Up – anonymous cases**
% of cases reported anonymously
62% (2020–21: 86%)

1 **Speak Up – days to close**
Average days to close cases
136 (2020–21: 308)

Corporate governance report continued

2. Purpose, value and culture continued

Boards must be clear on the impacts of decisions on customers and stakeholders and must be adequately informed about their views

Read more on pages 46 to 47

Customer engagement

The board are regularly informed about customer views using the latest customer research gathered by our customer insight team. Each time a relevant business case or particular topic is discussed by the board, the team provide summaries drawing on customer discussion sessions, customer videos and independently produced research reports, as well as reports from other organisations such as the Consumer Council for Water (CCW).

Our new Customer and Community Challenge Group met for the first time on 27 April 2022. An independent non-executive director attends the group and the meetings provide an opportunity to share and discuss insight in full for each relevant topic.

As well as regularly reviewing the different outputs from the customer insight team, senior executives take part in customer sessions. These sessions are moderated by our accredited research partners to discuss topics directly with customers and hear first-hand their challenges and feedback. Our senior executives also attend debrief presentations on key customer insight and receive bespoke summaries. For example we ran a dedicated customer insight session ahead of working on our long term strategy.

Stakeholder engagement

Throughout the year, the Board has been kept informed of the views of the company's stakeholders, including its customers, regulators, suppliers, investors and government. The company's Chair, Chief Executive Officer and our Chief Environment and Sustainability Officer regularly attend meetings with government bodies such as Ofwat, the Department for Environment, Food and Rural Affairs, the Environment Agency and Drinking Water Inspectorate.

The Chief Executive Officer also regularly attends meetings and other events with Water UK in respect of matters relevant to the water sector as a whole.

Further information about stakeholder engagement can be found on pages 46 to 47 and as part of the company's section 172(1) Statement on pages 71 to 73.

Employee engagement

In accordance with the UK Corporate Governance Code and in support of the Board's duty under section 172(1) to consider the interests of the company's workforce as well as part of the Board's role in its monitoring and assessing of culture, Kevin McCullough has been appointed as an independent non-executive director with the remit of communicating the views of the company's workforce (as defined in the UK Corporate Governance Code) to the Board. The scope of this role includes:

- Obtaining and communicating to the Board the views of the company's workforce in respect of matters, including pay and conditions; health, safety and wellbeing; working environment and culture. This enables the Board to give appropriate consideration of the interests of the workforce. Communication methods include: regular meetings with the company's workforce representatives, the HR Director, Director of Communications and Head of Health, Safety, Security and Wellbeing; attendance at workforce events; and visits to operational sites and offices.
- Providing regular reports to the Board.
- At least annually, meeting with the Chair of the Remuneration Committee to enable the committee to take into account the conditions of the workforce when setting executive remuneration policy (in accordance with the UK Corporate Governance Code).

Following on from their success during 2020–21, during the year the Chief Executive Officer also carried out Company Conversations meetings via tele- and video-conferencing facilities with all employees invited to attend and ask any questions.

Board listening approach

Board listening channels	What this channel brings
Non-Executive Director for Workforce Engagement	This provides an opportunity for the Board to obtain information about the views of the workforce directly as opposed to via management.
'Company Conversations'	These provide an opportunity for all employees to directly ask questions of and communicate their concerns to the CEO.
All-employee surveys	The all-employee surveys give the Board an insight into the engagement and satisfaction levels of employees as well as insight into the culture and ethics of the organisation.

A letter from our designated NED for workforce engagement

Kevin McCullough
Independent non-executive director

Since the changes introduced by the UK Corporate Governance Code in 2018, one of the suggested methods for the Board to obtain a clearer understanding of the concerns of the workforce is to assign a non-executive director with the remit of engaging with the workforce and reporting to the Board. In line with listed company practice, the Board appointed me to this role in 2020 to provide an important, potentially, alternative route for employees to raise concerns as well as provide a perspective on employee concerns and engagement independent of management.

As such, during the year, I have attended meetings with the company's human resources management and the workforce representative groups. I was pleased to see that the company revitalised workforce engagement through the launch of the Employee Voice groups from each team/function.

In addition, a key focus for the Board and the company has been on employee wellbeing and mental health. The COVID-19 pandemic brought this to the fore, particularly with the significant change in working patterns and potential for isolation. Therefore, workforce mental health should be on the agendas of all Boards.

My roles on the (now) Health and Safety and Operational Risk Committee and the ESG Committee also allow me to convey my knowledge of employee concerns and attitudes alongside my experience and knowledge of health and safety practice.

Kevin McCullough

Read more about **employee engagement** on page 151.

Corporate governance report continued

2. Purpose, value and culture continued

Board activities

During the year, the Board reviewed and considered a number of key matters as part of implementing the company's strategy.

Read more on page 4

Area	What was reviewed and considered?	Link to our strategy
Business strategy The company's plan to deliver over the 2020–25 period and beyond.	The Board approved additional investment in measures to reduce leakage in order to achieve its target of halving leakage by 2050 and approved accelerated investment in other areas to deliver a greater level of resilience.	Enhance, Protect, Sustain
The environment The company's impact on the environment.	The Board approved the company's environmental ambition, including a commitment to 'net zero' carbon by 2030. In addition, the Board approved the company's first Sustainable Bond Impact Report, which updated the investors in the sustainable bonds raised in May 2020 and in March 2021 on our investments to deliver sustainable outcomes across areas such as pollution prevention and leakage.	Protect
Our customers The company's delivery for our customers	The Board developed and agreed the company's execution plan for 2021 and has been focused on the development of our business plan for 2025–30 to enable us to continue to be able to deliver essential services for our customers.	Enhance, Sustain
Our finances The company's ability to continue to operate as a going concern and deliver its strategy.	In 2021, a fund managed by Macquarie Asset Management became the majority shareholder, investing £1bn of equity.	Enhance, Protect, Sustain
Our people The health and safety and wellbeing of our workforce.	An extensive assessment of health and safety was carried out by a third party firm. The Board reviewed the output from this assessment and supported the steps suggested to further enhance the development of a 'safety culture' within the business.	Enhance

Key:
- Enhance
- Protect
- Sustain

CASE STUDY

Further investments to tackle leakage

Our region faces pressure on its water supplies due to increases in population and impacts of climate change.

Following the major investment by funds managed by Macquarie Asset Management in 2021, the Board approved significantly increased investment in this area in order to reduce pressure on the network. This included the accelerated roll out of an advanced pressure management system and an expanded detection team.

As part of our Level Playing Field Investment Plan, the Board has approved ambitious targets in several areas and significant additional investment to reduce pollution incidents and minimise leakage is planned.

The company has an ambition to halve its leakage by 2050 and as such intends to continue to invest in water network resilience and use of advanced pressure management and better targeting of leakage areas should play a significant part in this.

Stakeholders impacted

15%
reduction in leakage by 2025.

Corporate governance report continued

3

Effectiveness

The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.

"A Board should consider whether it effectively discharges its responsibilities and where there are areas for improvement, address these."

Keith Lough

An evaluation should consider the balance of skills, experience, independence and knowledge, and diversity.

Board evaluation

In line with the UK Corporate Governance Code and the Ofwat Principles, there is an annual evaluation of the Board in terms of its performance and effectiveness. Due to the major changes on the Board following the investment by a fund managed by Macquarie Asset Management, it was agreed to have the Board evaluation facilitated by Korn Ferry notwithstanding that there was an external evaluation during 2020–21.

Typically, in accordance with listed company best practice, Southern Water conducts an externally-facilitated Board evaluation once every three years.

2020–21	External evaluation
2021–22	External evaluation
2022–23	Internal evaluation

Progress against last year's evaluation

The Board evaluation during 2020–21 was facilitated externally by Stanton Marris. The review indicated a few areas for improvement, including a greater focus on strategic rather than operational matters.

Good progress has been made in all areas identified and this can be seen by the outcomes of the externally-facilitated Board evaluation conducted in 2021–22.

Evaluation of the Board

As noted on the previous page, notwithstanding that an externally facilitated Board evaluation had been carried out the previous year, due to the change in majority shareholder and in the Board composition, it was agreed that a further externally facilitated review should be carried out in late 2021 with the results presented in January 2022. The review was undertaken by Korn Ferry, who have previously been engaged by the company to support searches for executive candidates, but otherwise have no connection with the company.

The evaluation was based on a number of key areas to be assessed, which were defined in conjunction with senior management, and were addressed during interviews with each of the directors. These areas included: alignment with strategy and direction of the group; alignment on Board responsibilities; Board composition; directors' contributions; quality of discussions; delivery; quality of secretariat support; and effectiveness of Board committees.

Following the completion of the evaluation, the outcomes and suggested actions were presented to the Board in January 2022. These outcomes and suggestions are summarised on page 164.

The Board also conducted an evaluation of the Chair, led by the senior independent director. The results of this review were positive and mirrored the findings of the externally facilitated review.

Step 1 – Preparation

Preliminary conversations with the company Chair, Company Secretary and shareholders to determine the scope of the review.

▼

Step 2 – Definition

Defining the areas to be assessed.

▼

Step 3 – Interview preparation

Preparing interview guidelines that were submitted to each key executive who took part in the evaluation.

▼

Step 4 – Interviews

Discussing the areas to be assessed during interviews with each director.

▼

Step 5 – Outcomes

Recommending actions for continuous improvement to the Board. These are summarised on page 164.

Read more on page 164

Corporate governance report continued

3. Effectiveness continued

Evaluation outcomes

The evaluation showed that the Board was making good progress, particularly when set against the challenging regulatory and operational environment and the significant changes seen during a short period. The investment by a fund managed by Macquarie Asset Management was seen as a positive event, giving a sense of renewed momentum and optimism. A number of specific comments and actions are shown below.

2021–22 areas of assessment	Commentary and actions
Alignment with the strategy and direction of the group	The Board is engaged and deeply committed to the success of Southern Water. The change in ownership has provided an opportunity for some pause and self-reflection. The Board needs to reflect on the current and future effectiveness of the company's organisational model and structure with a view to ensuring clear accountability.
Alignment on Board responsibilities and mandate	The response from the directors was very consistent on understanding their role with agreement on the focus being on getting the basics right as the current business plan period concludes and preparing for the next. It was suggested that the Board discuss its mandate with the new majority shareholder, refresh its Board Charter and agree short-term priorities.
Board composition and potential competency gaps	There is currently a good mix of experiences and the Board should be cautious about reducing the number of non-executive directors due to the significant workload in the immediate near term in preparation for the 2025–30 business plan period. The Board should also take steps to address the current gender imbalance.
Directors' contribution	All non-executive directors contribute and have a good understanding of Southern Water and the complex operational environment in which it operates. A number of suggestions were made to foster greater communication between the wider executive leadership and the individual Board members as well as informal mentoring arrangements.
Team dynamics and quality of Boardroom discussions	The broad team dynamic is open and transparent. The Chair in particular was singled out for praise. The relationship between the Chair and Chief Executive has also led to a positive relationship between the Board and management. Directors are free to air their views and the level of robustness of debates is appropriate.
Delivery of mandate	The Board discharges its duties effectively. A number of recommendations were made in the context of the Board taking greater ownership of succession within the wider leadership of the business, particularly with a view to the longer-term.
Quality of secretariat	The support provided by the Company Secretary and team was universally praised; some recommendations were made to improve the packs prepared for Board and committee meetings.
Effectiveness of the Board committees	Interaction between committees and the Board was characterised as good. There was scope to take a fresh look at the committees. In particular, it was recommended that the Risk Committee be modified to give greater focus to health and safety. In addition, the Board was recommended to consider where to place ESG and wider environmental issues in the committee structure. As can be seen, the Board formed the Health and Safety and Operational Risk Committee and ESG Committee in February 2022.

Board development and training

The Board also has access to professional development provided by external bodies and by the company's professional advisers.

In the Chair's annual appraisal of the non-executive directors, he considered any specific training and development needs for the non-executive directors. The Board members individually also carry out their own training and development, such as by attending relevant seminars and workshops to ensure that their knowledge is kept up to date.

Nomination Committee Report

Message from the Chair

This has been a busy year for the Nomination Committee. There have been a number of Board changes with the acquisition of a majority stake in the company by a fund managed by Macquarie Asset Management, which saw the departure of the previous shareholder-nominated directors and the nomination of new directors.

As a result of the change in shareholdings three new shareholder-nominated directors were appointed, replacing two of the female directors previously on the Board. This has negatively impacted the gender balance on the Board, causing it to fall below our target. There are a number of initiatives being considered by the Board and diversity will be a priority for the committee in the coming year.

Furthermore, owing to the change in group structure during the year, it was agreed to conduct the evaluation of the Board with the assistance of an independent third party, Korn Ferry. The feedback from this review was generally positive with some useful recommendations to assist the Board in its journey of improvement.

During the year we announced that both our Chief Executive Officer and Chief Financial Officer intended to retire in 2022–23. Following an exhaustive search and selection process led by the Nominations Committee, we were pleased to be able to announce that Lawrence Gosden would join the Board as Chief Executive Officer from 1 July 2022. Nadim Ahmad will join the Board as interim Chief Financial Officer from a date later in July 2022, pending the completion of the search for a new permanent Chief Financial Officer.

Keith Lough

15 July 2022

Committee membership (during 2021–22)

Keith Lough
Chair

Attendance 3/3

Paul Sheffield
Committee member

Attendance 3/3

Sara Sulaiman
Committee member

Attendance -/-*

Martin Bradley
Committee member

Attendance 3/3**

* Sara Sulaiman resigned as a director on 8 September 2021.

** Martin Bradley was appointed as a director on 8 September 2021 and joined the committee. After year-end, he resigned and was replaced by Will Price.

Areas of focus this year:

- Board and executive composition and succession planning.
- The externally facilitated Board evaluation.

Priorities for 2022–23:

- Succession planning
- Board and executive diversity
- Implementing the recommendations of the externally facilitated Board review.

Corporate governance report continued

3. Effectiveness continued

Our role is to ensure an effective Board

Read more on pages 148 to 149

Introduction

The Nomination Committee is responsible for reviewing the structure, size and composition of the Board and, based on the results of this review, for assessing the balance in terms of independence, skills, experience, expertise and diversity on the Board and making appropriate recommendations based on this assessment. The committee leads the process for identifying and nominating candidates to fill independent non-executive director vacancies.

Board appointment process

The Nomination Committee would lead the appointment process for a new independent non-executive director based on criteria for skills, experience and knowledge determined as a result of the committee's review of the Board's composition. The committee, typically supported by an external search firm with no connection to the business, would produce a role specification and then lead the search for appropriate candidates. The preferred candidate would be selected through a series of meetings between Board members and the candidate(s).

When the committee was satisfied with its preferred choice, it would then recommend the appointment to the Board for approval. In the case of the Chair, Chief Executive Officer or Chief Financial Officer, the proposed appointment would also be referred to Southern Water's parent company, Greensands Holdings Limited, for approval as a reserved matter. The candidate is also required to meet with Ofwat under the provisions of the Board leadership, transparency and governance principles. Once the candidate had met with Ofwat and, subject to receipt of the approvals by the Southern Water and Greensands boards, the individual would be appointed as a director on the terms published at **southernwater.co.uk/our-story/our-governance/appointment-of-non-executive-directors**.

The Board, as a whole, supported by the Nomination Committee, appoints those individuals nominated by investors under the terms of the Subscription and Shareholders' Agreement. These candidates are, as with the independent non-executive directors, required to meet with Ofwat prior to appointment.

The current Chair would not chair the committee if it was considering the succession of the Chair.

The committee led the process to seek replacement executive directors following the announced departure of both Chief Executive Officer and Chief Financial Officer. In addition to its three formal meetings during the year, the committee also met informally on a number of occasions as part of this process. Based on the recommendation of the committee and following interviews with the Board members, we were pleased to be able to announce that Lawrence Gosden, the current Chief Operating Officer, would be appointed as Chief Executive Officer from 1 July 2022. Further Nadim Ahmad would be appointed as Chief Financial Officer, with effect from a date later in July 2022.

Director induction

On appointment to the Board, induction coverage is agreed with each appointee and then an appropriate comprehensive and individualised induction is provided. This will include access to, and time with, the Executive Leadership Team and other key staff, 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, the appointee will meet with the company's external advisers as appropriate. The appointee will also be afforded the opportunity to visit the company's sites.

Board diversity

Diversity of views and opinions in a decision-making body ensure that proposals face sufficient scrutiny and challenge and that decisions are made based on a broad range of perspectives.

Diversity and different perspectives facilitate innovation, which is of great importance for any business. Therefore, the composition of the Board is made up of individuals from a diverse range of backgrounds, industries and professions to encourage a range of perspectives. Furthermore, a Board must also reflect the communities and other stakeholders served by that business and there should be representation of different genders and of different ages, ethnic and social groups.

The Board continues to be supportive of gender representation of those historically under-represented in senior leadership positions. In considering the Board's diversity, the committee takes note of the practice followed in the listed sector in particular. As at 31 March 2022, two out of 12 (16%) of directors were female. Prior to September 2021, four out of 11 (36%) of directors were female. The Board and committee are considering a number of initiatives to address this significant reduction in diversity following the change in shareholder-nominated directors and this area will be a priority for the committee during 2022–23.

Approach to succession planning

A considered and thorough assessment of the skills and expertise on the Board and what will be required in the future is of great importance for the long-term resilience of an organisation. The Board, assisted by the Nomination Committee, has reviewed its current array of skills and expertise as well as what is required in order to ensure that the Board continues to be effective.

Conflicts of interest and time commitments

As a matter of law as well as being able to function effectively, directors must be free of conflicts between the interests of the company and their own interests, or, where such conflicts are unavoidable, appropriate mitigations must be in place. Directors are required to declare any external interests that they or persons closely connected to them might have which could, reasonably, conflict with the interests of Southern Water. Under its Articles of Association, the Board of Southern Water is not permitted to authorise conflicts of interest.

The Board is aware of the potential for conflicts of interest in respect of the directors nominated by the investors and closely monitors this. As statutory directors, these individuals must manage any conflicts arising from their position in accordance with the provisions of the Companies Act 2006.

It is accepted that most directors will also have appointments on other boards (or similar bodies) or, in the case of non-executives, potentially also have full-time executive positions in other companies.

This is viewed positively, as it allows for a breadth of experience and enables Southern Water to take advantage of perspectives and expertise from other industries and sectors. However, the director must be able to devote sufficient time to their role at Southern Water and be able to discharge their duties effectively. Therefore, the number of external appointments of each director is kept under review. Under their terms of appointment, independent non-executive directors are expected to devote at least 24 days per year to their role at Southern Water.

The Board is satisfied that all directors were able to devote sufficient time and attention to their role at Southern Water throughout the year.

Corporate governance report continued

4

Transparency and accountability

The board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.

"One of the most important roles of the Board is to ensure that the financial and non-financial information published by the company is both transparent and accurate. The generation of such information must be supported by good governance and rigorous assurance processes."

Malcolm Cooper

The Board is there to make sure that the company reports transparently about its performance to markets and key stakeholders such as its regulators and customers.

The publication of financial statements and other documents is a core element of ensuring transparency and accountability on the part of the company. These disclosures must be correct and accurate, otherwise they cannot be relied upon by their respective audiences. The Audit Committee plays a key role in this process.

The committee is supported in its work by both internal and external auditors who can give independent assurance of the information presented by management.

Companies must also be transparent about the market and environment in which they operate, including the risks faced and what risks the company is willing to accept as well as its strategies for mitigation of these. Accordingly, companies need to clearly understand the risk landscape in which they operate and the Board needs to agree what level and type of risk is acceptable.

Audit Committee Report

Message from the Chair

The Audit Committee continues to play a key role in ensuring that information – both financial and non-financial – published by the company is accurate, transparent and in accordance with relevant accounting and other standards, and that such information is supported by an appropriate assurance framework, including external assurance in certain cases.

As is to be expected, the main area of focus for the committee has been on the company's annual and interim financial statements, including the accounting treatment for the ongoing regulatory investigations/ prosecutions.

The committee has continued to support the company's cultural change programme through its monitoring of the Speak Up service and the progress on the various undertakings and commitments given to regulators following the Ofwat penalty in 2020.

Following the significant investment by a fund managed by Macquarie Asset Management in 2021, the committee was pleased to welcome Will Price as a member, replacing Sara Sulaiman.

Malcolm Cooper
15 July 2022

Committee membership (during 2021–22)

Malcolm Cooper
Chair

Attendance 4/4

Rosemary Boot
Committee member

Attendance: 4/4

Mike Putnam***
Committee member

Attendance: 4/4

Sara Sulaiman*
Committee member

Attendance: 1/1

Will Price**
Committee member

Attendance: 3/3

* Sara Sulaiman resigned as a director on 8 September 2021

** Will Price joined the company as a director on 8 September 2021 and joined the committee.

*** Mike Putnam resigned from the committee on 1 May 2022.

Areas of focus this year:

- Annual and interim financial statements
- Non-financial reporting and assurance
- Progress on undertakings and commitments given to our regulators
- Review by the FRC of our 2020-21 financial statements
- The assurance of proposals in respect of the Western Area
- Ongoing investigations and the accounting treatment for these
- Preparation for the introduction of a Director's Responsibility statement on the effectiveness of controls ('UK SOx').

Priorities for 2022–23:

- Assurance of our business plan for the period 2025–30
- New requirements resulting from the Task Force on Climate-Related Financial Disclosures.
- Additional disclosures required by Public Interest Entities following the removal of the Cayman Islands-registered entity.

Corporate governance report continued

4. Transparency and accountability

Read more on risks on pages 108 to 120

Introduction

The Audit Committee focuses on the monitoring and review of the company's internal controls in respect of its financial and non-financial data, as well as the controls put in place to address risk. The committee also oversees the relationship with the company's external auditor and oversees the work of the company's internal audit function. In February 2022, it was agreed to transfer responsibility for monitoring and reviewing risk appetite and 'strategic' risks from the (then) Risk Committee to the Audit Committee.

A primary area of focus is the company's annual and interim financial statements, including reviewing, assessing and recommending to the Board related areas including any relevant judgments and accounting treatments, going concern and long-term viability statement and 'fair, balanced and understandable' assessments, as well as on reviewing and assessing the non-financial reports such as the Annual Performance Report.

Throughout 2021–22, the committee received regular reports from the Head of Group Accounts, Group Treasurer, Head of Internal Audit and the company's external financial and non-financial assurers and auditors. The Chief Executive Officer, Chief Financial Officer, Director of Risk and Compliance and the company's external financial and non-financial audit partners are all regular attendees at meetings of the Audit Committee. The committee also has access, as appropriate, to external professional advisers.

The committee comprise a majority of independent non-executive directors. No executive directors or the Chairman of the Board may be members of the committee, and at least one member of the committee must have recent and relevant financial experience, and at least one member must also have competence in accounting and/or auditing. Prior to February 2022, the Chair of the then Risk Committee was also a member of the Audit Committee, and the Chair of the Audit Committee was a member of the Risk Committee to ensure that there were no gaps between the scope of the two committees. Since the changes in committee remits in February 2022, this arrangement was no longer considered necessary due to the delineation between the two committees' roles.

Work of the Audit Committee during the year

Throughout the year, the committee received regular updates on financial reporting, risk, internal audit and the company's regulatory framework. An area of focus continues to be the company's performance in improving its internal controls and reporting in respect of non-financial information.

During the year the work of the Audit Committee focused on the following key areas:

- The company's annual and interim financial statements and going concern and viability statements
- 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
- Oversight of internal and external audit
- Compliance with the company's legal and regulatory obligations in relation to financial and non-financial reporting
- Water and wastewater regulatory compliance
- A review by the FRC of our accounts for 2020–21
- Speak Up
- The undertakings given to Ofwat as part of the regulatory settlement
- The assurance of the proposals in respect of the Western Area for Water for Life – Hampshire.
- The ongoing investigations by the Environment Agency and Ofwat and the associated accounting considerations
- The level of non-audit fees paid to the external audit firm.
- Initial internal controls review in preparation for UK SOx

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. There were no significant issues raised by Deloitte. The company continues to take steps to address the matters raised by Deloitte's audit and the committee will monitor progress.

There was a review by the FRC of our accounts for 2020–21. The queries raised by the FRC have now been resolved to its satisfaction and details of the review can be found on the FRC website. Following the review, we have enhanced our disclosures regarding our revenue recognition accounting policy and the judgments in relation to provisions and contingent liabilities.

Revenue

There were no changes to treatment of revenue recognition in the year, nor to the underlying system for estimating the measured income accrual.

Further information

Non-household revenues recovered during the year, which was expected following the lifting of COVID-19 restrictions. The higher levels of household consumption experienced during the lockdown period have continued as many customers continue to spend more time working from home. No additional judgment was made for the impact of the pandemic on revenues in 2021–22.

Impairment of trade receivables

The company's policy for providing for bad debt based on customer segments and the age of outstanding debt has not changed in the year and the methodology used last year was applied, on a consistent basis, to calculate the base underlying provision charge for the full-year accounts.

Further information

Over the past two years, additional judgments have been applied to recognise the impact of the COVID-19 pandemic on the likely recoverability of the outstanding debt. As our provision methodology uses cash collection history that now includes two years of performance affected by the pandemic, no additional judgment has been made for this in 2021–22.

For the assessment at 31 March 2022, we have made an additional judgment in relation to the current levels of high inflation and pressure that customers are experiencing on their finances as a result. To form this judgment, we have ranked our customer segments as high, medium or low risk and made an additional provision for them based on this ranking. This is a significant judgment for these accounts given the lack of prior evidence for the impact of inflation at current levels and has resulted in an additional provision charge of £10.3 million being recognised at March 2022.

Provisions and contingent liabilities

Following the Court hearing in July 2021 the company was issued with a fine of £90 million. This has been disclosed separately on the face of the financial statements.

The investigation by the Environment Agency (EA) into wastewater sampling compliance and the separate industry-wide investigations by Ofwat and the EA wastewater treatment works are ongoing.

Further information

The Audit Committee has considered the status of these investigations along with advice from internal and external legal advisers in order to assess whether it would be appropriate to make a provision or disclose the matters as a contingent liability. Given the status of the investigations, the Committee concluded that it was appropriate to disclose them as a contingent liability, see note 33 to these accounts.

Software as a Service (SaaS)

The IFRS Interpretations Committee published its agenda decision regarding the treatment of configuration and customisation costs in Cloud Computer Arrangements (SaaS) during the year. This has resulted in a review of the treatment of may previously have been recorded within intangible assets.

Further information

The details of the decision were reviewed along with the IT service contracts that we have in place. We identified one significant contract, entered into in 2021–22, that met the SaaS criteria and, as a result, have recognised a prepayment on the Statement of Financial Position for the life of the contract with a charge of £1.3 million being recognised as an operating cost in the year.

Viability statement

We have continued to use the period to 2030, being the end of the next regulatory Price Review period, for the viability assessment.

Further information

The committee reviewed the company's viability assessment and agreed for this to be made for the period to 2030 for this year. Please see pages 121 to 124 for our statement.

Corporate governance report continued

4. Transparency and accountability

Read more on pages 176 to 191

Our Ofwat performance commitments

The company has an external non-financial assurer to independently assure its non-financial reporting to Ofwat and that there is a robust system of internal controls in place for non-financial regulatory reporting, such that information in the Annual Performance Report fairly represents the company's progress and delivery of its promises. The assurer attends meetings of the Audit Committee and reports formally the results of its assurance.

Section 19 Undertakings

As part of the regulatory settlement reached with Ofwat in 2019–20, the company agreed to certain undertakings to implement improvements in the business in areas such as culture and robustness of non-financial reporting, as well as to recompense current and former customers. The Audit Committee is responsible for monitoring and reviewing the controls and assurance put in place by management in respect of these undertakings and receives regular reports from management about the progress against the agreed action plans and from the company's external assurers in respect of such progress.

Internal controls

The committee keeps under review the internal financial controls systems of the company that identify, assess, manage and monitor financial risks along with other internal control and risk management systems and, accordingly, receives regular reports from both Internal Audit, external audit and any external assurers that have been appointed by the company to review particular areas of concern.

The Board has overall responsibility for the Group's systems of internal financial control and for monitoring their effectiveness. As part of prior year and current year audits, a number of deficiencies were raised by internal and external audit in respect of IT controls, and during FY22 management has made progress in remediating the deficiencies identified. The Board and Audit Committee has commenced a business process review of its financial processes and controls with a view of improving and developing an internal control environment where reliance can be placed on the internal controls for the purpose of financial reporting.

The committee 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 is provided with updates on matters identified via the company's Speak Up policy. There were no material incidents reported via Speak Up during the year.

The committee is also aware of the need to ensure that the group complies with sanctions placed on individuals and organisations in Belarus and Russia following the invasion of Ukraine.

Oversight of internal audit and external audit

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 external auditors on an annual basis to ensure that they remain effective.

In accordance with best practice, the committee 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 committee received regular reports throughout the year from Internal Audit in respect of its work during the year in accordance with the internal audit plan agreed with the committee at the beginning of the year. The reports from Internal Audit are a material element of the assurance received by the committee on the company's 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 able to raise any issues with the committee or its Chair at any time during the year.

Fair, balanced and understandable

At the request of the Board, the committee has considered whether, in its opinion, this Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and whether it provides the information necessary for shareholders to assess the company's position, performance, business model and strategy.

Step 1 – Developing key themes

The initial themes and structure for the Annual Report are developed, taking into account feedback from Ofwat and other stakeholders as well as a 'best practice' review.

▼

Step 2 – Drafting content

Subject matter experts are identified to provide the detailed information used to draft the content for each section of the Annual Report.

▼

Step 3 – Review

The draft content is reviewed by the subject matter experts, the project team, legal team and members of the Executive Leadership Team.

▼

Step 4 – Assessment

The content of the report is reviewed to determine which statements are 'positive' and which are 'negative'. These are then extracted and provided to the Audit Committee organised by section and/or subject for it to review the key areas of the report for fairness, balance and understandability.

▼

Step 5 – Decision

Based on the content provided to it as well as their own reading of the draft Annual Report, the Audit Committee members make their decision whether or not to advise the Board that the Annual Report, taken as a whole, is fair, balanced and understandable.

Risk

During the year, the committee was responsible for supporting the Risk Committee's work in overseeing and challenging the effectiveness of our approach to risk management. This included responsibility for monitoring the effectiveness of 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. Following changes to the committee remits in February 2022, the Audit Committee is now responsible for monitoring and reviewing risk appetite and tolerance and for more 'strategic' risks.

It is also responsible for monitoring that any risk mitigations and controls are working within the organisation.

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 current audit partner, Delyth Jones, rotated onto the audit for the 2021–22 annual report following the rotation of the previous audit partner, Anthony Matthews, in March 2021.

The Audit Committee reviews the external auditor's effectiveness each year, seeking views from the committee and management via a questionnaire, and would report to the Board any concerns over the continuation of the appointment.

The committee undertakes an annual review of the external auditor's independence and objectivity within the context of the applicable regulatory requirements and professional standards. This includes an assessment of the impact of any non-audit work carried out on the auditor's independence and objectivity. In the committee's view the external auditor met these criteria. The committee also monitored the ratio of audit fees to non-audit fees and approved non-audit services and fees paid to Deloitte during 2021–22.

Details of the amounts paid to Deloitte are provided in note 6 to the financial statements.

In accordance with listed company practice, 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 auditor, although it is mindful of non-audit services currently being undertaken by other external audit providers. A tendering exercise was carried out in 2020–21 with Deloitte being re-appointed as the external auditor for the financial year ending 31 March 2022.

Corporate governance report continued

4. Transparency and accountability

Health and Safety and Operational Risk Committee Report

Message from the Chair

In February 2022, the Risk Committee, which was established in 2018 to ensure appropriate focus was given to risk within the company, was reconstituted as the Health and Safety and Operational Risk Committee with a greater focus on both health and safety and day-to-day risks.

The monitoring of risk appetite and enterprise-level risks were transferred to the Audit Committee.

As with the previous year, the then Risk Committee continued to develop and improve the company's approach to risk management and reporting with the objective being a consistent and easy to comprehend method of reporting and assessing risks facing the company.

The committee also received regular updates on the effectiveness of health, safety, security and wellbeing within the company and has reviewed and agreed some initial steps to increase focus on health and safety. Assisted by a third party advisory firm, DuPont Sustainable Solutions, the executive have committed to the development of a safety improvement plan to continue the embedment of a 'safety culture within the organisation.

Throughout the year, the committee also received reports on the company's progress against its resilience action plan to ensure that it was on-track. This is a key element of ensuring that supply of vital water and wastewater services to our customers is maintained even under the most trying of circumstances such as during the fairly extreme weather seen in late 2021 and early 2022 with a number of storms.

A number of deep-dives were also performed into areas of the business, including customer service, health and safety incidents and security.

The committee was also pleased to welcome Mark Mathieson as a new member of the committee. Mark brings extensive operational experience in this area from the energy sector in particular.

Mike Putnam

Chair of the Health and Safety and Operational Risk Committee

15 July 2022

Committee membership (during 2021–22)

Mike Putnam
Chair
Attendance: 3/3

Gillian Guy***
Committee member
Attendance: 3/3

Kevin McCullough
Committee member
Attendance: 3/3

Malcolm Cooper***
Committee member
Attendance: 3/3

Marykay Fuller*
Committee member
Attendance: 1/1

Mark Mathieson**
Committee member
Attendance: 2/2

* Marykay Fuller resigned as a director on 8 September 2021.

** Mark Mathieson joined the company as a director on 8 September 2021 and was appointed to the committee.

*** Gillian Guy and Malcolm Cooper resigned from the Committee on 1 May 2022.

Areas of focus this year:

- Rolling out the new risk taxonomy.
- Monitoring the company's progress against its Resilience Action Plan.
- Health and safety, including employee wellbeing.

Priorities for 2022–23:

- Improving management of health and safety in the organisation and developing an enhanced 'safety culture'.
- Employee wellbeing and mental health.

Introduction

In February 2022, it was agreed to move the then Risk Committee's responsibility for monitoring and advising on current risk exposures and risk strategy – with the exception of monitoring day-to-day 'operational' risks – to the Audit Committee, and, having advised on the appropriate taxonomy and approach, moving the Risk Committee's previous role in respect of risk appetite, tolerance and strategy to the Board, as risk is a matter for the Board as a whole. The now Health and Safety and Operational Risk Committee continues to have responsibility for reviewing and monitoring health, safety, security and wellbeing and providing appropriate advice and recommendations to the Board in this area.

Throughout the year, the committee received regular reports from the Director of Risk and Compliance, the Head of Risk and Assurance, and the Head of Health and Safety. The Chief Executive Officer, Chief Financial Officer, Director of Risk and Compliance, Head of Risk and Assurance and Head of Health, Safety, Security and Wellbeing are all regular attendees at meetings of the committee. The committee also has access, as appropriate, to external professional advisers.

The committee comprise a majority of independent non-executive directors. The Chair of the Audit Committee was also a member of the Risk Committee and, to ensure no gaps in the remits of the two committees, the Chair of the then Risk Committee is a member of the Audit Committee. This practice was no longer considered necessary with the transition to the Health and Safety and Operational Risk Committee, as there is now sufficient delineation between the committees' respective roles.

Risk

During the year, the previous Risk Committee received reports on significant risks faced by the company and the appropriateness of controls and mitigation measures in respect of such risks. The committee carried out 'deep dives' into particular areas of risk, including security and customer service.

The Risk Committee continued to focus on rolling out the company's new risk taxonomy to improve the presentation and understanding of the most significant risks faced by the company. The committee reviewed changes to risk appetite in line with the new risk taxonomy, ahead of discussions at the Board.

From February 2022, the Health and Safety and Operational Risk Committee was granted the remit of monitoring and reviewing the company's operational risks and relevant risk management systems, including in the area of information security. At its March 2022 meeting, the committee received an update on cyber-security threats following the heightened risk as a result of the conflict in the Ukraine.

Resilience

As stated previously, the then Risk Committee was a key participant in the development of the company's Resilience Action Plan. Subsequently, the committee received regular reports on the progress with the plan during 2021–22. The storms experienced in late 2021 and early 2022 demonstrated how essential it is for companies in sectors such as water and wastewater to ensure that they are resilient and capable of maintaining operations even under the most unusual of circumstances. With climate change, these 'extreme' weather events can be expected to increase, which only serves to further highlight the importance of resilience. The Risk Committee noted the company's good progress with the actions included in the plan during the year.

Health, safety, security and wellbeing

As already stated, the previous Risk Committee was reconstituted as the Health and Safety and Operational Risk Committee in February 2022 to give greater focus and attention to health, safety, security and wellbeing in the company. In particular, following a review of health and safety within the company by a third party carried out in late 2021, a number of actions and proposals for improvement have been agreed, which the committee will continue to review and make recommendations on.

Throughout the year, the committee received regular reports from the Head of Health, Safety, Security and Wellbeing. In addition to information about relevant key performance indicators and metrics, the committee carries out 'deep dives' on particular topics and areas. During 2021–22, this included wellbeing, which is considered to be of significant importance to the company, particularly in the wake of the COVID-19 pandemic and in the current economic uncertainty. The committee also received reports on health and safety incidents, hazards and 'high potential near misses' by both the company and its supply partners.

Read more about our **health and safety risks** on page 119

Read more about our **risk management and principal risks** on pages 108 to 120

Directors' Remuneration Report

Remuneration Committee Report

Chairman's Annual Statement

I am pleased to present the Remuneration Committee's report for the year to 31 March 2022.

One of the purposes of the Remuneration Committee is to put in place the incentive and retention structures that allow Southern Water to drive performance delivery and improvement across a broad and balanced set of outcomes. These outcomes are shaped to deliver benefits for our customers, the environment and our shareholders, while encouraging our employees to align with the high ethical values of the company of 'doing the right thing'.

Summary of the year

2021–22 has been another challenging year for the company. We have been heavily fined for what we know was an unacceptable level of performance between 2010–15, we have continued to strengthen our culture and underlying business performance and we have delivered for our customers through uncertain times as a result of the continuing global pandemic. Long-term and sustained changes in customer demand have been met.

In addition, the process that resulted in a fund managed by Macquarie Asset Management investing more than £500 million to recapitalise the company presented significant demands on a number of key senior executives. The major investment in the business is an endorsement of the improvements of the past years that have resulted in better outcomes for customers and stakeholders; it provides a solid foundation on which continued performance improvements can now be delivered. A small number of executives were incentivised to support a successful outcome to the investment transaction; details of the awards to the CEO and CFO are in the report.

Ian McAulay, CEO, declared his intention to retire from the organisation by 31 March 2023, and the process to find a successor has recently concluded; as reported elsewhere, Lawrence Gosden takes over as CEO from Ian on 1 July 2022. Ian's very substantial contribution to the ongoing transformation of the company has been recognised by the company Chair in his report. In addition, Sebastiaan Boelen will be leaving Southern Water later in July 2022 and his permanent replacement will be announced in due course. Nadim Ahmad will replace Sebastiaan as Interim CFO. The remuneration aspects of the changes to the executive directors will be reported on in 2022–23.

The bonus arrangements for the coming years have been reviewed and new arrangements designed to deliver stretching levels of performance, delivering customer, environmental and stakeholder benefit, will be introduced for April 2022 onwards.

Throughout the year, and within this context, the Remuneration Committee reviewed the remuneration policy, committee terms of reference and base and variable pay arrangements and satisfied itself on their application. It also sought the opinion of remuneration consultants at PwC on a number of matters.

Membership of the committee changed over the year as a consequence of the change in control of Southern Water and the related Board membership changes; it remains a majority of independent non-executive directors, the company Chair being considered independent for these purposes.

Remuneration outcomes for the 2021–22 Year

Delivering operational performance and better outcomes for customers was at the heart of the metrics agreed for the 2021–22 year; details of the metrics, and the associated targets, which the committee considered to be very stretching and linked to the delivery of the agreed business plan and customer outcomes, are in the Remuneration Report. In addition to measuring achievement against the agreed targets, the committee also had regard to legitimate concerns of all stakeholders, guidance from Ofwat, and broader corporate governance and ESG principles. In particular the committee has been satisfied that no employees have been inappropriately rewarded for environmental performance, including meeting environmental permits, and compliant with the undertakings given to Ofwat in October 2019, and taking heed of the letter from David Black of Ofwat dated 18 February 2022.

The committee chose to exercise its discretion to reduce the overall achievement against one of the customer metrics in light of the company's forecast ODI performance to the end of AMP7 being below levels anticipated at the end of 2020–21. The reduction was equal to the percentage bonus award earned in 2020–21.

The committee also chose to further reduce the overall bonus outcome to 50.00% of maximum. This reflected the committee's discretion to reflect overall outcomes for customers and other stakeholders against the calculated achievement of KPIs, as well as the anticipated reduction in the company's Environmental Performance Assessment to one star. It compared to 63.33% the previous year, and was awarded for all levels of the company.

As noted elsewhere, the committee has agreed to move to new incentive arrangements for 2022 onwards. It has therefore agreed that the existing Incentive and Retention Plan will close. Bonus awarded to executives this year will be paid into a 'deferred Incentive and Retention Pool' and as a result of the decision to close the existing scheme, 50% of an executive's pool will be paid in July 2022 with the balance being paid in July 2023, subject always to the rules of the scheme.

Looking ahead to 2022–23

In last year's report the committee signalled its intent to review the bonus arrangements for the coming year. Supported by PWC, the committee has now completed that review and has decided to put in place new arrangements for 2022–23 onwards. These new arrangements will incorporate an Annual Bonus Plan (ABP) and, for a very small group of senior executives, a three-year Long-Term Incentive Plan (LTIP). Targets will continue to be stretching and strongly aligned with delivering customer and environmental outcomes and associated appropriate behaviours. At the same time, with the recent investment from a fund managed by Macquarie Asset Management, the committee remains focused on ensuring that the company continues to strengthen its financial position in the interests of all of its current and future customers and stakeholders. Targets will be reported in due course. In designing the new schemes, the committee has had regard to Ofwat's guidance as well as industry market practice.

The Remuneration Committee remains committed to ensuring that the company maintains well designed and forward-looking variable pay arrangements that are flexible to the needs of all stakeholders.

Paul Sheffield
Chair of the Remuneration Committee
15 July 2022

Directors' Remuneration Report continued

Remuneration Committee Report continued

Introduction

This report details the activities of the Remuneration Committee for the period to 31 March 2022. 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 the Corporate Governance Code, the Ofwat Board, Leadership, Transparency and Governance Objectives and Principles, the guidance issued by Ofwat in Regulatory Accounting Guidance (RAG) 3.12 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.

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 Chair. The committee has defined terms of reference, which are published at **southernwater.co.uk/board-committee-terms-of-reference**. These have been reviewed and revised during the year.

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 are a majority on the committee. The Chair of the Company is considered independent for these purposes.

Only committee members are entitled to attend meetings, with the Chief Executive Officer and Chief Financial Officer attending by invitation. The Company Secretary acts as secretary to the committee.

No attendee participates in discussions regarding their own remuneration.

Committee membership

Paul Sheffield
Chair

Attendance 4/4

Keith Lough
Committee member

Attendance 1/1

Rosemary Boot
Committee member

Attendance 3/3

Sara Sulaiman
Committee member

Attendance 2/2

Kevin McCullough
Committee member

Attendance 2/2

Martin Bradley
Committee member

Attendance 2/2

Rosemary Boot left the Committee on 7 February 2022.

Sara Sulaiman left the Committee on 8 September 2021 upon her retirement from the Board.

Kevin McCullough left the Committee on 7 February 2022.

Martin Bradley joined the Committee on 8 September 2021. Martin left the Committee on 1 May 2022 and was replaced by Will Price.

Keith Lough joined the Committee on 7 February 2022.

Directors' Remuneration Report continued

Remuneration Committee Report continued

Remuneration at a glance

Key objectives

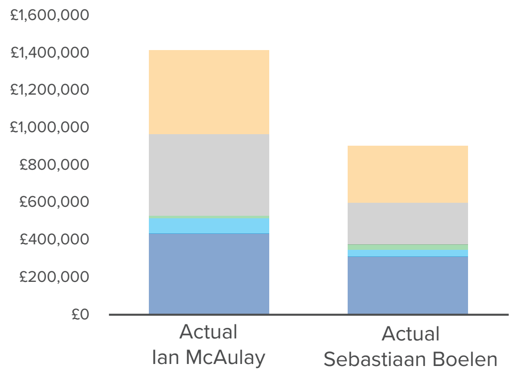
Providing transparent alignment between performance-related pay and quality customer outcomes	Governance, risk management and rigorous application	Applying stretching targets linked to customer outcomes

Executive directors' remuneration policy

Elements of executive directors' pay

Element	Aspects
Base salary	Attracts and retains executives of the quality required to deliver our strategy.
Incentive and Retention Plan	Drives and rewards performance against stretching financial, customer and operational KPIs, which are directly linked to business strategy.
Pension	Defined contribution scheme.
Other benefits	Provides market competitive benefits.

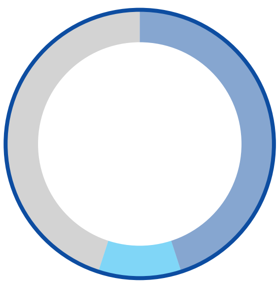
Single total figure of remuneration for executive directors for year ended 31 March 2022



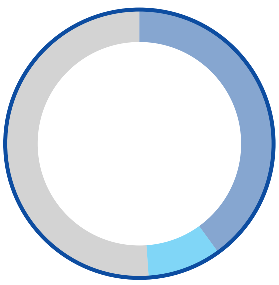
Key:
- One-off investment transaction incentive
- Annual (IRP) bonus award
- Benefits
- Pension
- Salary

Ian McAulay

2021–22



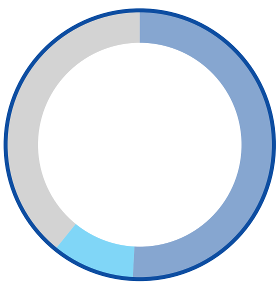
2020–21



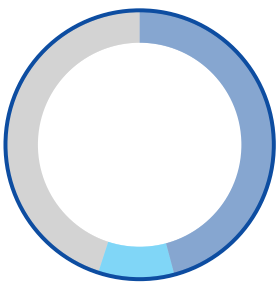
	2021–22	2020–21
Fixed	**55%**	**49%**
Base Salary	45%	40%
Pension and other benefits	10%	9%
Performance linked	**45%**	**51%**
Annual bonus – awarded	45%	51%

Sebastiaan Boelen

2021–22



2020–21



	2021–22	2020–21
Fixed	**61%**	**55%**
Base Salary	51%	46%
Pension and other benefits	10%	9%
Performance linked	**39%**	**45%**
Annual bonus – awarded	39%	45%

Exceptionally, for 2021–22 Ian McAulay and Sebastiaan Boelen were awarded a one-off investment transaction incentive linked to the successful delivery of the transaction which saw a fund managed by Macquarie Asset Management invest more than £500 million into the company. To aid comparison, these charts exclude this investment transaction incentive.

Directors' remuneration Report continued

Remuneration policy applicable in year (unaudited)

Purpose

This remuneration policy applies to all Southern Water employees. The Board of Directors has adopted the remuneration policy at the recommendation of the Remuneration Committee. This policy applies to remuneration earned from 1 April 2022 to 31 March 2025. This was last updated in May 2022.

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 clear alignment to delivering stretching performance improvement, which is in the interests of customers as well as providing sustained and long-term value creation for shareholders and other stakeholders 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
- ensuring that performance payments do not compromise employees' compliance with the Ofwat Section 19 requirements
- 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 Southern Water is able to attract, develop and retain high-performing and motivated employees in a competitive market.

The table on page 183 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
- 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, priorities and long-term goals
- the Remuneration Committee consists of two independent non-executive directors and one non-executive director and no executive directors, which avoids any conflicts of interest and aligns the principle of protection of customers and the interests of investors
- a commitment to the transparent reporting of executive pay within our Annual Report and Financial Statements, and any other channels as appropriate in accordance with legal and regulatory requirements, including the Ofwat Board leadership, transparency and governance principles
- a commitment to transparently report any changes to the policy, including the underlying reasons, within the Annual Report and Financial Statements, 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 the Board and its committees through regular external and independent evaluation.

Directors' Remuneration Report continued

Remuneration policy applicable in year (unaudited) continued

Read more on pages 76 to 91

Applying stretching targets linked to customer outcomes

The Board sets stretching bonus targets linked to outcomes for customers that require equivalent stretching performance. The Board is committed to setting more than 50% of bonus targets that are linked to these outcomes. For 2021–22 these included customer outcomes such as ODIs, C-MeX, D-MeX, efficiency of service delivery, service through people as well as treating the environment as our customer.

Customers will also benefit from the value metrics, which will drive the long-term financial resilience of the organisation and capture the financial consequences of delivering for our customers, aligned with the needs of our shareholders. For 2021–22, these included outcomes such as totex and net operating cash flow.

All metrics were used throughout the organisation so that all company employees are incentivised to achieve stretching levels of customer service. More detail can be found on pages 76 to 91 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 2021–22. The maximum percentages are made up of customer metrics and value metrics as follows:

	CEO	CFO
Customer metrics range and maximum:	0% – 100%	0% – 80%
Value metrics range and maximum:	0% – 100%	0% – 75%
Total maximum variable remuneration	0% – 200%	0% – 155%

Performance-based remuneration is disbursed as a cash bonus. The total of any executive bonus earned during the year is added to the individual's bonus pool carried over from prior years. Each year, 50% of the pool is paid out in cash, with the remaining 50% deferred and retained as the bonus pool for future years. 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, long-term executive performance. The Committee has determined that new arrangements for executive bonuses will be put in place for future years and that the current scheme will close. Therefore, following the addition of the current year's earned bonus to the individual's bonus pool, 50% will be paid in July 2022, with the remaining 50% paid in July 2023, subject to the rules of the bonus scheme.

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 currently receives an 18% of base salary 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 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
- The gender pay gap across the company.

An investor representative non-executive director sits on the committee and as such is 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 advisers, PwC.

Remuneration components

Element of remuneration	Purpose and link to strategy	Policy and approach	Maximum opportunity 2021–22
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 184. • 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, 80% of the opportunity available for each measure is created for achieving a threshold target. 100% is awarded for achieving the actual target, with stretch targets creating between 120% and 150% 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. • Plan awards are disclosed on pages 188 to 189. • New bonus plans being put in place for 2022–23 onwards to replace the Incentive and Retention Plan.	200% of salary for the CEO 155% of salary for the CFO

Directors' Remuneration Report continued

Remuneration policy applicable in year (unaudited) continued

Element of remuneration	Purpose and link to strategy	Policy and approach	Maximum opportunity 2021–22
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.	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 2021–22 year are shown below:

Ian McAulay	Chief Executive Officer
Sebastiaan Boelen	Chief Financial Officer

Details are given on page 188 to 189 of the amounts paid to them in the year ended 31 March 2022.

Operation of the Incentive and Retention Plan

The Incentive and Retention Plan operates as follows:

1. **Annual contribution:** Each year, participants have had 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. As the plan is closing, following the addition of the current year's earned bonus to the individual's bonus pool, 50% will be paid in July 2022, with the remaining 50% paid in July 2023, subject to the rules of the bonus scheme.

Measures used in the Incentive and Retention Plan

During the year, the Remuneration Committee identified and operated both customer and value performance measures in the Incentive and Retention Plan. The customer performance measures for 2021–22 were focused on issues that affect customers such as:

- Customer satisfaction, as measured by our C-MeX performance
- Delivery of our business plan commitments, as measured by our in-year ODI performance
- A number of measures aimed at delivering financial performance of the company
- Delivery of measurable milestones as set out in our environment plan, which was approved by the Board in March 2021
- Progress against the PR19 maturity assessment and our S19 undertakings.

Value metrics for 2021–22 included a number of KPIs, all of which underpinned performance improvement.

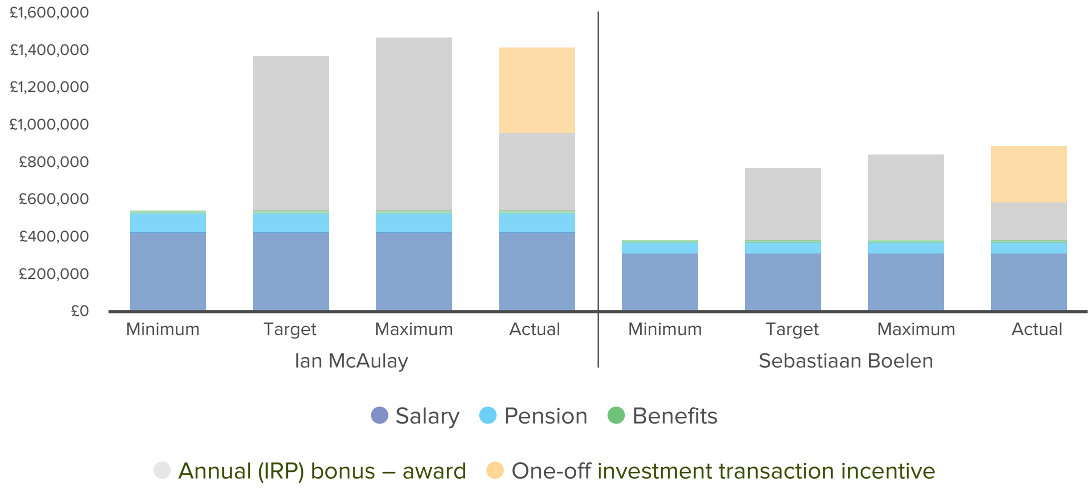
An executive leaving the company will only be eligible for release of any deferred incentives if they are deemed as a 'good leaver' and meets specific targets prior to departure.

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 scenarios for 2021–22

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 2021–22, which includes the exceptional, one-off investment transaction incentive.



Notice periods 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	12 months by either party
Sebastiaan Boelen, CFO	Six months by either party

Ian McAulay was replaced as CEO by Lawrence Gosden on 1 July 2022. Sebastiaan Boelen will be leaving the company later in July 2022 to be replaced by Nadim Ahmad as Interim CFO. Details of the final remuneration arrangements for Ian McAulay and Sebastiaan Boelen, and the remuneration of their successors will be reported in the Annual Report for 2022–23.

Directors' Remuneration Report

Annual remuneration report
Single figure of remuneration for 2021–22 (audited)

Details of the remuneration received by the executive directors are shown below. The figures shown are the amounts paid or awarded for each of these financial years. Base salary is generally reviewed in July each year and so the amounts reported for base salary reflect a part-year effect of any pay award granted.

£'000		Base salary paid	Benefits	Annual Bonus/ Incentive and Retention Plan[1]	Investment transaction incentive[2]	Total	Pension related benefit	Total including pension
Ian McAulay	**2021–22**	**435.0**	**18.5**	**435.0**	**435.0**	**1,323.5**	**78.3**	**1,401.8**
	2020–21	435.0	18.2	550.9	–	1,004.1	78.3	1,082.4
Sebastiaan Boelen	**2021–22**	**302.3**	**14.6**	**234.8**	**300.0**	**851.7**	**45.3**	**897.0**
	2020–21	300.0	14.4	290.8	–	605.2	45.0	650.2

1 The amount reported is added to the bonus pool for the year as shown in the table under Incentive and Retention Plan on page 188. That table also provides details of payments made from the bonus pool and that carried forward to future years.

2 The executive directors were incentivised to support a successful outcome to the investment transaction whereby Macquarie Asset Management invested £530 million to recapitalise the company.

Notes to the single figure of remuneration (unaudited)
Base salary

The base salary for Ian McAulay was reviewed on 1 July 2021 and, as in previous years, at Ian's request (which was supported by the Board), remained unchanged from the 1 July 2018 level of £435,000. The base salary for Sebastiaan Boelen was reviewed on 1 July 2021, a 1% increase was applied, increasing his salary from £300,000 to £303,000 per annum. Salary was paid monthly via PAYE.

Incentive and Retention Plan (customer and value metrics)

The performance measures agreed by the Committee for 2021–22 were:

- In-year ODIs – delivery of performance commitments
- ODIs RIF (minus C-MeX and D-MeX) – total five-year forecast position
- Retail cost to serve (retail Totex), including bad debt – efficient delivery of the operational promises made to customers as part of our business plan
- C-MeX – incentivises excellent customer experience for residential customers across the retail and wholesale parts of the value chain
- D-MeX – incentivises excellent customer experience for developer services (new connections) customers
- Environment – building our future environmental plan
- Gallup Q12 people rating – colleague engagement
- Health, Safety, Security and Wellbeing – ensuring our employees are kept safe and healthy at work
- TCC Opex – total expenditure within plan
- Capital Delivery TCC capex – total expenditure within plan
- Non-Capital Delivery TCC capex – total expenditure within plan
- Progress against PR19 Maturity Assessment and Section 19 Plan – progress against the commitments agreed with Ofwat to ensure we robustly manage performance to avoid further regulatory breaches
- Net operating cash flow – cash generation.

The performance for 2021–22 was assessed by the committee in May 2022. 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
Customer targets	100%	24.32%[1]	24.32%
Value targets	100%	87.92%	87.92%
Discretionary adjustment applied			**-12.24%[2]**
Total outturn as a percentage of salary	**200%**		**100.00%**

1 Includes discretionary reduction of the overall achievement against one of the customer metrics in light of the Company's forecast ODI performance to the end of the current five-year investment period being below levels anticipated at the end of 2020–21. The reduction was equal to the percentage bonus award earned in 2020–21.

2 To reflect the committee's discretion to recognise the overall outcome for customers and other stakeholders against the calculated achievement of KPIs as well as the anticipated reduction in the company's Environmental Performance Assessment to one star.

CFO	Maximum bonus achievable	Outturn %	Outturn as a % of salary
Customer targets	80%	24.32%[1]	19.45%
Value targets	75%	87.92%	65.94%
Discretionary adjustment applied			**-7.89%[2]**
Total outturn as a percentage of salary	**155%**		**75.5%**

1 Includes discretionary reduction of the overall achievement against one of the customer metrics in light of the Company's forecast ODI performance to the end of the current five-year investment period being below levels anticipated at the end of 2020–21. The reduction was equal to the percentage bonus award earned in 2020–21.

2 To reflect the committee's discretion to recognise the overall outcome for customers and other stakeholders against the calculated achievement of KPIs as well as the anticipated reduction in the company's Environmental Performance Assessment to one star.

Directors' Remuneration Report continued

The overall bonus awarded across the business of 50.00% is the weighted average of the customer and value target performance shown above. The outturn as a percentage of salary is calculated by multiplying the maximum bonus achievable by the outturn percentage.

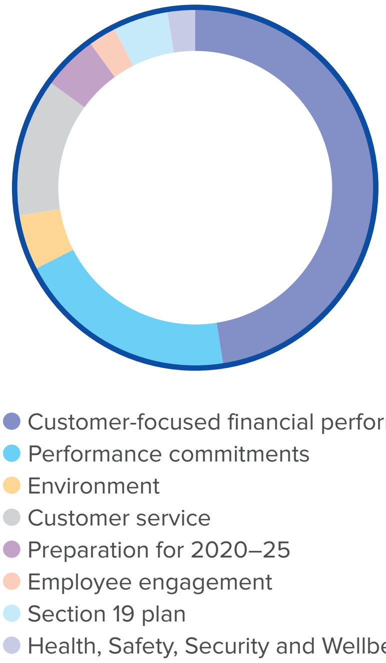
Incentive and Retention Plan 2021–22	2021–22	Threshold performance level	Target performance level	Stretch performance level	Performance[1]	CEO weighting (% of salary)	CFO weighting (% of salary)	CEO pay-out (% of salary)	CFO pay-out (% of salary)
In-year ODIs	Performance	-£24.25m	-£23.1m	-£20.79m	-£37.4m	30.0%	24.0%	0.0%	0.0%
	Bonus percentage	80%	100%	150%					
ODIs RIF (minus C-MeX and D-MeX)	Performance	-£81.4m	-£74.4m	£66.96m	-£88.9m	10.0%	8.0%	-10.20%[2]	-8.16%[2]
	Bonus percentage	80%	100%	150%					
Retail cost to serve (Retail Totex), excluding Bad Debt	Performance	£69.08m	£62.8m	£56.52m	£64.4m	15.0%	12.0%	14.24%	11.39%
	Bonus percentage	80%	100%	120%					
C-MeX	Performance	15th	14th	13th	16th	17.5%	14.0%	0.0%	0.0%
	Bonus percentage	75%	100%	120%					
D-MeX	Performance	14th	13th	12th	14th	7.5%	6.0%	5.63%	4.50%
	Bonus percentage	75%	100%	120%					
Environment (Progress against plans)	Performance	n/a	Satisfactory	Excellent	Satisfactory	10.0%	8.0%	10.0%	8.0%
	Bonus percentage	0%	100%	120%					
Gallup Q12 Colleague Engagement	Performance	3.89	3.95	4.00	3.93	5.0%	4.0%	4.65%	3.72%
	Bonus percentage	80%	100%	120%					
Health, Safety & Wellbeing	Performance	90%	95%	100%	74%	5.0%	4.0%	0.0%	0.0%
	Bonus percentage	80%	100%	120%					
Total Controllable Costs (TCC) Opex	Performance	£489.56m	£445.05m	£400.55m	£467.91m	30.0%	22.5%	26.92%	20.19%
	Bonus percentage	80%	100%	120%					
Capital Delivery TCC Capex	Performance	£352.91	£336.11	£319.31	£293.39m	15.0%	11.25%	15.0%	11.25%
	Bonus percentage	80%	100%	120%					
Non-Capital Delivery TCC Capex	Performance	£233.68m	£212.43m	£191.19m	£245.96m	15.0%	11.25%	0.0%	0.0%
	Bonus percentage	80%	100%	120%					
Progress against PR19 Maturity Assessment	Performance	Satisfactory progress	Good progress	Excellent progress	Good progress	10.0%	7.5%	10.0%	7.5%
	Bonus percentage	80%	100%	120%					
Progress against Section 19 Plan	Performance	Satisfactory progress	Good progress	Excellent progress	Excellent progress	10.0%	7.5%	12.0%	9.0%
	Bonus percentage	80%	100%	120%					
Net operating cash flow	Performance	-£232.54m	-£211.40m	-£190.26m	-£131.0m	20.0%	15.0%	24.0%	18.0%
	Bonus percentage	80%	100%	120%					
Total								**112.24%**	**85.39%**
Discretionary adjustment								-12.24%[3]	-7.89%[3]
Total awarded								**100.0%**	**77.5%**

1 Where the performance has been based on the latest forecast position available at the time, any subsequent changes to the final outcome position will be adjusted for in the following performance year and in accordance with the IRP scheme rules.

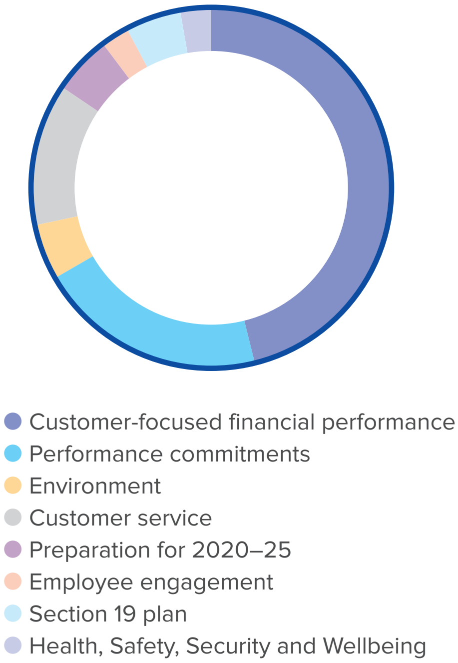
2 This KPI was intended to continue to motivate and stretch the executive to develop a viable plan to minimise ODI penalties for the whole five-year period, even if they were missing out on the short term. In 2020–21 a credible plan saw the ODI forecast penalty over the five-year period to be in-line with the original business plan levels. This earned a bonus award of 10.2%. For a number of reasons (weather included), the ODI target for the year was missed and the plan for the remainder of the five-year period is no longer hitting the cumulative target. In light of this, the remuneration committee exercised its discretion by applying a negative 10.2% pay-out for the ODI RIF in the current year, effectively reversing that earned for ODI RIF in 2020–21.

3 To reflect the committee's discretion to recognise the overall outcome for customers and other stakeholders against the calculated achievement of KPIs as well as the anticipated reduction in the company's Environmental Performance Assessment to one star.

CEO Bonus distribution



CFO Bonus distribution



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 2021–22	(a) Bonus pool brought forward (£'000)	(b) Bonus awarded in year (£'000)	(c) Bonus paid out (£'000) (50%)	(d) Bonus pool carried forward to be paid in 2023 (£'000) (50%)
Ian McAulay	513.6	435.0	474.3	474.3
Sebastiaan Boelen	224.0	234.8	229.4	229.4

The amounts paid out (c) and carried forward (d) are each calculated as ((a) + (b)) ÷ 2. The closure of the Incentive and Retention Plan means that the balance of an individual's bonus pool will be paid in July 2023.

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	435.0	18%	74.3	4.0	78.3
Sebastiaan Boelen	302.2	15%	31.1	14.2	45.3

Following the closure of the company's defined benefit pension scheme to future accrual and the introduction of a new defined contribution scheme for the company's workforce, the Remuneration Committee reviewed the pension contribution payable to the executives. In doing so, the Remuneration Committee also considered the expectation in Provision 38 of the UK Corporate Governance Code that the pension contributions payable to the executive directors are aligned to that of the workforce. Accordingly, it was agreed that from 1 April 2020, the employer pension contributions offering for new executive director appointments would be aligned to the 'all employee' rate of 11%.

Directors' Remuneration Report continued

Non-executive director fees for the year (audited)

The Chair and the 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.

The Board as a whole is responsible for setting the level of non-executive director fees and in doing so receives input from the Remuneration Committee.

Details of the emoluments received by the Chair and non-executive directors are shown below:

	2021–22			2020–21		
£'000	Fees	Other	Total	Fees	Other	Total
Keith Lough (Chair)	275.0	3.9	278.9	275.0	7.7	282.7
Paul Sheffield (Senior independent non-executive director)	70.0	0.6	70.6	70.0	0.0	70.0
Rosemary Boot (Independent non-executive director)	50.0	1.1	51.1	50.0	0.2	50.2
Mike Putnam (Independent non-executive director)	60.0	0.6	60.6	60.0	1.4	61.4
Dame Gillian Guy DBE (Independent non-executive director)	50.0	0.3	50.3	50.0	0.0	50.0
Kevin McCullough (Independent non-executive director)	65.0	0.7	65.7	65.0	2.3	67.3
Malcolm Cooper (Independent non-executive director)	65.0	0.7	65.7	65.0	0.8	65.8
Marykay Fuller (Greensands Board-nominated non-executive director) (from 15 June 2020 to 8 September 2021)	26.3	0.1	26.4	47.7	0.4	48.1
Martin Bradley (Investor-nominated non-executive director) (from 8 September 2021)	–	–	–			
Will Price (Investor-nominated non-executive director) (from 8 September 2021)	–	–	–			
Mark Mathieson (Investor-nominated non-executive director) (from 8 September 2021)	–	–	–			
Sara Sulaiman (Investor-nominated non-executive director) (to 8 September 2021)	–	–	–	–	–	–

The base fees for the non-executive directors are £50,000.

In May 2022, the Remuneration Committee reviewed the fees paid to the Chair and independent non-executive directors, comparing the fee data between 2014–15 and 2020–21 of a number of other companies in the sector. Following this review, the Remuneration Committee agreed to increase the Chair's fees from £275,000 to £290,000 with effect from 1 July 2022.

The same data was subsequently presented to the Board at its May meeting, at which it was agreed to increase the base fees of non-executive directors from £50,000 to £55,000 per annum with effect from 1 July 2022, noting that there had been no increase since 2014. The Board also agreed that a responsibility supplement should be paid to the Chair of the newly-formed ESG Committee, Rosemary Boot, with effect from 1 May 2022.

The table below provides details of applicable responsibility payments for 2021–22.

	Current Chair and date appointed	Responsibility supplement	Comments on supplement
Audit Committee Chair	Malcolm Cooper 23 December 2019	£15,000	Increased from £10,000 with effect from 1 July 2019
Health, Safety and Operational Risk Committee Chair	Mike Putnam 1 July 2019	£10,000	Introduced with effect from 1 July 2019
Remuneration Committee Chair	Paul Sheffield 1 April 2015	£10,000	Introduced with effect from 1 October 2018
Senior independent non-executive director	Paul Sheffield 1 July 2015	£10,000	With effect from 1 August 2015
Workforce non-executive director	Kevin McCullough 26 February 2020	£15,000	Role introduced with effect from 26 February 2020
Greensands Board-nominated director	Marykay Fuller 15 June 2020 to 8 September 2021	£10,000	With effect from 15 June 2020

The other amounts payable to the non-executive directors include taxable expenses incurred in connection with attendance at Board meetings and shareholder events.

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)

Creating an environment to enable a diverse and inclusive workforce will have a positive effect on our organisation and this is a key part of Southern Water's People Strategy.

This year there was an increase in the mean gender pay gap from 1.9% to 4.8%. The median gap also increased from -2.0% to -0.2%, a gap in favour of women. The increase was due to a number of senior roles being vacant in 2020 which were subsequently filled by men. We noted a small reduction in the mean bonus gap from 35.0% to 34.4%, and a reduction in the median bonus gap from 24.5% to 16.1%. We believe this is largely due to the actions taken in response to COVID-19 with the removal of performance measures being linked to bonus payment. With the reintroduction of this measure and based on our gender balance we expect this will widen the gap again in the 2022 report.

The company will continue to support the aspirations of its female employees, concentrating on further improvements in the areas of recruitment, talent development and remuneration as well as policies which further support colleagues to achieve a balance of work with family commitments. For more information, see the report on our gender pay gap at **southernwater.co.uk/gender-pay-gap**.

Creating a workplace where all of our people feel they belong

We have deliberately designed our diversity and inclusion approach and outcomes to be understandable, actionable and deliverable. We have created a clear vision that communicates our intent to consciously recognise and value our differences, ensuring that all of our people feel they belong and that we succeed together. So far we've made significant progress against our action plan and have welcomed external recognition through our improvement in the Inclusive Top 50 UK Employers list where we moved from 49th to 46th within 12 months. In terms of pay, we are committed to ensuring that we have a fair pay structure and that we have processes in place to make sure we have a consistent and fair approach. We recognise that while we do not have all the answers, we are keen to learn and grow, valuing the different experiences and perspectives that our people bring.

Directors' Remuneration Report continued

Executive pay gap reporting

From 2020 onwards, the Companies (Miscellaneous Reporting) Regulations 2018 require all publicly-listed companies with more than 250 UK employees to publish the ratio between their CEO's full-time equivalent remuneration and that of employees at the 25th, 50th and 75th percentile when total remuneration is calculated and ranked from highest to lowest.

Although not a listed company, Southern Water has chosen to publish this information in line with our commitment to providing information about pay diversity and fairness within our organisation.

The regulations set out three options for calculating the pay ratio.

- Option A – takes into account all forms of remuneration and payments (pension etc)
- Option B – uses the gender pay calculation figures
- Option C – uses some other method

Our ratio has been calculated using 'Option A' as this takes into account full remuneration and is therefore the most comprehensive comparison.

Year	Method	25th Percentile Ratio	50th Percentile Ratio	75th Percentile Ratio
2021	A	**43.4:1**	**34.3:1**	**26.6:1**
2020	A	27.3:1	22.0:1	17.2:1

We have seen an increase in our Executive Pay Gap this year. This is in relation to a small number of executives, including our CEO and CFO, who were incentivised to support the investment transaction.

Implementation of policy for 2022–23 (unaudited)

Base salary

The base salary for the new CEO and CFO will be reported in next year's annual report.

The revised base salaries for each executive director are as follows:

Base salary	Base salary for 2021–22 (£'000)	Base salary increase (%)	Base salary to 30 June 2022 (£'000)
Ian McAulay	435.0	0%	435.0
Sebastiaan Boelen	303.0	n/a	n/a

Annual Bonus Plan and Long Term Incentive Plan

The Annual Bonus Plan will be based on performance conditions designed to focus the executive directors on the areas of key strategic importance for the company. As such, the performance conditions will be strongly aligned with delivering customer and environmental outcomes and associated appropriate behaviours, while ensuring that the company continues to strengthen its financial position in the interests of customers and stakeholders alike.

We have fully committed to comply with Ofwat's code of practice for executive remuneration for 2020–25 and our Remuneration Policy 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, while 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 2022–23 will focus on positive outcomes for our customers and other stakeholders

In determining the performance measures for 2022–23, the Remuneration Committee considered the expectation under the Ofwat Principles that the company's performance-related elements should be linked to stretching delivery for customers, as well as the steps needed to further embed the Ofwat code of practice for executive remuneration. It was agreed that the following measures will be used to assess our performance:

Annual Bonus Plan objectives

- 4 x Ofwat PR19 ODI performance commitments (Pollution incidents; Internal sewer flooding incidents; Leakage; C-MeX score)
- 2 x Health, Safety, Security and Wellbeing (Lost time accident frequency rate and progress on actions set out in the Health and Safety Transformation Plan)
- Controllable Opex
- Role-specific objectives

LTIP objectives

- ODIs
- 2 x Delivery of Customer plans (Capital scheme completions; Achievement of regulatory outputs)
- Delivery of five strategic projects
- 2 x Environment
- 3 x PR24 Outcomes

Weightings and targets, along with actual performance, will be fully disclosed in the 2022–23 Remuneration Report.

Directors' report

for the year ended 31 March 2022

The Directors of Southern Water Services Limited (registered no. 02366670) present their report and the audited financial statements for the year ended 31 March 2022.

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 2.6 million people and provides wastewater services to over 4.6 million people.

Strategic Report

The information that fulfils the requirement of the Strategic Report can be found in our Annual Report on pages 21 to 124 including the Section 172 (1) Statement on pages 71 to 73.

Future developments

The information regarding future developments of the company can be found in our Annual Report on pages 50 and 76 to 91.

Post balance sheet events

There were no significant events after the statement of financial position date.

Results and dividends

The income statement on page 202 shows the company's results and loss for the year. Further details are also available in the Annual Report on pages 16 and 92 to 101.

Interim dividends of £nil per ordinary share (2021: £70.87 per share), totalling £nil million (2020: £4.0 million) were paid during the year to Southern Water Services Group (SWSG). These dividends have historically been used, along with associated group tax relief, to enable SWSG to pay interest due to SWS on an inter-company loan as disclosed in note 15 to the financial statements. This inter-company loan was repaid during the year as part of the investment made into the group by a fund managed by Macquarie Asset Management. As a result, no further dividends will be made in relation to this 'dividend loop'. Further details are provided on pages 98 and 105 of this report.

No ordinary interim dividends were paid during the year (2021: £nil). No final dividend has been declared or paid for the year ended 31 March 2022.

Directors and their interests

Directors during the year ended 31 March 2022 and up to the date of signing the financial statements, were as follows (details on pages 128 to 133):

Keith Lough
Chairman

Ian McAulay
(Executive director – Chief Executive Officer)
(Resigned 30 June 2022)

Sebastiaan Boelen
(Executive director – Chief Financial Officer)

Lawrence Gosden
(Executive director – Chief Executive Officer)
(Appointed 1 July 2022)

Paul Sheffield
(Senior independent non-executive director)

Rosemary Boot
(Independent non-executive director)

Malcolm Cooper
(Independent non-executive director)

Gillian Guy
(Independent non-executive director)

Kevin McCullough
(Independent non-executive director)

Michael Putnam
(Independent non-executive director)

Martin Bradley
(Investor-nominated non-executive director)
(Appointed 8 September 2021, resigned 1 May 2022)

Will Price
(Investor-nominated non-executive director)
(Appointed 8 September 2021)

Mark Mathieson
(Investor-nominated non-executive director)
(Appointed 8 September 2021)

Stephen Fraser
(Investor-nominated non-executive director)
(Appointed 1 May 2022)

Marykay Fuller
(Non-executive director)
(Resigned 8 September 2021)

Sara Sulaiman
(Non-executive director)
(Resigned 8 September 2021)

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

Improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the company's strategy to enhance the quality of service to customers and improve ways of working. Research and development expenditure charged to the income statement for the year amounted to £0.8 million (2021: £0.6 million).

Financial risk management

The Financial Risk Management Policy is included in the Strategic Report which can be found in the Annual Report on page 116.

Corporate governance

A description of the company's corporate governance arrangements for the purposes of Part 8 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as introduced by regulation 14 of the Companies (Miscellaneous Reporting) Regulations 2018 can be found in the Annual Report on pages 136 to 200.

Employees

The company recognises the importance of its employees and is committed to effective two-way communication and consultation.

The company re-established an Employee Voice group during 2020–21 to facilitate meaningful consultation between company management and employees through elected employee representatives. The group meets regularly at both a functional and company-wide level.

In 2017, the company introduced the Gallup employee survey, which has continued to be undertaken every six months to help develop management action plans and provide insight into the views of employees. The company also conducts further surveys throughout the year on specific matters, the results of which are reported to management and/or the Board as appropriate.

The company recognises the rights of every employee to join a trade union and participate in its activities. Southern Water has a single union agreement with Unison.

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.

During 2020–21, the company's Executive directors and Executive Leadership Team members as well as individual non-Executive directors initiated monthly 'Company Conversations', using video conferencing, to inform and engage with the company's employees about the company's priorities based on the new business plan 2020–25 as well as to inform and engage with the company's employees about the company's purpose and values and working arrangements as a result of the pandemic. These sessions have continued throughout 2021–22 and afforded employees an opportunity to put questions to the executive directors and senior leadership about anything regarding the business.

In line with the UK Corporate Governance Code, one of the company's independent non-executive directors, Kevin McCullough, has been given the remit of communicating the views of the company's workforce to the Board.

Further details of the company's employees and the company's engagement activities, as well as how the directors have had regard to employee interests, can be found in the Strategic Report on pages 62 to 66 and page 151.

Equal opportunity: The company's policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. It takes full account of the needs of people with disabilities and follows set policies and procedures to support reasonable adjustments.

Health, safety, security and wellbeing: The company recognises its duties to make proper provision for the health, safety and welfare at work and the security of its employees and assets.

Every employee receives training, instruction and supervision to deliver their role, propionate to the specific level of risk. There is an enterprise-wide meeting and consultation structure in place that delivers top down/bottom-up engagement in the health, safety and wellbeing space.

Change is consultative and tested with employee, supply-chain and industry groups. The company holds multiple Health and Safety engagement events throughout the year, many of which this year focused on wellbeing.

Directors' report continued

Southern Water has recently engaged with Du Pont to conduct an independent assessment of the management of health and safety risk. The results of this assessment form the core of our transformation plan. The transformation plan will deliver cultural, behavioural, process and system improvements over the course of the next several years and well into the next five-year period.

The company 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

The company recognises the importance of its suppliers to ensure the company's ability to continue to deliver an essential public service. Further details of the company's engagement with its suppliers during the year can be found on pages 10 and 70.

Due to the nature of its business and the regulatory framework in which the company operates, engagement with its customers is of key importance. The company undertakes extensive customer engagement activities throughout the year. Further details can be found on pages 46 to 47.

As a private limited company, Southern Water Services Limited is not required to hold an annual general meeting.

The company, its senior executives and Board regularly engage with the company's regulators, with local and national government as well as with relevant industry groups through meetings and other events.

The company's statement explaining how the directors have had regard to the matters set out in section 172(1)(a) to (f) of the Companies Act 2006, and which provides further detail in respect of how the directors have taken into account the interests of the company's employees, suppliers, customers and others during the year, can be found on pages 71 to 73.

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.

The company was prosecuted by the Environment Agency for permit breaches at wastewater treatment works and was sentenced and fined £90 million plus £2.5 million of costs for these historic offenses. The company is also subject to ongoing investigations by the Environment Agency and Ofwat regarding wastewater performance and further details are disclosed on page 38.

The company's environmental performance for 2021–22 is reported on pages 83 to 87, and 54 to 60. 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.

Streamlined Energy and Carbon Report (SECR)

This section fulfils the requirements of the Companies (Directors Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2019.

Further information about our climate change activities can be found on pages 56 to 60 of the Annual Report.

Quantification and reporting methodology

The methodology used to calculate operational greenhouse gas emissions for the provision of water and wastewater services follows the GHG Protocol Corporate Reporting Standard.

The water sector employs a bespoke carbon accounting workbook which reflects best practice and is updated every year in order to use the latest emission factors, derived from the UK's GHG Conversion Factors. Version 16_V05 of the Carbon Accounting Workbook (May 2022) has been utilised to prepare the GHG estimations.

Operational boundary

The reporting boundary covers all the company's operational services and is congruous with our financial reporting boundary.

Energy use

Area	2021–22 kWh	2020–21 kWh
Electricity	**458,402,906**	459,873,901
Imported	**396,418,121**	396,768,099
Self-generated	**61,984,786**	63,105,802
Gas	**2,871,346**	2,077,548
Business transport	**13,447,058**	13,373,597
Total incl. self-generation	**474,721,310**	475,325,046
Total excl. self-generation	**412,736,525**	412,219,244

The company's self-generated supply comes from combined heat and power (CHP), solar PV and diesel generation. In addition, the company exported excess electricity to the grid, predominantly renewable energy from the company's 16 CHP installations.

Greenhouse gas emissions

Scope	Description	Included in scope	2021–22 ($ktCO_2e$)	2020–21 ($ktCO_2e$)
1	Direct emissions from activities that the company own or control including combustion of fuel	Gas oil use, process emissions, company transport	63.5	63.1
2	Indirect emissions from purchase of electricity (location-based)	Grid electricity	84.5	91.4
	Indirect emissions from purchase of electricity (market-based)	Grid electricity	0.0	9.5
3	Other Indirect emissions	Business travel on public transport/private vehicles, outsourced activities, grid electricity transmission and distribution	18.0	18.5
Total Gross emissions for Scope 1 & 2	Location-based approach		148.1	154.6
	Market-based approach		63.5	72.6

* Location-based approach uses the average grid emission factor for power from the electricity grid.
** Market-based approach uses the carbon intensity of the energy we procure from the electricity grid.

Directors' report continued

Targets

In order to mitigate the company's climate impact it is committed to delivering net zero operational greenhouse gas emissions by 2030 as a water sector. This target was published in March 2019.

Global greenhouse gas and energy intensity metrics

Area	Unit of measurement	2021–22	2020–21
All company (location-based approach)	Tonnes of CO_2e from Scope 1 and 2 gross emissions per £100,000 turnover	18.0	19.7
All company (market-based approach)	Tonnes of CO2e from Scope 1 and 2 gross emissions per £100,000 turnover	7.7	9.3
All company energy (incl. self-generation)	kWh/ £100,000 of turnover	57,647	60,469
All company energy (excl. self-generation)	kWh/ £100,000 of turnover	50,120	52,422
Water services	kgCO_2e per megalitre (Ml) of water treated (location-based approach)	130	178
Water services	kgCO_2e per megalitre (Ml) of water treated (market-based approach)	18	37
Water services (electricity incl. self-generation)	kWh/Ml	537	718
Water services (electricity excl. self-generation)	kWh/Ml	529	704
Water services (total energy incl. self-generation)	kWh/Ml	558	744
Water services (total energy excl. self-generation)	kWh/Ml	549	730
Wastewater services	kgCO_2e per megalitre (Ml) of wastewater treated (location-based approach)	245	241
Wastewater services	kgCO_2e per megalitre (Ml) of wastewater treated (market-based approach)	137	141
Wastewater services (electricity incl. self-generation)	kWh/Ml	662	623
Wastewater services (electricity excl. self-generation)	kWh/Ml	534	502
Wastewater services (total energy incl. self-generation)	kWh/Ml	685	643
Wastewater services (total energy excl. self-generation)	kWh/Ml	557	523

Note: Turnover 2021–22 reported as £823.5 million for use in intensity metrics. This reflects a reduction of £21.0 million due to an Ofwat regulatory settlement.

Energy efficiency action

Southern Water has continued to invest heavily in energy efficiency throughout 2021–22, in multiple areas, covering multiple technologies including:

- Investments of over £4 million on pump refurbishments and replacements across more than 73 sites. Increasing the energy efficiency of delivered water
- Over £2 million investment on VSD drives and control systems, allowing us to deliver water more efficiently
- £1.2 million investment in aeration systems which improved the efficiency when we treat our water treating
- We have also invested in real-time control, which allows us to trend our water treatment, resulting in reduced energy demands at water treatment sites.

Assurance statement

This quantification of greenhouse gas emissions and energy usage is checked internally through a governance framework and subsequently audited by independent consultants as part of the company's annual regulatory reporting.

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 2022.

In forming this assessment the directors have considered the period to 31 July 2023 and 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 21 to 124.
- 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 92 to 101.
- The company has available a combination of cash of £442.9 million (including £27.5 million of cash held in an O&M Reserve Account which can only be used in the event of a default) and committed undrawn bank facilities of £330 million totalling £772.9 million at 31 March 2022 (2021: £714.5 million). These funds are sufficient to fund the operating and capital investment activities of the company as set out in the Board approved budget for a period of at least 12 months from the date of signing the financial statements.
- The company regularly needs to raise new finance in order to fund the capital investment programme and to refinance maturing debt and expects to continue raising new finance. The next scheduled bond maturity of £257.1 million (based on the Balance Sheet value at March 2022) is 31 March 2023, and an amortising loan is in its repayment period.
- The company's credit rating is Baa3/BBB+/BBB+.
- The company obtained a waiver from its Lenders in February 2021 which allows full use of available liquidity, plus the raising of new finance, even in a Trigger Event scenario of a credit rating downgrade or a breach of a trigger debt compliance ratio. The next planned financing activity of circa £300 million will be in anticipation of a bond maturity on 31 March 2023.
- The company operates in an industry that is 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 31 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 pages 121 to 124 of this report.

Directors' report continued

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 FRS101 '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 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. they have taken all the steps that they ought to have taken as a director in order to make themselves 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

15 July 2022

Financial statements

Income statement

For the year ended 31 March 2022

	Note	2022 £m	2021 £m (Restated)*
Continuing operations			
Revenue	5	**823.5**	784.2
Amortisation of regulatory settlement	5	**21.0**	35.6
Total revenue		**844.5**	819.8
Other operating income	5	**1.8**	1.7
Operating costs			
– before court fine and costs, charge for bad and doubtful debts, depreciation and amortisation		**(384.7)**	(360.0)
– court fine and costs		**(91.5)**	–
– charge for bad and doubtful debts		**(29.9)**	(34.8)
Operating costs before depreciation and amortisation		**(506.1)**	(394.8)
Depreciation and amortisation	6	**(324.1)**	(287.9)
Total operating costs		**(830.2)**	(682.7)
Operating profit	6	**16.1**	138.8
Operating (loss)/profit before regulatory settlement		**(4.9)**	103.2
Amortisation of regulatory settlement		**21.0**	35.6
Operating profit		**16.1**	138.8
Profit on disposal of fixed assets	6	**1.5**	0.8
Finance income	9	**4.8**	**11.4**
Finance costs	9	**(201.0)**	**(166.4)**
Fair value losses on derivative financial instruments	9	**(669.0)**	**(346.1)**
Net finance costs	9	**(865.2)**	**(501.1)**
Loss before taxation		**(847.6)**	**(361.5)**
Taxation	10	**86.1**	**65.7**
Loss for the financial year		**(761.5)**	**(295.8)**

* Please refer to note 1 for explanation regarding prior year changes.

The notes on pages 207 to 251 form part of these financial statements.

Statement of other comprehensive income

For the year ended 31 March 2022

	Note	2022 £m	2021 £m (Restated)*
Loss for the financial year		**(761.5)**	(295.8)
Other comprehensive (expense)/income:			
Items that cannot be reclassified to profit or loss:			
Actuarial loss on pension scheme	24	**(18.4)**	(70.0)
Movement on deferred tax relating to retirement benefit obligations	23	**13.3**	13.3
Total other comprehensive expense for the year, net of tax		**(5.1)**	(56.7)
Total comprehensive expense for the year attributable to the owner of the company		**(766.6)**	(352.5)

* Please refer to note 1 for explanation regarding prior year changes.

Statement of financial position

As at 31 March 2022

	Note	2022 £m	2021 £m (Restated)*	2020 £m (Restated)*
Non-current assets				
Intangible assets	12	**100.0**	58.6	42.1
Property, plant and equipment	13	**6,712.4**	6,445.0	6,325.7
Investments	14	**29.2**	29.2	29.2
Derivative financial instruments	22	**45.6**	68.2	194.3
Other non-current assets	15	**–**	130.0	130.0
		6,887.2	6,731.0	6,721.3
Current assets				
Inventories	16	**10.2**	6.3	5.1
Trade and other receivables	17	**244.0**	220.7	273.2
Investments	32	**285.0**	–	25.0
Cash and cash equivalents	32	**157.4**	339.5	104.3
		696.6	566.5	407.6
Total assets		**7,583.8**	7,297.5	7,128.9
Current liabilities				
Trade and other payables	18	**(400.7)**	(289.5)	(260.8)
Borrowings	19, 20	**(304.4)**	(29.6)	(709.1)
Lease liabilities	21	**(3.6)**	(2.5)	(2.2)
Regulatory settlement liability	25	**(25.0)**	(24.2)	(35.6)
Provision for liabilities	26	**(1.5)**	(3.9)	(5.1)
		(735.2)	(349.7)	(1,012.8)
Non-current liabilities				
Borrowings	20	**(3,680.1)**	(3,922.1)	(2,808.5)
Lease liabilities	21	**(29.6)**	(27.2)	(28.2)
Derivative financial instruments	22	**(2,188.9)**	(1,500.6)	(1,376.4)
Deferred tax liabilities	23	**(203.0)**	(302.4)	(382.3)
Retirement benefit obligations	24	**(59.9)**	(116.5)	(62.5)
Regulatory settlement liability	25	**(53.8)**	(75.6)	(99.9)
Provision for liabilities	26	**(5.0)**	(4.3)	(4.7)
Other non-current liabilities	27	**(39.3)**	(34.7)	(32.7)
		(6,259.6)	(5,983.4)	(4,795.2)
Total liabilities		**(6,994.8)**	(6,333.1)	(5,808.0)
Net assets		**589.0**	964.4	1,320.9
Equity				
Called up share capital	28	**0.1**	0.1	0.1
Share premium account	29	**437.5**	46.3	46.3
Non-distributable reserve	30	**85.1**	76.9	60.2
Retained earnings	31	**66.3**	841.1	1,214.3
Total equity		**589.0**	964.4	1,320.9

* Please refer to note 1 for explanation regarding prior year changes.

The financial statements of Southern Water Services Limited (Registered no. 02366670) on pages 201 to 251 were approved by the Board and authorised for issue on 15 July 2022. They were signed on its behalf by:

Sebastiaan Boelen
Chief Financial Officer

Statement of changes in equity

For the year ended 31 March 2022

	Note	Called up share capital (note 28) £m	Share premium account (note 29) £m	Non-distributable reserve (note 30) £m	Retained earnings (note 31) £m (Restated)*	Total £m (Restated)*
Balance at 1 April 2020		**0.1**	**46.3**	**60.2**	**1,146.9**	**1,253.5**
Prior year adjustment*		–	–	–	67.4	67.4
Restated as at 1 April 2020		**0.1**	**46.3**	**60.2**	**1,214.3**	**1,320.9**
Profit/(loss) for the financial year		–	–	18.2	(314.0)	(295.8)
Other comprehensive (expense)/income for the year:						
Actuarial loss on pension scheme	24	–	–	–	(70.0)	(70.0)
Movement on deferred tax relating to retirement benefit obligations	23	–	–	–	13.3	13.3
Total comprehensive income/(expense) for the year		**–**	**–**	**18.2**	**(370.7)**	**(352.5)**
Reserves transfer**		–	–	(1.5)	1.5	–
Equity dividends paid	11	–	–	–	(4.0)	(4.0)
Balance at 31 March 2021		**0.1**	**46.3**	**76.9**	**841.1**	**964.4**
Profit/(loss) for the financial year		–	–	9.9	(771.4)	(761.5)
Other comprehensive (expense)/income for the year:						
Actuarial loss on pension scheme	24	–	–	–	(18.4)	(18.4)
Movement on deferred tax relating to retirement benefit obligations	23	–	–	–	13.3	13.3
Total comprehensive income/(expense) for the year		–	–	**9.9**	**(776.5)**	**(766.6)**
Issue of shares		–	391.2	–	–	391.2
Reserves transfer**		–	–	(1.7)	1.7	–
Equity dividends paid	11	–	–	–	–	–
Balance at 31 March 2022		**0.1**	**437.5**	**85.1**	**66.3**	**589.0**

* Please refer to note 1 for explanation regarding prior year changes.

** The non-distributable reserve arose upon 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 2022

	Note	2022 £m	2021 £m (Restated)*
Cash from operations	32	**235.2**	381.7
Tax paid		**–**	(0.9)
Net cash from operating activities		**235.2**	380.8
Investing activities			
Interest received		**8.9**	6.9
Purchase of property, plant and equipment		**(478.4)**	(344.8)
Purchase of intangible assets		**(34.1)**	(30.4)
Proceeds on disposal of property, plant and equipment		**1.2**	0.5
Acquisition of short-term investments		**(590.0)**	(280.0)
Maturity of short-term investments		**305.0**	305.0
Repayments of inter-company loan receivables		**130.0**	–
Net cash used in investing activities		**(657.4)**	(342.8)
Financing activities			
Equity dividends paid		**–**	(4.0)
Interest paid		**(177.6)**	(113.2)
Net settlements on derivative financial instruments		**45.7**	(94.8)
Repayment of borrowings		**(16.9)**	(696.2)
Repayments of principle on leases		**(2.4)**	(1.8)
Proceeds of new loans		**–**	1,107.2
Proceeds from share issue		**391.3**	–
Net cash generated from financing activities		**240.1**	197.2
Net (decrease)/increase in cash and cash equivalents		**(182.1)**	235.2
Cash and cash equivalents at beginning of the year		**339.5**	104.3
Cash and cash equivalents at end of the year		**157.4**	339.5

* Please refer to note 1 for explanation regarding prior year changes.

Notes to the financial statements

For the year ended 31 March 2022

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 2006. 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 the inside front cover of this report. The nature of the company's operations and its principal activities are set out in the Strategic Report on pages 21 to 124.

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 IFRS 16 '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: standards not yet effective, financial instruments, fair value measurement, revenue from contracts with customers, leases, 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.

The company has also elected not to take advantage of the exemption regarding presentation of a statement of financial position as at the beginning of the preceding period following a retrospective accounting policy application or restatement, in order to provide further clarity to support the prior year restatements made in the year as described below.

Notes to the financial statements continued

For the year ended 31 March 2022

1 Accounting policies (continued)

Separate line items on face of income statement

When assessing whether an event should be presented separately on the face of the income statement, management considers the nature, frequency, materiality and the facts and circumstances of each event. Management considers whether there is any precedent, and ensures consistent treatment for both favourable and unfavourable transactions. The fine imposed by the Court in relation to the Environment Agency prosecution is material due to size and incidents and has been separately disclosed.

Adoption of new and revised accounting and financial reporting standards

A number of new standards and amendments are effective for periods beginning from 1 January 2021. Except for the changes noted in the paragraphs below, these changes had no material impact on the company's financial statements.

The IFRS Interpretations Committee (IFRIC) has published two agenda decisions clarifying how arrangements in respect of a specific part of cloud technology, Software-as-a-Service (SaaS), should be accounted for.

In March 2019, the Committee published their agenda decision concluding that SaaS arrangements are likely to be service arrangements, rather than intangible assets under IAS 38 Intangible assets. This is because the customer typically only has a right to receive future access to the supplier's software running on the supplier's cloud infrastructure and therefore the supplier controls the intellectual property (IP) of the underlying software code.

In April 2021, the Committee finalised their agenda decision regarding configuration and customisation costs in implementing SaaS. The guidance clarified that in order for an intangible asset to be capitalised in relation to configuration and customisation costs, it is necessary for there to be control of the underlying software asset or for there to be a separate intangible asset which meets the definition in IAS 38.

The company's previous policy was to capitalise costs relating to SaaS arrangements and is therefore required to implement a change in accounting policy to align with the agenda decisions. A detailed assessment has been carried out by management to determine the amount of costs that are required to be accounted for differently in accordance with the interpretation.

As a result, the company identified £4.5 million of costs relating to SaaS arrangements incurred in the year that would have been capitalised under the previous policy. Of the costs incurred in the year, £3.1 million relating to prepaid charges has been deferred to the balance sheet, resulting in £1.4 million being expensed through the income statement in the year to 31 March 2022.

No prior year restatement has been identified in relation to the change in accounting policy.

Prior year restatements

There has been a presentational change in terms of accounting for movements on derivatives to align with accounting standards. As a result, all movements on derivatives have been presented in a single line in the income statement.

Accordingly, on the income statement, income related to settlements on derivatives of £98.7 million has been reclassified from 'interest receivable on swap instruments' within 'finance income' to 'movements on derivative financial instruments' within 'net finance costs' for the year ended 31 March 2021 reducing total 'finance income' from £110.1 million to £11.4 million and reducing 'movements on derivative financial instruments' from £444.8 million to £346.1 million. There is no impact on overall 'net finance costs' of £496.4 million. In addition, on the cash flow statement, £99.7 million of cash inflows received as a result of settlements on derivatives has been reclassified from 'interest received' within investing activities to 'net settlements on derivative financial instruments' (described as 'payments on derivative instruments' in the prior year) within financing activities within the cash flow statement, thereby reducing 'interest received' from £106.6 million to £6.9 million and reducing the outflow on 'net settlements on derivative financial instruments' from £194.5 million to £94.8 million.

Cash on deposit with a maturity of more than three months from the date of acquisition of £25.0 million as at 1 April 2020 has been reclassified from 'cash and cash equivalents' to 'investments'. As a result, for the year ended 31 March 2021 the net decrease in short term investments of £25.0 million has been reclassified in the cash flow statement from 'cash and cash equivalents' to 'investing activities'. £280.0 million was placed on deposit disclosed as 'acquisition of short-term investments' and £305.0 million matured in the period and is disclosed as 'maturity of short term investments'.

1 Accounting policies (continued)

Prior year restatements (continued)

In the prior year the company recognised an intangible asset and associated liability for the right to receive water in the future after the construction of a reservoir by Portsmouth Water at Havant Thicket and Southern Water has laid a pipe to the reservoir. Following a detailed review of the complex contractual arrangement, and with a better understanding of the contractual terms of the agreement, which require both parties to complete certain activities to enable the water to be provided, the company has formed the judgment that this contract should be accounted for as an executory contract until such time that both parties have fulfilled their obligations and the right to water can be met. As a result, the intangible asset and associated liability of £124.6 million have been reversed in the prior year and the payments made during 2020–21 of £6.5 million have been reclassified from intangible assets to prepayments due after more than one year. Accordingly, there is no impact on the net assets as previously reported in the year ended 31 March 2021, but non-current assets and intangible fixed assets have reduced by £131.1 million, prepayments increased by £6.5 million and contractual obligations reduced by £124.6 million. There is no impact on the profit and loss account or retained earnings for the year ended 31 March 2021. The contract runs for the period from 2021 to 2100 and comprises fixed capacity charge payments as well as volumetric charges for the water to be supplied. The fixed contractual payments over the period from 2021 to 2100 total £658 million and the volumetric charge will be recognised as water is supplied, from 1 April 2029. An annual review of the performance obligations of both parties will be performed to assess whether the contract is an executory contract.

In 2011 the company received consideration for taking on derivative obligations that were 'out of the money' at the time the derivative obligations were transferred. The derivative obligations are used to economically hedge inflation linked debt (hedge accounting is not applied). Under previous GAAP the amount of the consideration was recognised as "deferred credit" within borrowings and amortised to interest cost in the income statement over the life of the associated debt. This deferred credit should have been derecognised on transition to IFRS, but was not. As a result, the prior years have been restated, transferring the value of this deferred credit as at 31 March 2020 totalling £81.0 million (net of deferred tax of £13.6 million) to retained earnings, resulting in a decrease in the carried forward deferred tax liability as at 31 March 2020 of £13.6 million and an increase in retained earnings of £67.4 million. Amortisation of £4.7 million in the year to 31 March 2021 has been removed from the income statement and the deferred balance of £76.3 million removed from borrowings as at 31 March 2021. This transaction also resulted in additional tax credit of £0.9m. The table below shows the impact of these adjustments to the relevant line in the financial statements for the year ended 31 March 2021:

	31 March 2021 As reported £m	Restatement £m	31 March 2021 As restated £m
Current borrowings	(34.3)	4.7	(29.6)
Deferred tax liabilities	(289.7)	(12.7)	(302.4)
Non-current borrowings	(3,993.7)	71.6	(3,922.1)
		63.6	
Finance costs	(161.7)	(4.7)	(166.4)
Tax credit	64.8	0.9	65.7
Retained earnings brought forward	1,146.9	67.4	1,214.3
		63.6	

There has also been a presentational change in the cash flow statement in respect of the company's payments into and movements out of the debt service payments bank account held by the company's subsidiary Southern Water Services (Finance) Limited. In previous years, the movement on this bank account has been included within total movements on inter-company receivables within investing activities however the substance of this movement has now been reassessed as relating to interest paid under IAS 7 'Statement of cash flows' and has been reclassified as such within financing activities in the cash flow statement. As a result, the decrease on this bank account for the year ended 31 March 2021 of £39.4 million representing interest prepaid to Southern Water Services (Finance) Limited in the previous year, has been moved out of 'repayments of inter-company loan receivables' within investing activities and included within financing activities, decreasing 'interest paid' in the year from £152.6 million to £113.2 million.

Notes to the financial statements continued

For the year ended 31 March 2022

1 Accounting policies (continued)

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 on pages 21 to 124.

The directors have undertaken a detailed review of the company's liquidity requirements compared with the cash and facilities available, which includes cash on hand excluding £27.5 million of restricted cash, cash on deposit and the revolving credit facility of £330 million secured until 18 March 2024, 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, and the board approved latest cash flow forecast, 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. This assessment includes the company's ability to raise new finance to repay existing debt and the management of operational cash flows. 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 pages 194 to 200.

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 executive leadership team is considered to be the company's chief operating decision maker. The executive leadership team review all internal management information on a single segment basis and accordingly no segmental information is provided in this report.

Revenue recognition

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.

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.

For provisioning purposes, revenues and outstanding arrears are segmented based on customer characteristics. Since the company 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. 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 2021–22 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.

Water and wastewater services also include the treatment of cesspool and trade effluent waste as well as the provision of bulk water supplies to other water companies.

1 Accounting policies (continued)

Revenue recognition (continued)

Services to developers and third parties

Grants and contributions are also received from developers and third parties in relation to the provision of new infrastructure and/or new connections to the water and/or sewerage network. These 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. The significant components of grants and contributions, and their treatment, are as follows:

New connections

The company considers that the developer requesting the new connection is the customer and that 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.

Income received in advance of the new connection being made is held on the statement of financial position as a receipt in advance.

Infrastructure charges

Infrastructure charges are a developer's contribution to fund future general network reinforcement resulting from the incremental growth in the number of customers served. These charges must be paid by the developer at the point of connection and do not relate to any specific network reinforcement activity.

The company considers that the developer requesting the new connection associated with the infrastructure charge is the customer and that 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 infrastructure charges are recognised at this point.

Requisitions

The company receives contributions from developers towards requisitions of new water mains and public sewers.

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. The contribution receivable is held on the statement of financial position as deferred revenue and subsequently recognised in full as revenue on completion of the requisition works.

Diversions

The company receives contributions from third parties to divert existing water mains and public sewers.

The company considers the requesting party to be the customer in these contracts and the contribution received towards the cost of undertaking the diversion is held on the statement of financial position as deferred revenue and subsequently recognised as revenue on completion of the performance commitment in the contract, in this case on completion of the diversion of the water main or sewer.

Fair value of assets adopted

Infrastructure assets, constructed by a developer, which are contributed to the company for £nil consideration, in exchange for relieving the developer of any future liability, are recognised at fair value of the asset upon adoption. The fair value is based on a valuation provided on the vesting certificate when the asset is transferred into the company's ownership. At the point of legal transfer of the asset, the company has concluded that the performance obligation to the developer, adopting the asset, has been satisfied and the fair value of the asset is recognised as a contribution through revenue at this point.

These 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.

Other contributions

Grants and contributions receivable in respect of other non-current assets where the performance commitment is also delivered over the life of the asset, are treated as deferred income and released to other operating income over the useful economic life of those fixed assets.

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.

Notes to the financial statements continued

For the year ended 31 March 2022

1 Accounting policies (continued)

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 net 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 comprise:

i. Assets in development, generally implementation of IT software.
ii. Other assets – comprising software and development projects.

Intangible assets are measured at cost less subsequent amortisation and any impairment.

Cost

Software acquired separately, or internally generated where a separate resource that is controlled by the company is created, are capitalised at cost.

Capitalised development costs are for plant installed on sites or work undertaken by suppliers to test new processes for performance data and scalability. The data is used to identify innovative and efficient future assets and processes to meet higher environmental or quality standards. Development costs can relate to projects or can be more general such as network modelling or catchment management. General development costs that are capitalised are amortised over five years. Where a development project concludes that there is insufficient chance of success of the related investment, it is amortised in full in the same year.

Costs in respect of development costs are capitalised as an intangible asset where the following criteria are met:

- It is technically feasible to create and make the asset available for use or safe;
- There are adequate resources available to complete the development and to use or sell the asset;
- There is the intention and ability to use or sell the asset;
- It is probable that the asset created will generate future economic benefits; and
- The development costs can be measured reliably.

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Finite life intangible assets are reviewed for impairment where indicators of impairment exist.

1 Accounting policies (continued)

Intangible assets (continued)

Useful economic lives

Amortisation of intangible assets is calculated on a straight-line basis over the estimated useful lives. 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.

Assets in development are not amortised and are transferred to other intangible assets at the point at which they are operational.

Software is amortised over the length of the licence, generally three to five years.

Development costs relating to specific projects are amortised over the life of the related scheme.

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 – prior to completion/commissioning, all capital investment projects are classified as 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'.

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.

Notes to the financial statements continued

For the year ended 31 March 2022

1 Accounting policies (continued)

Property, plant and equipment (continued)

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

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.

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.

Right-of-use assets are depreciated over the shorter period of the lease term and the useful life of the underlying asset. If a lease transfers ownership of the underlying asset or the cost of the right-of-use asset reflects that the company expects to exercise a purchase option, the related right-of-use asset is depreciated over the useful life of the underlying asset.

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.

Leases

The company adopted IFRS 16 'Leases' with effect from 1 April 2019.

The company as lessee

The company assesses whether a contract is, or contains, a lease, at inception of the contract. The company recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets (£5,000 or less). For these leases, the company recognises the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

1 Accounting policies (continued)

Leases (continued)

Lease payments included in the measurement of the lease liability comprise:

- fixed lease payments;
- variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date;
- the amount expected to be payable by the lessee under residual value guarantees;
- the exercise price of purchase options, if the lessee is reasonably certain to exercise the options; and
- payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.

The lease liability is presented as a separate line in the statement of financial position.

The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made.

The company remeasures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever:

- The lease term has changed or there is a significant event or change in circumstances resulting in a change in the assessment of exercise of a purchase option, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate.
- The lease payments change due to changes in an index or rate or a change in expected payment under a guaranteed residual value, in which cases the lease liability is remeasured by discounting the revised lease payments using an unchanged discount rate (unless the lease payments change is due to a change in a floating interest rate, in which case a revised discount rate is used).
- A lease contract is modified and the lease modification is not accounted for as a separate lease, in which case the lease liability is remeasured based on the lease term of the modified lease by discounting the revised lease payments using a revised discount rate at the effective date of the modification.

The company did not make any such adjustments during the year.

The right-of-use assets comprise the initial measurement of the corresponding lease, lease payments made at or before the commencement day and any direct initial costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

Right-of-use assets are depreciated over the shorter period of lease term and useful life of the underlying asset. The depreciation starts at the commencement date of the lease.

The right-of-use assets are presented separately from other assets in the notes to the financial statements.

The company applies IAS 36 to determine whether a right-of-use asset is impaired and accounts for any identified impairment loss as described in the 'Property, Plant and Equipment' policy.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. The company has used this practical expedient with respect to the maintenance element associated with vehicle leases.

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.

Notes to the financial statements continued

For the year ended 31 March 2022

1 Accounting policies (continued)

Current asset investments

Current asset investments comprise cash on deposit with a maturity of more than three months from the date of acquisition.

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, and 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.

Executory contracts

Executory contracts are contracts under which neither party has performed any of its obligations, or both parties have partially performed their obligations to an equal extent. Provisions are not recognised for executory contracts unless they are onerous.

Retirement benefits

SWS operated a defined benefit pension scheme which closed to future accrual on 31 March 2020, 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 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 24.

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 charged and actually paid are shown as either accruals or prepayments in the statement of financial position.

1 Accounting policies (continued)

Financial instruments

IFRS 9 contains requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) impairment for financial assets and 3) general hedge accounting.

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 the 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.

Notes to the financial statements continued

For the year ended 31 March 2022

1 Accounting policies (continued)

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 22.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured 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.

2 Critical accounting judgments and key sources of estimation uncertainty (continued)

Judgments

Critical judgments, apart from those involving estimations, that are applied in the preparation of the financial statements are discussed below:

Revenue recognition in relation to new connections, infrastructure charges, requisitions, diversions and adoptions

As described in note 1 Accounting policies, the company receives income from developers and third parties for new connections, infrastructure charges, requisitions, diversions and adoptions either in cash or, for adoptions, in the form of infrastructure assets.

In selecting its accounting policy for the recognition of revenue from these services, the company uses judgment to determine

- the customer of each contract;
- the performance obligation; and
- whether the service is distinct from the ongoing provision of water and wastewater services.

The company considers that these services are contracts with the developer and not the future occupiers of the property and as such the developer is considered the customer for these services.

The promise to undertake the activity is separately identifiable from any other services that may be being provided to the developer as there is a separate application process and contract for each of these items and once they have been provided the obligation to the developer is complete. The performance obligation is therefore considered to be the completion of the new connection, requisition, diversion or adoption.

As the future network services are readily available to the occupiers of the property, without the need for them to have made the earlier connection-related transactions, the revenue for these services is deemed to be distinct from revenue from the ongoing provision of water and wastewater services and is therefore recognised on completion of the connection-related service.

The future provision of water services are separate contracts with the owner/occupiers of the property at a later date, and the income for these is recognised as that service is consumed.

During the period, the company recognised income from infrastructure assets with a fair value of £9.9 million (2021: £18.2 million), new connections amounting to £4.1 million (2021: £4.0 million) infrastructure charges amounting to £5.2 million (2021: £5.3 million) and requisitions and diversions amounting to £2.5 million (2021: £1.5 million).

Amortisation of regulatory settlement

In 2018–19 an accrual of £135.5 million was recognised for rebates to be made to customers through bills, over the period from 2020 to 2025, as part of a regulatory settlement agreed with Ofwat following its investigation into wastewater treatment compliance, as noted on page 93.

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 was concluded to be to treat the invoice reductions as a reduction in revenue in 2018–19. These rebates are now being made and recorded through revenue, and the accrual made in 2018–19 is being unwound on the face of the income statement, also through revenue, in line with the annual profile of the rebates to be made, which is reassessed annually to provide for fluctuations in the future estimates of inflation. See note 25 for more detail.

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 made when it is judged that it is probable that an obligation exists for which a reliable estimate can be made. Individual matters are considered carefully to assess the likelihood that a pending claim will succeed, or a liability will arise, and the point of recognition for the associated liability.

Matters that are judged to be either possible obligations or do not meet the recognition criteria for a provision are disclosed as contingent liabilities in note 33, unless the possibility of transferring economic benefits is remote.

For all the matters set out in note 33, management judge that it is either not possible to measure reliably the outflow of economic benefit or that settlement is not probable.

Notes to the financial statements continued

For the year ended 31 March 2022

2 Critical accounting judgments and key sources of estimation uncertainty (continued)

Judgments (continued)

Right to receive water from 1 April 2029 from Portsmouth Water

In February 2021 the company entered into a contractual arrangement with Portsmouth Water Limited ('Portsmouth Water'), under which Portsmouth Water will obtain planning permission, design, build, finance, and operate a reservoir in Havant (the Havant reservoir). Once the construction is complete, and Southern Water has laid a pipe, Portsmouth Water will supply, on the request of Southern Water Services Limited, up to 21 million litres of treated water per day from 1 April 2029. Following a detailed review of the complex contractual arrangement, and with a better understanding of the contractual terms of the agreement, which require both parties to complete certain activities to enable the water to be provided, the company has formed the judgment that this contract should be accounted for as an executory contract until such time that both parties have fulfilled their obligations and the right to water can be met. As a result, the accounts for the prior year have been restated as disclosed in note 1. The contract runs for the period from 2021 to 2100 and comprises fixed capacity charge payments as well as volumetric charges for the water to be supplied. The fixed contractual payments over the period from 2021 to 2100 total £658 million and the volumetric charge will be recognised as water is supplied, from 1 April 2029. An annual review of the performance obligations of both parties will be performed to assess whether the contract is an executory contract.

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 capitalises 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.

Climate change

While climate change is a key emerging risk, the company does not currently consider this to represent a material estimation uncertainty for the financial statements. As set out in the risk section of this Annual Report on pages 108 to 120 and the sustainability section on pages 52 to 75, climate change is embedded into everything the company does, and the long-term strategy is focussed on identifying, managing and mitigating climate related risks. Further details are also set out in the company's climate change adaptation report which was published in December 2021.

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. The company does not view the uncertainty around the potential future impact of climate change to indicate that the current useful life policy needs revising. Climate change, and the environment in general, are heavily embedded in the planning stage of asset construction to mitigate future risk.

Key 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:

Derivative financial instruments

Derivative financial instruments are sensitive to changes in interest and inflation rates. The following values illustrate the impact based on a movement of one basis point:

		31 March 2022 (£m)
Net derivative financial instruments		2,143.3
Sensitivity:		
Interest rates - SONIA	+ 0.01%	6.4
Inflation rates - RPI	+ 0.01%	(11.8)

Multiple inflation linked derivatives contain an inflation floor optionality. These floors kick in, in case of a deflation (e.g. less than 0% inflation) over periods specified on a derivative level.

2 Critical accounting judgments and key sources of estimation uncertainty (continued)

Key sources of estimation uncertainty (continued)

Provisions

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 26 and the value provided at 31 March 2022 was £6.5 million (2021: £8.2 million) based on an agreed schedule of works required. The company estimates that actual costs could vary up to +/- 10% due to fluctuations in prices.

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. Given the nature of the balance it is not practical to assess how this estimate will change in the next 12 months.

Sensitivity analysis shows that the measured accrual would vary by £2.0 million and £6.0 million if consumption estimates were between 1% and 3% above or below those predicted. The sensitivities of 1% and 3% illustrate the impact expected to be seen from a change in the level of consumption.

Measured accrual sensitivity analysis	31 March 2022	Sensitivity			
		1%	3%	–1%	–3%
Measured accrual balance (£m)	233.6	2.0	6.0	–2.0	–6.0

The value of household billings raised in the year ended 31 March 2022 for consumption in prior years was £227.9 million. The value of these billings was higher than the accrual made at 31 March 2021 of £214.5 million. The estimation difference was £13.4 million (6.2%) and this has been recognised in the current year's turnover. This difference is higher than normally expected and was driven by the significant change in customer usage patterns, resulting from the response to COVID-19, over the estimation period at March 2021.

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. In general for each segment, forecast cash collection rates are estimated using this range of data and other macro-economic assumptions, which then determines 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. For the year to 31 March 2022 this includes a reflection of the impact of the COVID-19 pandemic to date. The underlying charge to the income statement on this basis was £19.6 million.

To reflect the expected impact that high inflation is having on the macro-economic environment, the company has recognised an additional charge of £10.3 million, for the impairment of trade receivables, to the income statement in 2021–22. This is a significant judgment as the overall impact of the pressure on the cost of living from high inflation is continuing to evolve.

The assessment of the future impact of these economic factors was based on the Ofwat Cost of living survey, published in May 2022. The findings of the survey showed an increase in the proportion of customers expecting to struggle to pay household bills.

The value of the provision for doubtful debts as at 31 March 2022 was £283.9 million (2021: £253.9 million). The actual level of receivables collected may differ from the estimated levels of recovery, which could impact future operating results positively or negatively.

Notes to the financial statements continued

For the year ended 31 March 2022

2 Critical accounting judgments and key sources of estimation uncertainty (continued)

Key sources of estimation uncertainty (continued)

Impairment of trade receivables (continued)

Sensitivity analysis shows that the impairment provision would vary by £2.7 million and £8.1 million if cash collections estimates were between 1% and 3% above or below those predicted. The sensitivities of 1% and 3% illustrate the impact expected to be seen from a change in the level of cash collection. The company's experience is that cash collection in general could vary by 3.5% from expectations.

Impairment provision sensitivity analysis	31 March 2022	Sensitivity			
		–1%	–3%	1%	3%
Impairment provision estimate (£m)	283.9	2.7	8.1	–2.7	–8.1

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 £18.4 million (2021: loss of £70.0 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 the CMI 2021 model with a smoothing factor of 7.5 and a 1.25% p.a. 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 24 of the financial statements.

3 Changes in significant accounting policies

A number of new standards and amendments are effective for periods beginning from 1 January 2021. These changes had no material impact on the company's financial statements.

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 executive leadership team is considered to be the company's' chief operating decision maker. The executive leadership 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:

	2022 £m	2021 £m (Restated)*
Water and sewerage services:		
Household – measured	**542.5**	512.6
Household – unmeasured	**113.8**	110.6
Non-household – measured	**110.2**	99.1
Non-household – unmeasured	**4.0**	4.0
Total water and sewerage services	**770.5**	726.3
Bulk supplies	**5.4**	4.5
Infrastructure charge receipts	**5.2**	5.3
Trade effluent	**7.6**	7.5
Cesspools	**5.8**	5.2
New connections	**4.1**	4.0
Adoptions (see note (a) below)	**9.9**	18.2
Other services	**15.0**	13.2
Total revenue before amortisation of regulatory settlement	**823.5**	784.2
Amortisation of regulatory settlement (see note (b) below)	**21.0**	35.6
Total revenue	**844.5**	819.8
Other operating income (see note (c) below)	**1.8**	1.7
Profit on disposal of fixed assets	**1.5**	0.8
Interest receivable (note 9)	**0.8**	1.9
Interest revenue from Southern Water Services Group Limited	**4.0**	9.5
Total income	**852.6**	833.7

* Figures have been restated to show £1.2 million previously included within Non-household –measured as Household – measured. Total revenue from water and sewerage services for the year to 31 March 2021 remains as previously stated.

(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) The company co-operated with Ofwat in relation to its investigation into the management, operation and performance of its wastewater treatment works.

To ensure that 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. These rebates are now being made and recorded through the water and sewerage services revenue shown above. The provision for these rebates made in the financial statements for 2018–19 is also being released through revenue in line with the annual profile of the rebates to be made.

(c) Other operating income in the current year relates to 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.

Notes to the financial statements continued

For the year ended 31 March 2022

6 Profit for the year

Profit for the year has been arrived at after charging/(crediting):	2022 £m	2021 £m
Depreciation on:		
– Owned assets	**299.0**	270.8
– Leased assets	**3.7**	3.4
	302.7	274.2
Amortisation of intangible assets	**21.4**	13.7
Depreciation and amortisation	**324.1**	287.9
Profit on disposal of fixed assets	**1.5**	0.8
Research and development expenditure	**0.8**	0.6
Rentals under operating leases (see note (a) below):		
– Properties	**0.2**	0.1
– Vehicles	**2.9**	1.7
Employee costs (note 7)	**74.8**	67.6
Amortisation of grants and contributions (see note 27)	**(1.7)**	(1.4)
Fees payable to the company's auditor in respect of:		
– statutory audit of the company's financial statements	**0.5**	0.5
– other services pursuant to legislation (see note (b) below)	**0.1**	0.1
– all other services	**0.1**	0.1

(a) The company adopted IFRS 16 'Leases' with effect from 1 April 2019. Rentals under operating leases comprise payments on leases that have been assessed as short-term (12 months or less) agreements and leases of low value assets (£5,000 or less) (see note 1 'Accounting policies' for more information on the company's approach to IFRS 16 'Leases').

(b) Other services pursuant to legislation and other non-audit services primarily relate to regulatory assurance fees.

7 Employee information

			2022 £m	2021 £m (Restated)*
(a)	**Employee costs (including directors' emoluments):**			
	Wages and salaries		**107.6**	96.5*
	Social security costs		**12.3**	10.9
	Pension costs	– Defined contribution	**13.2**	12.5*
		– Defined benefit	**–**	0.2
	Total employee costs		**133.1**	120.1
	Less: charged as capital expenditure		**(58.3)**	(52.5)
	Charged to the income statement		**74.8**	67.6

Employee costs that are charged as capital expenditure are those directly related to the construction or acquisition of assets.

* Figures have been restated to show £4.8 million related to employee salary sacrifice schemes as employer pension contributions (previously included within wages and salaries). Total employee costs for the year to 31 March 2021 remains as previously stated.

(b) Average number of persons employed by activity

The average monthly number of persons (including executive directors) employed by the company during the year was:

	2022 Number	2021 Number
Operations	**1,279**	1,176
Customer services	**35**	37
Corporate centre	**902**	925
	2,216	2,138

8 Directors' emoluments

	2022 £000	2021 £000
Aggregate emoluments (including benefits in kind)	**2,968**	2,428

No retirement benefits accrued to directors (2021: £nil) under a Southern Water Services Limited defined benefit scheme. Retirement benefits of £18,250 accrued to directors (2021: £14,833) under a Southern Water Services Limited defined contribution scheme.

Further details can be found in the Directors' Remuneration Report on pages 176 to 193.

Details of emoluments and benefits for the highest paid director:

	2022 £000	2021 £000
Highest paid director's aggregate emoluments and benefits	**1,402**	1,082

During the year the company made contributions of £4,000 (2021: £4,000) to a money purchase pension scheme in respect of the highest paid director's qualifying services.

9 Net finance income/(costs)

	2022 £m	2021 £m (Restated)*
Finance income		
Interest revenue from Southern Water Services Group Limited	**4.0**	9.5
Deposit income on short-term bank deposits	**0.8**	1.9
	4.8	11.4
Finance costs		
Interest payable on bank loans	**–**	(1.3)
Interest payable on other loans	**(2.1)**	(2.1)
Interest paid to Southern Water Services (Finance) Ltd	**(159.6)**	(168.0)
Indexation	**(46.5)**	(20.5)
Amortisation of issue costs	**(1.5)**	(1.5)
Amortisation of gilt lock proceeds	**0.1**	0.1
Amortisation of bond premium	**0.7**	0.7
Interest on lease liabilities	**(0.8)**	(0.5)
Other finance expense (note 24)	**(2.3)**	(1.3)
Dividends on preference shares – see note (a) below	**(4.9)**	(4.9)
	(216.9)	(199.3)
Amounts capitalised on qualifying assets	**15.9**	32.9
	201.0	166.4
Fair value losses on derivative financial instruments		
Derivative financial instruments not designated as hedges (note 22)	**(669.0)**	(346.1)
Net finance costs	**(865.2)**	(501.1)

* Please refer to note 1 for explanation regarding prior year changes.

The interest revenue from Southern Water Services Group Limited relates to the long-term loan disclosed in note 15.

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 2.10% to expenditure on such assets (2021: 4.10%).

Dividends on preference shares

(a) Dividends due to Class B preference shareholders of £70 per share totalled £4.9 million (2021: £4.9 million). Of this amount £nil was paid during the year (2021: £nil) with £4.9 million accrued at 31 March 2022 (2021: £4.9 million). The cumulative balance sheet liability for unpaid preference share dividends at 31 March 2022 was £12.2 million (2021: £7.3 million).

Notes to the financial statements continued

For the year ended 31 March 2022

10 Taxation

	2022 £m	2021 £m (Restated)*
Current tax:		
Current year	–	0.9
Total current tax charge	–	0.9
Deferred tax:		
Origination and reversal of timing differences	(145.4)	(66.6)
Adjustment in respect of prior years	0.1	–
Effect of corporation tax rate change	59.2	–
Total deferred tax credit	(86.1)	(66.6)
Total tax credit	(86.1)	(65.7)

* Please refer to note 1 for explanation regarding prior year changes.

The tax assessed for the year is different to the standard rate of corporation tax in the UK due to the following factors:

	2022 £m	2021 £m (Restated)*
Loss before tax	(847.6)	(361.5)
Tax at the UK corporation tax rate of 19% (2021: 19%)	(161.1)	68.7
Permanent differences	20.7	3.0
Differences between current and deferred tax rates	(5.0)	–
Impact of tax rate changes	59.2	–
Adjustment in respect of prior years:		
Deferred tax	0.1	–
Total tax credit for year	(86.1)	(65.7)

* Please refer to note 1 for explanation regarding prior year changes.

Factors that may affect future tax charges:

In the March 2021 Budget it was announced that legislation will be introduced in Finance Bill 2021 to increase the main rate of UK corporation tax from 19% to 25%, effective 1 April 2023. As the majority of the company's deferred assets and liabilities will reverse after 1 April 2023 the relevant deferred tax balances have been remeasured at the increased corporation tax rate having regard to their reversal profiles. The total deferred tax credit of £86.1 million includes £6.6 million relating to super deductions, calculated at the rate of 25%.

Permanent differences include £17.3 million in relation to the regulatory fine and associated costs not being tax deductible.

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:

	2022 £m	2021 £m
Deferred tax		
Arising on income and expenses recognised in other comprehensive income:		
Tax credit relating to retirement benefit obligations	(3.5)	(13.3)
Deferred tax movement due to rate change	(9.8)	–
Total deferred tax credit recognised in other comprehensive income/(expense)	(13.3)	(13.3)

11 Dividends

	2022 £m	2021 £m
Dividends available for distribution to investors in the ultimate parent company:		
Current year interim dividend	–	–
	–	–
Dividends not available for distribution to investors in the ultimate parent company:		
Current year interim dividend (2021: £37.95 per share)	–	2.1
Current year interim dividend (2021: £32.92 per share)	–	1.9
	–	4.0

The interim dividends of £4.0 million in the prior year to 31 March 2021 were paid to Southern Water Services Group Limited (SWSG). These dividends, along with associated group tax relief of £0.9 million, enabled SWSG to pay £4.9 million of the interest of £9.5 million due to Southern Water Services Limited on an inter-company loan as disclosed in note 15. The inter-company loan was repaid in full in September 2021.

No additional interim or final dividend has been declared for the year ended 31 March 2022 (2021: Interim additional – £nil, final – £nil).

12 Intangible assets

	Externally generated		
	Assets in development £m	Other £m	Total £m
Cost			
At 1 April 2021	22.8	145.1	**167.9**
Additions	50.9	–	**50.9**
Transfers	(36.6)	36.6	**–**
Reclassifications*	8.8	3.5	**12.3**
At 31 March 2022	45.9	185.2	**231.1**
Amortisation			
At 1 April 2021	–	109.3	**109.3**
Charge for the year	–	21.4	**21.4**
Reclassifications*	–	0.4	**0.4**
At 31 March 2022	–	131.1	**131.1**
Net book amount			
At 31 March 2022	45.9	54.1	**100.0**
At 31 March 2021	22.8	35.8	**58.6**

* Reclassifications in the current year relate to assets previously presented as tangible.

Intangible assets, which generally relate to the implementation of computer software, are transferred from assets under development to other intangible assets at the point at which they are deemed operational.

Other intangible assets consists of IT software with a net book value of £51.4 million, and development projects with a net book value of £2.7 million.

The company does not currently have any internally-generated intangible assets.

Included within additions above is £2.9 million (2021: £1.0 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 £3.7 million (2021: £1.6 million).

Notes to the financial statements continued

For the year ended 31 March 2022

13 Property, plant and equipment

	Land & buildings £m	Plant & machinery £m	Infrastructure assets £m	Assets under construction £m	Other £m	Total £m
Cost						
At 1 April 2021	1,597.4	3,684.1	2,887.9	782.2	714.6	**9,666.2**
Additions	–	–	–	582.0	–	**582.0**
Transfers	2.2	439.1	182.5	(674.3)	50.5	**–**
Reclassifications*	–	–	–	(8.8)	(3.5)	**(12.3)**
Disposals	–	(6.3)	(0.5)	–	(10.8)	**(17.6)**
At 31 March 2022	1,599.6	4,116.9	3,069.9	681.1	750.8	**10,218.3**
Depreciation						
At 1 April 2021	845.1	1,646.3	208.7	–	521.1	**3,221.2**
Charge for the year	42.1	172.0	35.1	–	53.5	**302.7**
Reclassifications*	–	–	–	–	(0.4)	**(0.4)**
Disposals	–	(6.3)	(0.5)	–	(10.8)	**(17.6)**
At 31 March 2022	887.2	1,812.0	243.3	–	563.4	**3,505.9**
Net book amount						
At 31 March 2022	**712.4**	**2,304.9**	**2,826.6**	**681.1**	**187.4**	**6,712.4**
At 31 March 2021	**752.3**	**2,037.8**	**2,679.2**	**782.2**	**193.5**	**6,445.0**

* Reclassifications in the current year relate to intangible assets previously presented as tangible.

Freehold land is stated at a cost of £51.7 million at 31 March 2022 and 31 March 2021 and is not depreciated.

The company's interests in land and buildings are almost entirely freehold.

Other property, plant and equipment consists of vehicles with a net book value of £7.8 million, and computer hardware and IT infrastructure with a net book value of £179.6 million.

Included within additions above is £13.0 million (2021: £31.9 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 £241.9 million (2021: £239.2 million).

Leased assets

Right-of-use assets included in the table above are as follows:

	Land & buildings £m	Infrastructure assets £m	Other £m	Total £m
Net book amount at 31 March 2021	15.8	11.4	3.0	30.2
Additions	–	–	6.8	6.8
Depreciation charge for the year	(1.6)	(0.1)	(2.0)	(3.7)
Net book amount at 31 March 2022	**14.2**	**11.3**	**7.8**	**33.3**

14 Investments

Shares in subsidiary Southern Water Services (Finance) Limited	2022 £m	2021 £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 2022:

	Registered Office	Class of share capital	Activity
Southern Water Services (Finance) Limited (SWSF)	Ugland House, PO Box 309, George Town, Grand Cayman	Ordinary (100%)	To raise debt finance
SW (Finance) I plc	Southern House, Yeoman Road, Worthing	Ordinary (100%)	To raise debt finance
SW (Finance) II Limited	Southern House, Yeoman Road, Worthing	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 tax resident 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.

On 13 October 2021, two entities, SW (Finance) I plc and SW (Finance) II Limited, were incorporated as part of the process to remove the Cayman Islands-registered entity, SWSF. Both of the new companies are wholly-owned by Southern Water Services Limited.

On 26 October 2021, the company commenced the process of obtaining lender consents to substitute SW (Finance) I plc and SW (Finance) II Limited as Issuer/Borrower of the Bonds and Artesian loans currently held by Southern Water Services (Finance) Limited and on 26 November 2021, the STID Proposal* in connection with the consent process was approved.

* STID Proposal means a proposal or request made by the Security Group Agent in accordance with the Security Trust and Intercreditor Deed (STID) proposing or requesting the Borrower Security Trustee to concur in making any modification, giving any consent or granting any waiver under or in respect of any Common Document.

15 Other non-current assets

Non-current receivables	2022 £m	2021 £m
Amounts owed by group undertakings	**–**	130.0

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. The loan was fully repaid in September 2021.

16 Inventories

	2022 £m	2021 £m
Raw materials	**6.0**	4.3
Work in progress	**4.2**	2.0
	10.2	6.3

Notes to the financial statements continued

For the year ended 31 March 2022

17 Trade and other receivables

	2022 £m	2021 £m (Restated)*
Trade receivables	**361.3**	334.4
Provision for impairment	**(278.0)**	(247.5)
Net trade receivables	**83.3**	86.9
Loan to Southern Water Services (Finance) Limited	**35.0**	16.9
Other amounts owed by other group undertakings	**10.5**	13.7
VAT recoverable	**13.0**	11.0
Other amounts receivable	**3.6**	7.3
Net accrued income	**75.1**	64.7
Prepayments	**23.5**	20.2
	244.0	220.7

* Please refer to note 1 for explanation regarding prior year changes

Trade receivables comprise balances from contracts with customers where the company has performed some or all of its contractual obligations.

Amounts owed by group undertakings are unsecured, interest-free and settled regularly. All entities are wholly owned within the group.

Prepayments includes a balance of £6.5 million (2021: £6.5 million) in relation to capacity charge payments made to Portsmouth Water Limited in respect of the Havant Thicket reservoir as described in note 1 – accounting policies, note 2 – critical judgments and note 34 – financial commitments.

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:

	2022 £m	2021 £m
At 1 April	**(253.9)**	(216.4)
Net impairment charge	**(29.9)**	(34.8)
Net amounts written back during the year	**(0.1)**	(2.7)
At 31 March	**(283.9)**	(253.9)

At each reporting date, the company evaluates the recoverability of trade receivables and records allowances for impairment of receivables based on experience.

The following table provides information regarding the ageing of receivables that are specifically provided for:

	2022 £m	2021 £m
Current	**–**	0.1
1–2 years	**–**	0.1
2–3 years	**0.1**	0.2
3–4 years	**0.2**	0.6
More than 4 years	**20.8**	14.5
	21.1	15.5

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.

17 Trade and other receivables (continued)

The aged analysis of receivables that were overdue at the reporting date but not individually provided for is as follows:

	2022 £m	2021 £m
Current	**80.0**	72.7
1–2 years	**42.1**	45.5
2–3 years	**38.1**	37.4
3–4 years	**32.8**	33.9
More than 4 years	**122.0**	103.6
	315.0	293.1

The amounts above are reconciled to gross and net receivables in the tables below:

At 31 March 2022	Gross £m	Provision £m	Net £m
Accrued income – not due	**81.0**	**(5.9)**	**75.1**
Trade receivables			
Not due	**25.2**	**–**	**25.2**
Overdue and not specifically provided	**315.0**	**(256.9)**	**58.1**
Overdue and specifically provided	**21.1**	**(21.1)**	**–**
	442.2	**(283.9)**	**158.4**

At 31 March 2021	Gross £m	Provision £m	Net £m
Accrued income – not due	71.1	(6.4)	64.7
Trade receivables			
Not due	25.8	–	25.8
Overdue and not specifically provided	293.1	(232.0)	61.1
Overdue and specifically provided	15.5	(15.5)	–
	405.5	(253.9)	151.6

18 Trade and other payables

	2022 £m	2021 £m
Trade payables	**26.8**	32.4
Amounts owed to group undertakings	**57.0**	51.8
Capital creditors and capital accruals	**189.1**	100.5
Taxation and social security	**3.1**	4.0
Accruals	**91.7**	71.0
Deferred revenue	**33.0**	29.8
	400.7	289.5

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.

Included in deferred revenue above are contract liabilities from contracts with customers where some or all of the performance obligations of the company have not yet been fulfilled of £2.0 million (2021: £1.3 million).

Notes to the financial statements continued

For the year ended 31 March 2022

19 Current borrowings

	Note	2022 £m	2021 £m (Restated)*
Class A £150m – 3.826% index linked 2023	20(ii)	257.1	–
Unamortised debt issuance costs	20(iii)	(1.5)	(1.5)
Bond premium deferred		0.7	0.7
Deferred gilt lock proceeds	20(iv)	0.1	0.1
Other loans from subsidiary Southern Water Services (Finance) Limited	20(v)	30.3	30.3
Class A £60m – 0.000% index linked 2025	20(vi)	10.7	–
Class A £40m – 0.000% index linked 2026	20(vi)	7.0	–
Current borrowings excluding lease liabilities		**304.4**	29.6
Lease liabilities		3.6	2.5
Total current borrowings including lease liabilities		**308.0**	32.1

* Please refer to note 1 for explanation regarding prior year changes.

20 Total borrowings

	Note	2022 £m	2021 £m (Restated)*
Loans from subsidiary Southern Water Services (Finance) Limited:	20(i)		
Class A £350m – 6.202% fixed rate 2029	20(ii)	**348.9**	348.8
Class A £150m – 3.716% index linked 2034	20(ii)	**257.2**	247.7
Class A £35m – 3.716% index linked 2034	20(ii)	**60.0**	57.7
Class A £350m – 6.650% fixed rate 2026	20(ii)	**349.3**	349.1
Class A £150m – 3.826% index linked 2023	20(ii)	**257.1**	247.7
Class A £150m – 5.010% fixed rate 2041	20(ii)	**147.3**	147.2
Class A £200m – 4.510% fixed rate 2052	20(ii)	**197.3**	197.3
Class A £300m – 5.135% fixed rate 2056	20(ii)	**292.8**	292.8
Class A £375m – 2.385% fixed rate 2028	20(ii)	**370.8**	370.2
Class A £450m – 3.010% fixed rate 2037	20(ii)	**443.8**	443.5
Class A £300m – 1.626% fixed rate 2027	20(ii)	**295.3**	294.3
Class A £175m – 2.790% fixed rate 2031	20(ii)	**174.2**	174.1
Class A £75m – 2.970% fixed rate 2036	20(ii)	**74.6**	74.6
Artesian £165m – 4.086% index linked 2033	20(ii)	**283.0**	272.6
Artesian £156.5m – 3.645% index linked 2032	20(ii)	**261.9**	252.2
Total Class A debt from Southern Water Services (Finance) Limited		**3,813.5**	3,769.8
Unamortised debt issuance costs	20(iii)	**(8.4)**	(10.0)
Bond premium deferred		**6.9**	7.5
Deferred gilt lock proceeds	20(iv)	**4.4**	4.5
Other loans from Southern Water Services (Finance) Limited	20(v)	**30.3**	30.3
Total loans and other borrowings from Southern Water Services (Finance) Limited		**3,846.7**	3,802.1
Class A £60m – 0.000% index linked 2025	20(vi)	**36.6**	44.1
Class A £40m – 0.000% index linked 2026	20(vi)	**31.4**	35.7
Class B Preference shares	20(vii)	**69.8**	69.8
Lease liabilities	21	**33.2**	29.7
Total borrowings		**4,017.7**	3,981.4
Included in:			
Current liabilities			
Borrowings	19	**304.4**	29.6
Lease liabilities	21	**3.6**	2.5
		308.0	32.1
Non-current liabilities			
Borrowings		**3,680.1**	3,922.1
Lease liabilities	21	**29.6**	27.2
		3,709.7	3,949.3

* Please refer to note 1 for explanation regarding prior year changes.

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.

Notes to the financial statements continued

For the year ended 31 March 2022

20 Total borrowings (continued)

Notes in respect of the specific instruments on the previous page:

(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 a margin of 0.01% or 0.001%. 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.

The value of the capital and interest elements of the index-linked loans is linked to movements in inflation. The increase in the capital value of index-linked loans during the year of £46.5 million (2021: £20.5 million) has been taken to the income statement as part of finance costs.

(iii) 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 2022 unamortised debt issuance costs amounted to £8.4 million of which £1.5 million represents the short-term amount which is disclosed separately in note 19.

(iv) 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.

(v) 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.

(vi) 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.
Amounts for scheduled repayments due in the year to 31 March 2023 have been shown as current borrowings in the year to 31 March 2022 (note 19).

(vii) The Class B preference shares are redeemable at the option of SWS at any time. At the date of signing these accounts, no plans have been made to redeem these shares.

The 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. The shares were issued at £1,000 per share. Shareholders are entitled to receive dividends at £70 per share.

These dividends are payable on 31 March and 30 September each year. No dividends were paid to the shareholders in the year and at 31 March 2022 the cumulative accrual for unpaid dividends due was £12.2 million (2021: £7.3 million).

20 Total borrowings (continued)

The maturity profile of borrowings disclosed within this note is given below:	2022 £m	2021 £m (Restated)*
Borrowings excluding leases:		
Between one and two years	**17.0**	246.9
Between two and five years	**674.9**	(2.3)
After five years	**2,988.2**	3,677.5
	3,680.1	3,922.1
On demand or within one year	**304.4**	29.6
	3,984.5	3,951.7
Leases:		
Between one and two years	**3.0**	2.9
Between two and five years	**7.0**	5.8
After five years	**19.6**	18.5
	29.6	27.2
On demand or within one year	**3.6**	2.5
	33.2	29.7
Borrowings including leases:		
Between one and two years	**20.0**	249.8
Between two and five years	**681.9**	3.5
After five years	**3,007.8**	3,696.0
	3,709.7	3,949.3
On demand or within one year	**308.0**	32.1
	4,017.7	3,981.4

* Please refer to note 1 for explanation regarding prior year changes.

The company leases various offices and vehicles and has a lease on its outfall pipes.

Vehicle leases have terms of between four and five years. Leases on office buildings have terms of between 15 and 99 years from commencement date. The outfall lease had an initial term of 99 years and commenced on 1 April 1997.

Obligations relating to vehicle leases include some commercial vehicle leases with optional residual value balloon payments due 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.

All lease obligations are denominated in sterling.

The fair value of the company's lease obligations is approximately equal to their carrying amount.

Interest rates are fixed at the contract date. All leases (except outfalls (see note 21)) are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

The company's lease obligations are secured by the lessors' rights over the leased assets disclosed in note 13.

Notes to the financial statements continued

For the year ended 31 March 2022

21 Leases

This note provides information for leases where the company is a lessee.

(i) Amounts recognised in the statement of financial position

The statement of financial position shows the following amounts relating to leases:

	2022 £m	2021 £m
Right of use assets within property, plant and equipment:		
Buildings	**14.2**	15.8
Infrastructure	**11.3**	11.4
Other	**7.8**	3.0
	33.3	30.2
Lease liabilities		
Current	**3.6**	2.5
Non-current	**29.6**	27.2
	33.2	29.7

Additions to the right-of-use assets during the financial year to 31 March 2022 were £6.8 million (2021: £1.1 million).

(ii) Amounts recognised in the income statement

The income statement shows the following amounts relating to leases:

	31 March 2022 £m	31 March 2021 £m
Depreciation charge of right-of-use assets		
Buildings and infrastructure	**(1.7)**	(1.7)
Other	**(2.0)**	(1.7)
	(3.7)	(3.4)
Interest expense (included in finance costs)	**(0.8)**	(0.5)
Expense relating to short-term leases (included in operating costs)	**(3.1)**	(1.8)

(iii) Amounts recognised in the statement of cash flows

	31 March 2022 £m	31 March 2021 £m
Total cash outflow for leases	**(2.4)**	(1.8)

21 Leases (continued)

(iv) The company's leasing activities and how these are accounted for

The company leases various offices and vehicles.

Rental contracts are typically made for fixed periods, but may have extension options.

Contracts may contain both lease and non-lease components. For leases of vehicles for which the company is a lessee, it has elected not to separate lease and non-lease components and instead accounts for these as a single lease component.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowing purposes.

Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the company.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease payments included in the measurement of the lease liability comprise (where applicable):

- fixed lease payments;
- variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date;
- the amount expected to be payable by the lessee under residual value guarantees;
- the exercise price of purchase options, if the lessee is reasonably certain to exercise the options; and
- payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.

Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, the lessee's incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

The company has a lease on its outfall pipes which contains variable lease payments. These payments will increase by RPI every 10 years. The next review date is on 1 April 2022 and the lease expires on 31 March 2096.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs; and
- restoration costs.

Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. If the company is reasonably certain to exercise a purchase option, the right-of-use asset is depreciated over the underlying asset's useful life.

Payments associated with short-term leases of equipment and vehicles and all leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise assets less than £5,000.

Notes to the financial statements continued

For the year ended 31 March 2022

22 Derivative financial instruments

Categories of financial instruments at fair value

	2022 £m	2021 £m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Inflation swaps – not hedge accounted	**45.6**	68.2
Total derivative financial assets	**45.6**	68.2
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Inflation swaps – not hedge accounted	**(2,188.9)**	(1,500.6)
Total derivative financial liabilities	**(2,188.9)**	(1,500.6)

There are no liabilities offset against assets and no assets offset against liabilities where there is no legal right to do so.

Changes in value of financial instruments at fair value	2022 £m	2021 £m
Movements on derivative financial assets at FVTPL	**(22.6)**	(126.1)
Movements on derivative financial liabilities at FVTPL	**(688.3)**	(124.2)
Total movements on derivative financial instruments at FVTPL	**(710.9)**	(250.3)
Realised movements on derivative financial liabilities in the period	**41.9**	(95.8)
Total movements on derivative financial instruments	**(669.0)**	**(346.1)**

The regulatory framework, under which revenues and the Regulatory Capital Value (RCV) are indexed, exposes the company to CPIH inflation risk. The company enters into RPI inflation-linked derivative financial instruments to manage its exposure to that risk.

Under inflation 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.

The nominal value of the interest rate swaps held at 31 March 2022 are shown in the table below:

	Notional £m	Start date	Maturing in	Mandatory break
Lloyds Bank	99.3	2016	2037	–
ING Bank	77.8	2016	2037	–
SMBC Nikko	75.0	2016	2037	–
UBS	75.0	2016	2037	–
Bank of America	50.0	2016	2037	–
National Australia Bank	44.1	2016	2037	–
Banco Santander	20.0	2016	2037	–
JP Morgan	50.0	2017	2056	2029
National Australia Bank	92.1	2017	2039	2025
Banco Santander	13.2	2017	2039	2025
SMBC Nikko	70.2	2017	2039	2025
Lloyds Bank	150.0	2016	2041	–
Alum Bay & NatWest SPV*	89.4	2016	2041	–
Lloyds Bank	50.0	2016	2031	–
NatWest SPV*	9.5	2016	2031	–
BNP Paribas	200.0	2016	2051	–
Alum Bay & NatWest SPV*	185.4	2016	2051	–
Morgan Stanley	250.0	2015	2055	–
Morgan Stanley ILCA	250.0	2015	2055	2025
Alum Bay & NatWest SPV*	206.0	2015	2055	–
Bank of America	150.0	2037	2046	–
Alum Bay & NatWest SPV*	31.9	2037	2046	–
Bank of America	50.0	2037	2046	–
Alum Bay & NatWest SPV*	37.7	2037	2046	–
JP Morgan	441.2	2037	2046	–
Alum Bay & NatWest SPV*	185.1	2037	2046	–

* Series of future inflation payments have been stripped from the bank swaps with the result that nominal to real cash flows occur between company and bank, and the residual inflation cash flows are paid to the SPV. Investors into the SPV are established pension and insurance companies.

22 Derivative financial instruments (continued)

None of the interest rate swaps are due to be repaid in the next 12 months.

Interest rate benchmark reform

A fundamental reform of major interest rate benchmarks is being undertaken globally, including the replacement of some interbank offered rates (IBORs) with alternative nearly risk-free rates (referred to as 'IBOR reform'). The company has exposures to IBORs on its financial instruments that will be reformed as part of these market-wide initiatives. The company's main IBOR exposure at the report date is sterling LIBOR. The alternative reference rate for sterling LIBOR is the Sterling Overnight Index Average (SONIA).

On 5 March 2021, the Financial Conduct Authority announced that panel bank submissions for all LIBOR settings will cease as at 31 December 2021, after which representative LIBOR rates will no longer be available. The company completed the process of amending contractual terms or implementing appropriate fallback provisions in response to IBOR reform by the end of 2021.

The company anticipates that IBOR reform will impact its operational and risk management processes. The main risks to which the company is exposed as a result of IBOR reform are operational. For example, renegotiating borrowing contracts through bilateral negotiation with counterparties, implementing new fallback clauses with its derivatives counterparties, updating contractual terms and revising operational controls related to the reform. Financial risk is predominantly limited to interest rate risk.

23 Deferred tax liabilities

Deferred tax is provided as follows:

	Accelerated tax depreciation £m	Revaluation of financial instruments £m	Retirement benefit obligations £m	Other - timing differences £m	Total £m
At 1 April 2020	568.1	(181.6)	(13.2)	(4.6)	368.7
Prior year adjustment*	13.6	–	–	–	13.6
Restated as at 1 April 2020	**581.7**	**(181.6)**	**(13.2)**	**(4.6)**	**382.3**
Charge/(credit) to income statement (restated)*	9.7	(80.2)	3.7	0.2	(66.6)
Prior year adjustment:					
– Charge/(credit) to income statement	0.2	–	–	(0.2)	–
Credit to other comprehensive income	–	–	(13.3)	–	(13.3)
As restated* 1 April 2021	**591.6**	**(261.8)**	**(22.8)**	**(4.6)**	**302.4**
Charge/(credit) to income statement	(34.2)	(118.2)	6.6	0.4	(145.4)
Prior year adjustment:					
– Charge/(credit) to income statement	0.1	–	–	–	0.1
Credit to other comprehensive income	–	–	(3.5)	–	(3.5)
Effect of change in tax rate:					
– Charge/(credit) to income statement	176.2	(120.0)	4.5	(1.5)	59.2
Credit to other comprehensive income	–	–	(9.8)	–	(9.8)
At 31 March 2022	**733.7**	**(500.0)**	**(25.0)**	**(5.7)**	**203.0**

* Please refer to note 1 for explanation regarding prior year changes.

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:

	2022 £m	2021 £m (Restated)*
Deferred tax liabilities	**733.7**	591.6
Deferred tax assets	**(530.7)**	(289.2)
	203.0	302.4

* Please refer to note 1 for explanation regarding prior year changes.

Notes to the financial statements continued

For the year ended 31 March 2022

24 Retirement benefit obligations

The deficit associated with retirement benefit obligations has decreased to £59.9 million (2021: £116.5 million). The decrease in the deficit over the year is principally due to company contributions over the year, including an additional one-off lump sum contribution of £59.6 million, as well as the increase in AA corporate bond yields, which leads to a higher discount rate and therefore lower liabilities. This is offset to a lesser extent by lower than assumed returns on scheme assets, an increase in the assumed rate of future price inflation, and allowance for actual inflation over the year which was higher than assumed, resulting in higher liabilities.

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 scheme closed to accrual with effect from 31 March 2020.

   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 Pensions 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 outturn 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.

24 Retirement benefit obligations (continued)

2. A second company stakeholder scheme, which is a defined contribution scheme, is available to all employees.

   Contributions made to the defined contribution scheme for the year ended 31 March 2022 amounted to £13.2 million (2021 restated (see note 7): £12.5 million). No contributions were outstanding at the balance sheet date (2021: £1.1 million of contributions were outstanding for payment and were paid on 7 April 2021).

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 2019 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 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:

	2019 **SWPS** % per annum
Return on investments: pre-retirement	FI Gilt curve + 65 bps
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% per annum)	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 2019 actuarial valuation.

The assets of the scheme had a market value of £755.6 million at 31 March 2019. This was sufficient to cover 76% of the scheme's benefits. The weighted average duration of the scheme liabilities is 16 years.

The timing and quantum of future contributions in relation to the deficit were agreed with the Trustees and Pensions Regulator. The first payment was made in November 2018 and payments up to March 2021 totalled £51.4 million. On 1 April 2021 the company made a scheduled contribution of £17.7 million and on 31 March 2022 an additional one-off lump sum deficit contribution of £59.6 million into the Southern Water Pension Scheme covering agreed deficit contributions through to March 2025.

Future contributions will be dependent on levels of RPI, and based on the assumptions made at 31 March 2019 the expected base deficit contributions over the period from 1 April 2025 to 1 April 2029 will be paid annually and total £101.7 million.

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.

Notes to the financial statements continued

For the year ended 31 March 2022

24 Retirement benefit obligations (continued)

The major assumptions used by the actuary are set out in the table below:

	2022 % per annum	2021 % per annum
Price inflation (RPI)	3.50	3.15
Price inflation (CPI)		
– RPI less 1% per annum up to 2030	2.50	2.15
– Equal to RPI after 2030	3.50	3.15
Rate of increase in salaries (no longer applicable following cessation of accrual)	N/A	N/A
Rate of increase of pensions in payment:		
– MIS* members only***	2.50	2.15
– Old section** members only***	3.50	3.15
– New section and ex Final Salary LifePlan (FSLP) (RPI max 5%)***	3.35	3.05
– Post-5 April 1988 Guaranteed Minimum Pension (GMP) (CPI max 3%)***	2.15	1.90
– All sections post-31 March 2013 service (RPI max 2.5%)***	2.25	2.15
Rate of increase for deferred pensions:		
– MIS* members only***	2.50	2.15
– Old section** members only***	3.50	3.15
– New section and ex Final Salary LifePlan (FSLP) (RPI max 5%)***	3.35	3.05
– Post-5 April 1988 Guaranteed Minimum Pension (GMP) (CPI max 3%)***	2.15	1.90
– All sections post-31 March 2013 service (RPI max 2.5%)***	2.25	2.15
Discount rate	2.75	2.15

* 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.
*** Pension increase assumptions allow for caps and floors where appropriate based on a statistical model (the Black Scholes model).

Assumptions regarding future mortality experience are set based on advice, published statistics and experience.

The base mortality tables are unchanged from 2021 and reflect the best estimate basis from the Trustees' 2019 Actuarial Funding Valuation. Improvements rates have been updated to use the most recently available Continuous Mortality Investigation (CMI) model (CMI 2021), using the same smoothing factor of 7.5 and long-term improvement rate of 1.25% as used in 2021.

Assumed future life expectancy at age 65	2022 Years	2021 Years
Currently aged 45:		
Male	24.3	24.3
Female	26.4	26.4
Currently aged 65:		
Male	23.0	23.0
Female	24.9	24.9

24 Retirement benefit obligations (continued)

The assets and liabilities in the scheme and the expected rates of return at 31 March 2022 and 31 March 2021 were:

	Value at 2022 £m	Value at 2021 £m
Equities	200.5	197.1
Government bonds	151.3	173.1
Non-government bonds	348.0	367.3
Cash	79.6	34.0
Total market value of plan assets	779.4	771.5
Total value of plan liabilities	(839.3)	(888.0)
Accrued deficit in the plan	(59.9)	(116.5)
Related deferred tax asset	25.0	22.8
Net retirement benefit obligations	(34.9)	(93.7)

The equity investments and bonds which are held in plan assets are quoted and are valued at the current bid price. The equity holding quoted includes a number of small holdings in other return seeking assets (such as hedge funds, DGF etc). The government bond and cash allocation set out above includes £158.9 million held in a Liability Driven Investment (LDI) portfolio to mitigate interest rate risks arising from the liabilities.

Reconciliation of the present value of the scheme liabilities	2022 £m	2021 £m
At 1 April	888.0	840.1
Past service cost	–	0.2
Interest expense	18.6	19.3
Experience loss/(gain) on liabilities	22.7	(15.8)
Actuarial (gain)/loss on liabilities:		
– due to changes in demographic assumptions	(0.8)	0.2
– due to changes in financial assumptions	(48.0)	114.1
Benefits paid	(41.2)	(70.1)
Scheme liabilities at 31 March	839.3	888.0

Sensitivity analysis of the scheme liabilities

The sensitivity of the present value of the scheme liabilities to changes in the major assumptions used is set out below:

	Change in assumption	Impact on scheme liabilities £m
Discount rate	+0.1% p.a.	(12.7)
	-0.1% p.a.	13.0
Price inflation (RPI measure)*	+0.1% p.a.	9.3
	-0.1% p.a.	(9.2)
Mortality	+1 year	35.5
	-1 year	(34.0)

* These movements have been calculated assuming that changes in the inflation assumption affect all inflation-linked assumptions.

The above sensitivity analysis illustrates the impact expected to be seen from reasonably possible changes of the respective assumptions occurring at the end of the reporting period, 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.

Notes to the financial statements continued

For the year ended 31 March 2022

24 Retirement benefit obligations (continued)

Reconciliation of the value of the scheme assets	2022 £m	2021 £m
At 1 April	771.5	777.6
Interest income	16.3	18.0
Return on assets (less)/greater than discount rate	(44.5)	28.5
Employer contributions	77.3*	17.5
Benefits paid	(41.2)	(70.1)
Bid value of scheme assets at 31 March	**779.4**	**771.5**

The net return on scheme assets was a loss of £28.2 million (2021: return of £46.5 million).

* On 31 March 2022 the company made an additional one-off lump sum deficit contribution of £59.6 million into the Southern Water Pension Scheme.

Total cost recognised as an expense	2022 £m	2021 £m
Past service cost	–	0.2
Net interest cost	2.3	1.3
Total income statement expense before deduction for tax	**2.3**	**1.5**

Analysis of the amounts recognised in other comprehensive income	2022 £m	2021 £m
Loss/(gain) due to liability experience	22.7	(15.8)
(Gain)/loss due to changes in demographic assumptions	(0.8)	0.2
(Gain)/loss due to changes in financial assumptions	(48.0)	114.1
Return on plan assets greater than discount rate	44.5	(28.5)
Total loss recognised in OCI before adjustment for tax	**18.4**	**70.0**

The cumulative amount of actuarial losses recognised in other comprehensive income is £256.1 million (2021: £237.7 million).

Analysis of the movement in the scheme deficit during the year	2022 £m	2021 £m
Deficit in the scheme at 1 April	(116.5)	(62.5)
Employer's contributions	77.3	17.5
Employer's past service cost	–	(0.2)
Financing charge	(2.3)	(1.3)
Actuarial loss	(18.4)	(70.0)
Deficit in the scheme at end of year	**(59.9)**	**(116.5)**

25 Regulatory settlement liability

	2022 £m	2021 £m
At 1 April	99.8	135.5
Settlements in year	(23.9)	(35.7)
Reassessment of provision for changes in future inflation estimates	2.9	–
At 31 March	**78.8**	**99.8**

Included in:	2022 £m	2021 £m
Current liabilities	25.0	24.2
Non-current liabilities	53.8	75.6
	78.8	99.8

25 Regulatory settlement liability (continued)

In 2018–19 Ofwat concluded its investigation in relation to the management, operation and performance of the company's wastewater treatment works. That investigation resulted in Ofwat taking enforcement action. Ofwat issued Southern Water with a financial penalty amounting to £3.0 million as published on its website. To ensure that customers are not disadvantaged as a result of these matters, the company agreed to make direct customer rebates totalling £122.9 million in 2017–18 prices over the period 2020–25 reflecting the seriousness of the breaches identified in the investigation. These amounts have been provided for in the financial statements at outturn prices and are reassessed each year to account for the impact of inflation. After reassessment at 31 March 2022, the profile for release of the provision is as follows:

Year Ending:	2020/21	2021/22	2022/23	2023/24	2024/25	Total
AMP6 Bill Rebate (2017/18 CPI real)	33.54	22.33	22.33	22.33	22.33	122.86
Inflation	2.21	1.60	2.70	4.30	4.85	15.66
Provision (Nominal)	35.75	23.93	25.03	26.63	27.18	138.52

The company has given a number of formal undertakings to Ofwat in relation to the numerous measures that have been put in place and are being put in place to ensure that the issues identified in the investigation have ceased and cannot be repeated.

26 Provisions for liabilities

	Environmental obligations £m	Other £m	Total £m
Balance 1 April 2020	5.8	4.0	**9.8**
Utilised in year	(0.8)	(1.5)	**(2.3)**
Increase in year	0.7	–	**0.7**
Balance 1 April 2021	5.7	2.5	**8.2**
Utilised in year	(1.0)	(2.5)	**(3.5)**
Increase in year	1.8	–	**1.8**
Balance at 31 March 2022	**6.5**	**–**	**6.5**

Included in:	2022 £m	2021 £m
Current liabilities	**1.5**	3.9
Non-current liabilities	**5.0**	4.3
	6.5	8.2

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.

Other provisions at 31 March 2021 included £1.5 million relating to the payment of compensation for missed appointments under the Guaranteed Standards of Service Scheme. All payments have now been made and the provision fully released as at 31 March 2022.

Also included in other provisions at 31 March 2021 was £1.0 million relating to the Environment Agency investigation (further explanation below) which has now been paid.

Environment Agency

The company has been subject to a detailed investigation regarding permit breaches at some of its wastewater treatment works during the period 2010–15.

On 9 July 2021, the company was sentenced and fined £90.0 million plus £2.5 million of costs for these historic offences against the previous provision of £1.0 million made in the year to 31 March 2020, giving rise to a charge to the income statement in the period of £91.5 million. As a result, provisions for liabilities relating to this Environment Agency investigation are now £nil (31 March 2021: £1.0 million).

The company is seeking to work proactively with the Environment Agency to resolve its separate investigation into sampling compliance and reporting issues for the period 2013 to 2017 (inclusive). The Board has concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from this separate investigation and further details are provided in note 33 Contingent liabilities, to these accounts.

Notes to the financial statements continued

For the year ended 31 March 2022

27 Other non-current liabilities

	Grants & contributions £m	Deferred Revenue £m	Total £m
Balance at 1 April 2021	22.0	12.7	**34.7**
Increase in year	6.6	–	**6.6**
Released to income statement	(1.7)	(0.3)	**(2.0)**
Balance at 31 March 2022	**26.9**	**12.4**	**39.3**

Grants and contributions relate to property, plant and equipment.

Deferred revenue of £12.4 million (2021: £12.7 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.

28 Called up share capital

Equity shares	2022 £000	2021 £000
Authorised :46,050,000 ordinary shares of £1 each	**46,050**	46,050
Allotted and fully paid: Ordinary shares of £1 each		
At 1 April	**56**	56
Issued for cash	**56**	–
At 31 March	**112**	56

Non-equity shares	2022 £000	2021 £000
Issued: Preference shares		
69,829 (2021: 69,829) Class B shares of £1 each	**70**	70

On 8 September 2021, 56,000 ordinary shares with aggregate nominal value of £56,000 were issued at £6,987.18 each to SWS Holdings Limited. The premium arising on issue amounts to £391.2 million and is shown in note 29. See note 35 for further detail.

The redeemable preference shares are presented as a liability (see note 20) at an amount of £69.8 million including share premium of £69.7 million and accordingly are excluded from called up share capital in the balance sheet. The total statutory company share premium of £507.2 million (2021: £116.0 million) includes ordinary share premium of £437.5 million (2021: £46.3 million).

29 Share premium account

	2022 £m	2021 £m
Equity share premium		
At 1 April	**46.3**	46.3
Issued for cash	**391.2**	–
Balance at 31 March	**437.5**	46.3

On 8 September 2021, 56,000 ordinary shares with aggregate nominal value of £56,000 were issued at £6,987.18 each to SWS Holdings Limited. The premium arising on issue amounts to £391.2 million. See note 35 for further detail.

30 Non-distributable reserve

	£m
Balance at 1 April 2020	60.2
Profit for the financial year	18.2
Transfer to retained earnings	(1.5)
Balance at 1 April 2021	76.9
Profit for the financial year	9.9
Transfer to retained earnings	(1.7)
Balance at 31 March 2022	**85.1**

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.

31 Retained earnings

	£m
Balance at 1 April 2020	1,146.9
Prior year adjustment*	67.4
Restated at 1 April 2020	1,214.3
Equity dividends paid	(4.0)
Loss for the financial year*	(314.0)
Other comprehensive loss for the year	(56.7)
Transfer from non-distributable reserve	1.5
Balance at 1 April 2021	841.1
Equity dividends paid	–
Loss for the financial year	(771.4)
Other comprehensive loss for the year	(5.1)
Transfer from non-distributable reserve	1.7
Balance at 31 March 2022	**66.3**

* Please refer to note 1 for explanation regarding prior year changes.

Notes to the financial statements continued

For the year ended 31 March 2022

32 Notes to the statement of cash flows

	2022 £m	2021 £m (Restated)*
Operating profit	**16.1**	138.8
Adjustments for:		
Fair value of sewer adoptions	**(9.9)**	(18.2)
Depreciation of property, plant and equipment	**302.7**	274.2
Amortisation of intangible assets	**21.4**	13.7
Difference between pension charge and cash contributions	**(77.3)**	(17.3)
Receipt of grants and contributions	**6.6**	3.8
Amortisation of grants and contributions	**(1.7)**	(1.4)
Operating cash flows before movements in working capital	**257.9**	393.6
Increase in inventories	**(3.9)**	(1.2)
(Increase)/decrease in receivables	**(13.1)**	15.7
Increase in payables	**17.0**	10.9
Decrease in regulatory settlement liability	**(21.0)**	(35.7)
Decrease in provisions	**(1.7)**	(1.6)
Cash from operations	**235.2**	381.7
Tax paid	**–**	(0.9)
Net cash from operating activities	**235.2**	380.8

* Please refer to note 1 for explanation regarding prior year changes.

On 31 March 2022 the company made an additional one-off lump sum deficit contribution of £59.6 million into the Southern Water Pension Scheme.

Cash and cash equivalents	2022 £m	2021 £m
Cash and short-term bank deposits	**157.4**	339.5

Cash and cash equivalents comprise cash and short-term bank deposits and include £27.5 million of restricted cash to satisfy availability of funds as required by the terms of the securitisation. 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 statement of cash flows as cash flows from financing activities.

Analysis of net debt (including changes in liabilities from financing activities)	At 1 April 2021 £m (Restated)*	Cash flow changes £m	Fair value adjustments £m	New leases £m	Other non-cash changes £m	At 31 March 2022 £m
Cash and cash equivalents	339.5	(182.1)	–	–	–	**157.4**
Net liabilities from financing activities:						
Term facilities/index linked loans (note 20)	(79.8)	16.9	(5.1)	–	–	**(68.0)**
Loans from subsidiary (note 20)	(3,802.1)	–	(43.8)	–	(0.8)	**(3,846.7)**
Lease liabilities (note 20, 21)	(29.7)	2.4	–	(5.9)	–	**(33.2)**
Redeemable preference shares (note 20)	(69.8)	–	–	–	–	**(69.8)**
Net interest rate swaps (note 22)	(1,432.4)	(45.7)	(665.2)	–	–	**(2,143.3)**
Total liabilities from financing activities	(5,413.8)	(26.4)	(714.1)	(5.9)	(0.8)	**(6,161.0)**
Net debt	(5,074.3)	(208.5)	(714.1)	(5.9)	(0.8)	**(6,003.6)**

* Please refer to note 1 for explanation regarding prior year changes.

Other non-cash changes to loans from subsidiary of £0.8 million relate to the amortisation of loan issue costs, bond premium, and gilt-lock proceeds.

32 Notes to the statement of cash flows (continued)

Balances at 31 March 2022 comprise:	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m	Total £m
Cash and cash equivalents	–	157.4	–	–	**157.4**
Derivative financial instruments	45.6	–	–	(2,188.9)	**(2,143.3)**
Unamortised debt issuance costs	–	–	1.5	6.9	**8.4**
Gilt-lock proceeds	–	–	(0.1)	(4.3)	**(4.4)**
Borrowings due within one year	–	–	(305.8)	–	**(305.8)**
Borrowings due after one year	–	–	–	(3,682.7)	**(3,682.7)**
Leases	–	–	(3.6)	(29.6)	**(33.2)**
Net debt	45.6	157.4	(308.0)	(5,898.6)	**(6,003.6)**

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).

Cash and cash equivalents (which are presented as a single class of assets on the face of the statement of financial position) comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less , and excludes cash on deposit with a maturity of more than three months from the date of acquisition which are shown as current asset investments in the statement of financial position.

33 Contingent liabilities

There are currently two significant ongoing investigations being conducted by the Environment Agency of which one is also being considered by Ofwat.

As has been reported previously, the company continues to assist the EA in its investigation into legacy issues relating to wastewater sampling compliance for the period 2013 to 2017. This investigation is ongoing and there have not been any significant developments during the year. It is unknown when the investigation stage will be concluded, and if or when any charges against the company are likely, or how many charges may be brought, or how any specific charges might be framed. As the investigation is ongoing, and as the EA has not stated what its intentions are so far as the next steps in the investigation are concerned, the Board has concluded that it is not yet possible to make a reliable estimate of any financial obligation that may arise from this investigation, or its timing (which could be several months or years), but will keep the situation under review.

As has been reported in the media, in November 2021 the Environment Agency and Ofwat launched an investigation into sewage treatment works belonging to all water and wastewater companies in England and Wales. In March 2022, Ofwat opened enforcement cases into six water companies (not Southern Water). However, all water and wastewater companies in England and Wales remain subject to their ongoing investigation as they continue to review the information they have gathered. As the investigations are ongoing, and as neither the EA nor Ofwat have stated what their intentions are so far as the next steps in the investigations are concerned, the Board has concluded that it is not yet possible to make a reliable estimate of any financial obligation that may arise from these investigations, or its timing (which could be several months or years), but will keep the situation under review.

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

As well as the ongoing EA and Ofwat investigations, companies of the size and scale of Southern Water Services Limited are sometimes subject to civil claims, disputes and potential litigation. 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.

Notes to the financial statements continued

For the year ended 31 March 2022

33 Contingent liabilities (continued)

There is an ongoing claim in respect of property search income going back six years. A number of property search companies claim the return of amounts paid in respect of CON29DW water and drainage search reports, which they allege should have been provided to them either free of charge or for a nominal fee in accordance with the Environmental Information Regulations. It is a highly complex group action against multiple defendants across the sector, with many legal, factual, and evidential issues to be resolved. It is proceeding in phases, with the stage 1 trial expected in late 2023, and it is not anticipated to be concluded for several years. The Board has concluded that it is not yet possible to make a reliable estimate of any financial obligation that may arise from this claim, or its timing, but will keep the situation under review.

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 period end (2021: £nil).

34 Financial commitments

(a) Capital commitments are as follows:

	2022 £m	2021 £m (Restated)*
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	**1,179.0**	518.0
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	**22.3**	15.5
Right to receive water from Portsmouth Water Limited[1]	**658.0**	658.0

* Please refer to note 1 for explanation regarding prior year changes.

1 In February 2021 the company entered into a contractual arrangement with Portsmouth Water Limited ('Portsmouth Water'), under which after constructing the reservoir, and Southern Water have laid a pipe, Portsmouth Water will supply Southern Water with 21 million litres of water a day from 1 April 2029 as part of the development of the Havant Thicket Reservoir in Portsmouth Water's supply area. The contract runs for the period from 2021 to 2100 and comprises fixed capacity charge payments as well as volumetric charges for the water to be supplied. The present value of the fixed contractual payments, which total £658 million over the period to 2100, using a discount rate of 4.98%, being the nominal return on capital allowed per the PR19 final determination, is £130.8 million at 31 March 2022 (2021: £124.6 million). The volumetric charge will be recognised as water is supplied, from 1 April 2029.

(b) The company as lessee

	2022 £m	2021 £m
Lease payments under operating leases recognised as an expense in the year	**3.1**	1.8

As at 31 March 2022 and 2021, the company had no outstanding commitments for future minimum lease payments under non-cancellable operating leases in respect of vehicles and land and buildings.

Operating leases are charged to the income statement over the lease term and comprise short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets (£5,000 or less).

35 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 consortium of investors owning Greensands Holdings Limited (GSH) are considered to be related parties of the company as they each have the ability to influence the financial and operating policies of both the company and the group. Other related parties comprise key management personnel.

On 8 September 2021, under an agreement reached with the GSH's existing shareholders, a fund managed by Macquarie Asset Management acquired a majority stake in GSH, investing £1 billion of equity to recapitalise and implement a more sustainable financing strategy for the Greensands group.

The capital injection will enable the company to invest significantly to upgrade its assets with £2 billion to be invested over the next four years of the current regulatory period.

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.

36 Post balance sheet events

In December 2021, it was announced that Chief Financial Officer Sebastiaan Boelen would be retiring from office. He will step down in July 2022. In April 2022, it was announced that Nadim Ahmad would join the company and assume the role of Interim Chief Financial Officer upon retirement of Sebastiaan Boelen.

In February 2022 the company announced Chief Executive Officer Ian McAulay's intention to retire. In June 2022, it was announced that Lawrence Gosden had been appointed as the company's new Chief Executive Officer with effect from 1 July 2022.

Independent Auditor's report

to the members of Southern Water Services Limited

Report on the audit of the financial statements

1. 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 2022 and of its 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 comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- the statement of cash flows; and
- the related notes 1 to 36.

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.

2. 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.

3. Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Expected credit loss provision for bad and doubtful debts; • Revenue recognition – valuation of unbilled water accrual; • Valuation of capitalised overheads and capitalisation of enhancement expenditure; and • Valuation of financial instruments. Within this report, key audit matters are identified as follows: Newly identified Increased level of risk Similar level of risk Decreased level of risk
Materiality	The materiality that we used in the current year was £11.6 million which was determined on the basis of 3% of the Earnings before Interest, tax, depreciation and amortisation ('EBITDA') adjusted for the fine incurred of £90m as a result of the conclusion of the Wastewater Treatment Works criminal case in July 2021.
Scoping	Audit work to respond to the risk of material misstatement was performed directly by the audit engagement team.
Significant changes in our approach	Following the conclusion of the Wastewater Treatment Works criminal case, we no longer consider the litigation and claims associated with the wastewater plants to be a key audit matter.. Due to significance of balance and material fluctuations in current year due to external market factors we have considered valuation of financial instruments to be key audit matter in current year.

4. Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- Obtained an understanding of relevant controls related to the management assessment of going concern;
- Obtained third party bank confirmation for the group's bank accounts, which confirmed cash balances and borrowings;
- Inspected the revolving credit facility agreement
- Assessed the reasonableness of the cash flows projections;
- Performed integrity checks of management's going concern model, including checking for mathematical and clerical accuracy;
- Recalculated debt covenants and assessed compliance over the forecasted period, including consideration of the waiver from its Lenders in February 2021 ;
- Evaluated and challenged management's stress tests;
- Evaluated the appropriateness of management's identified mitigating actions;
- Evaluated the company's ability to raise debt finance in light of similar transactions in the market place; and
- Assessed the appropriateness of the disclosures over going concern included within the financial statements.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least 12 months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

5. 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.

Independent Auditor's report continued

to the members of Southern Water Services Limited

5.1. Expected credit loss provision for bad and doubtful debts

Key audit matter description

At 31 March 2022, the company held a bad debt provision of £283.8 million (2021: £253.9 million) and accrued a bad debt charge during the year of £29.9 million (2021: £34.8 million), which includes a reversal of the manual Covid-19 overlay provision of £8.6 million (2021: £7.4 million), initially recognised in FY20 and the recognition of an affordability overlay of £10.3 million (2021: £0) to take account of the impact of the current macroeconomic environment on customers' ability to pay which is not reflected in the historic data used to determine the value of the overall credit loss provision.

The bad debt provision represents 70.6%, or 68.0% excluding the manual overlays, of the gross receivables amount (2021: 68.0%, or 65.7% excluding the manual overlays).

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 bad debt provision is a key area of judgement and is based on assumptions made on the forecast collectability of debts across both invoiced amounts and accrued revenues.

We focused our work on the estimation of the bad debt provision on the following areas:

- The accuracy of customer data included within the aged debt report, specifically whether customer data has been correctly classified based on the age of debt; and
- The reasonableness of the cash collection assumptions made by management, including the impact of Covid-19.

Further details are included within the Audit Committee report on pages 169 to 173, 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 relevant controls around bad debt provisioning;
- used data analytics to recalculate, using the data inputs, the provision computed by theprovisioning model;
- tested the completeness and accuracy of the data used in the provisioning model;
- challenged the completeness of the non-model based provision balance through evaluating the reasonableness of the provisioning rates using historical trends and checking for consistency with FY21;
- used the cash collection performance in the year against current year billing, prior year and budgets to evaluate the completeness of the provision;
- challenged management's basis of affordability adjustment and data sources used for calculating overlay, particularly, in context of corelation between macroeconomic factors with historic bad debt trends and cash collection trends of the current and comparative periods; and
- assessed the overall bad debt provision and overlay adjustment by benchmarking against peer companies and reviewing post year end cash collection performance.

Key observations

We are satisfied that management's methodology for assessing impairment of trade receivables is reasonable and have been applied appropriately.

5.2. Revenue recognition – valuation of unbilled water accrual

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 2022 is £246.0 million (2021: £224.3 million).

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 of 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 pages 169 to 173, 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 the relevant controls around valuation of unbilled water accrual;
- for a sample of customers where revenue is accrued, recalculated the accrual based on the billing and consumption patterns over the last three years derived from meter readings and historical billing;
- performed analytical review procedures to assess accuracy and reasonableness of unbilled water accrual;
- for a sample of customers where payments have been received in advance, tested the payment received to bank statement; and
- performed a retrospective review of historical accuracy of the estimate.

Key observations

We are satisfied that management's estimates in relation to the recognition of unbilled revenue are appropriate.

5.3. Valuation of capitalised overheads and capitalisation of enhancement expenditure

Key audit matter description

The company continues to invest significantly in infrastructure renewal and replacement, with property, plant and equipment additions, of £582.2 million (2021: £393.5 million) in the year that includes £61.4 million (2021: £59.5 million) 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.

Further details are included within critical accounting estimates and judgements note (note 2) and in note 13 to the financial statements.

Independent Auditor's report continued

to the members of Southern Water Services Limited

How the scope of our audit responded to the key audit matter	We have: • obtained an understanding of the relevant controls around the valuation of capitalised overheads and capitalisation of enhancement expenditure; and • challenged the appropriateness of the company's capitalisation policies and its approach to determining which costs should be capitalised, and tested whether these policies are being followed. For classification of expenditure, we have: • inspected supporting documents to assess whether the additions are classified in accordance with the nature of the cost, the company's policies and in accordance with IAS 16 'Property, plant and equipment'. For capitalisation of overheads, we have: • tested the accuracy of a sample of overhead costs; • checked the appropriate classification of costs in the general ledger; • evaluated the estimates used in determining the value of the cost that is directly attributable to the construction of an asset; and • assessed the consistency of application of the method of estimation with FY21.
Key observations	We consider that the valuation of additions to property, plant and equipment and capitalisation of overheads to capital expenditure are appropriate.

5.4 Valuation of financial instruments

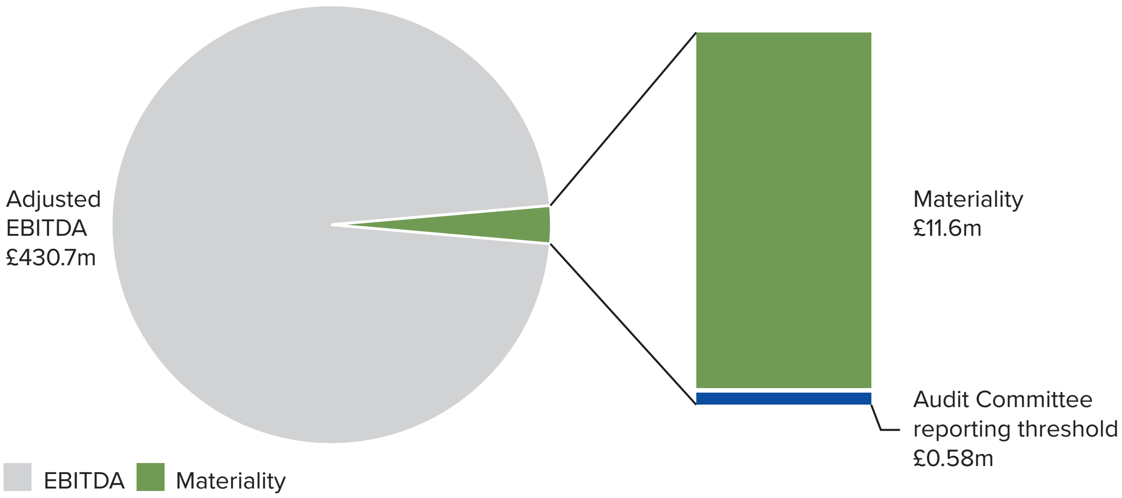
Key audit matter description	The company has both fixed interest rate and floating interest rate debt and the overarching aim of the inflation-linked derivative financial instruments (interest rate swaps) is to manage its exposure to the inflation risk. Due to significance of balance and material fluctuations in current year due to external market factors we have considered valuation of financial instruments to be key audit matter in current year. The company measures the derivative financial instruments at fair value through profit and loss, and the fair value is determined based on quoted prices adjusted for credit risk. Credit risk is computed in line with market practice. The fair value of the derivative liabilities was £2,188.9m (FY21: £1,500.6m) and the fair value of the derivative asset was £45.6m (FY21: £68.2m). We have identified a potential risk for material misstatement in the valuation of the financial instruments as the valuation requires management's judgement. Further details are included in note 22 to the financial statements.
How the scope of our audit responded to the key audit matter	We have: • obtained an understanding of the relevant controls around valuation of financial instruments; • involved internal financial instruments specialist to recalculate the risk free valuation of the derivative financial instruments; • challenged the credit risk adjustment through determining an independent range for the credit risk adjustment and assessing whether management's adjustment is within a reasonable range; • obtained independent counterparty confirmations to assess the completeness of financial instruments; and • assessed the appropriateness of the disclosure requirements in accordance with the requirements of IFRS 9: Financial Instruments, IFRS 17: Financial Instruments: Disclosures and IFRS 13: Fair Value Measurement.
Key observations	We are satisfied that management's valuation of derivative financial instruments is appropriate.

6. 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	£11.6m (2021: £11.8m)
Basis for determining materiality	3% of 'EBITDA' adjusted for the fine incurred of £90m as a result of the conclusion of the Wastewater Treatment Works criminal case in July 2021 (2021: 3% of EBITDA)
Rationale for the benchmark applied	Adjusted EBITDA is used as a basis for determining materiality as this excludes the volatility of a significant one-off item. EBITDA is aligned with cash flows, which is a key metric in the company's covenant calculation.



6.2 Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Performance materiality was set at 60% of materiality for the 2022 audit (2021: 60%). In determining performance materiality, we considered factors including the impact of Covid-19 on business operations and account balances, our ability to rely on general IT controls, management's willingness to make process improvements as well as to correct errors identified.

6.3 Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.58m (2021: £0.59m), 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.

Independent Auditor's report continued

to the members of Southern Water Services Limited

7. An overview of the scope of our audit

7.1. Scoping

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.

7.2. Our consideration of the control environment

The company uses SAP, a financial accounting software platform. With the involvement of our Information Technology specialists, we obtained an understanding of relevant General Information Technology Controls ('GITC') within the company's financial accounting software platform, including access controls, change management controls and controls around segregation of duties.

Additionally, we have obtained an understanding of manual key controls relevant to the audit as documented in section 5 above.

Our audit for the period identified a number of control deficiencies, including access controls, precision of management review control and controls around posting of manual journals.

As described by in the Corporate Governance section on page [172], the Board has commenced a review of the company's internal controls and asked management to remediate the deficiencies.

As a result of the deficiencies in IT controls and the business process controls summarised above, we extended the scope of our substantive audit procedures in response to the identified deficiencies.

8. Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report.

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.

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 course of 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 this gives rise to a material misstatement in the financial statements themselves. 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 this regard.

9. 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.

10. 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.

11. Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

11.1. Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the company's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- results of our enquiries of management, internal audit and the audit committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the company's documentation of their policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
- the matters discussed among the audit engagement team and relevant internal specialists, including tax, financial instruments, pensions and IT specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in relation to revenue recognition - valuation of unbilled water accrual. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory frameworks that the company operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act, pensions legislation and tax legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the company's ability to operate or to avoid a material penalty. These includes the license conditions imposed by The Water Services Regulation Authority (Ofwat).

Independent Auditor’s report continued

to the members of Southern Water Services Limited

11.2. Audit response to risks identified

As a result of performing the above, we identified revenue recognition – valuation of unbilled water accrual as a key audit matter related to the potential risk of fraud. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to that key audit matter.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the audit committee, in-house and external legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, the audit committee, reviewing internal audit reports and reviewing correspondence with Ofwat and other regulatory authorities; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

12. Opinion 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 its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors’ report.

13. 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.

14. Matters on which we are required to report by exception

14.1. 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, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

14.2 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.

We have nothing to report in respect of this matter.

15. 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.

Delyth Jones

Delyth Jones (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
15 July 2022

from

Southern Water

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