Greensands

Annual Report and Accounts 2013–14

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Introduction

Greensands Holdings Limited (GSH or 'the company') is the ultimate parent company of a group of companies (the group) that includes Southern Water Services Limited (Southern Water).

GSH was incorporated in Jersey on 28 September 2007 and on 15 October 2007 acquired the entire share capital of Greensands Europe Limited, whose subsidiaries include Greensands Investments Limited. Also on 15 October 2007, Greensands Investments Limited acquired the entire share capital of Southern Water Capital Limited, the then ultimate parent company of Southern Water.

The only operating company in the group is Southern Water and the information contained in this Strategic Report is therefore mainly based upon the activities of this company only. This information is fully supported by GSH and has been adopted from the Southern Water annual report. Sections 1 and 2 that follow contain reviews of GSH and Southern Water for the year to 31 March 2014, respectively.

The Board of GSH has approved this Strategic Report, from pages 2 to 5 covering GSH and pages 8 to 44 covering Southern Water, and hope it is of interest.

Michael Nagle
Director

1) Greensands Holdings Limited

Strategic Report: The Business

GSH acts as a holding company, with the only trading subsidiary being Southern Water.

This section sets out financial performance and structure of the group as well as the corporate governance in place at GSH. The activities, performance and corporate governance of Southern Water are described in section 2 on page 8.

Financial KPIs

Under the group financial structure there is a comprehensive set of covenanted financial ratios. Of these, two are key ratios by reference to Southern Water, namely the ratio of consolidated net debt to Regulatory Capital Value (RCV) and the ratio of consolidated EBITDA to consolidated net cash interest cost.

The net debt used in the net debt to RCV ratio is calculated as consolidated secured short and long-term borrowings less cash and short-term deposits. The RCV of Southern Water is set by Ofwat for five year periods at periodic reviews and reflects forecast growth in the asset base. It is adjusted at each periodic review for any out-performance, shortfalls in outputs or permitted additional investment and for certain asset disposals. The ratio of consolidated net debt to RCV for the group is targeted to reduce to 90 per cent during the current five year regulatory period ending March 2015, and the covenanted lock-up level is 93.0 per cent. Lock-up is defined as a restriction on all dividend payments.

The consolidated EBITDA to consolidated net cash interest is targeted to be maintained comfortably above the 2.0 times covenanted level.

Net debt: RCV	%
2012–13 performance:	88
2013–14 performance	88
Covenanted lock-up level	<93
Covenanted default level	<95

Consolidated EBITDA to cash interest cover	Times
2012–13 performance:	3.4
2013–14 performance	3.2
Covenanted default level	2.0

Group financial performance

The accounting policies of the group, including any changes in accounting policies in the period, are set out on pages 58 to 61.

Consolidated profit and loss account

The consolidated profit and loss account of GSH is summarised in Table 1 below:

Table 1	Years ended 31 March		Change
	2014 £m	2013 £m	%
Turnover	**806.2**	778.7	*3.5*
Operating costs before exceptional items	**(510.4)**	(481.9)	*5.9*
Other income	**0.2**	0.2	-
Operating profit before exceptional items	**296.0**	297.0	*(0.3)*
Exceptional items	**(18.8)**	-	-
Operating profit	**277.2**	297.0	*(6.7)*
Profit on disposal of fixed assets	**0.5**	1.0	*(50.0)*
Net interest	**(323.8)**	(301.4)	*7.4*
Loss before tax	**(46.1)**	(3.4)	*1,255.9*
Tax	**41.2**	(13.6)	*402.9*
Loss after tax	**(4.9)**	(17.0)	*71.2*

Operating profit largely reflects the trading results of Southern Water for the year (further details on pages 33 to 35) and additional depreciation from the revaluation of assets on acquisition.

The loss after taxation for the year amounted to £4.9 million (2012–13: loss of £17.0 million).

Balance sheet

As at 31 March 2014 the group had tangible fixed assets of £5,607.5 million (2012–13: £5,461.3 million), an increase of £146.2m from 31 March 2013. This increase largely results from the capital investment programme of Southern Water, of £415.5 million, offset by depreciation of £259.3 million. Total fixed assets as at 31 March 2014 includes goodwill arising on acquisition of £85.1 million (2012–13: £91.4 million).

Creditors falling due within one year totalled £250.2 million (2012–13: £545.3 million) as at 31 March 2014. The reduction relates mainly to a Class B loan of £250.0 million which was repaid in March 2014.

Creditors falling due after one year increased by £146.7 million to £4,835.1million at 31 March 2014. This increase principally resulted from inflation on index-linked bonds of £72.1 million and an increase in the accrued interest liability on the Eurobonds of £76.1 million.

As at 31 March 2014, net assets of the group were £559.2m (2012–13: £563.2m).

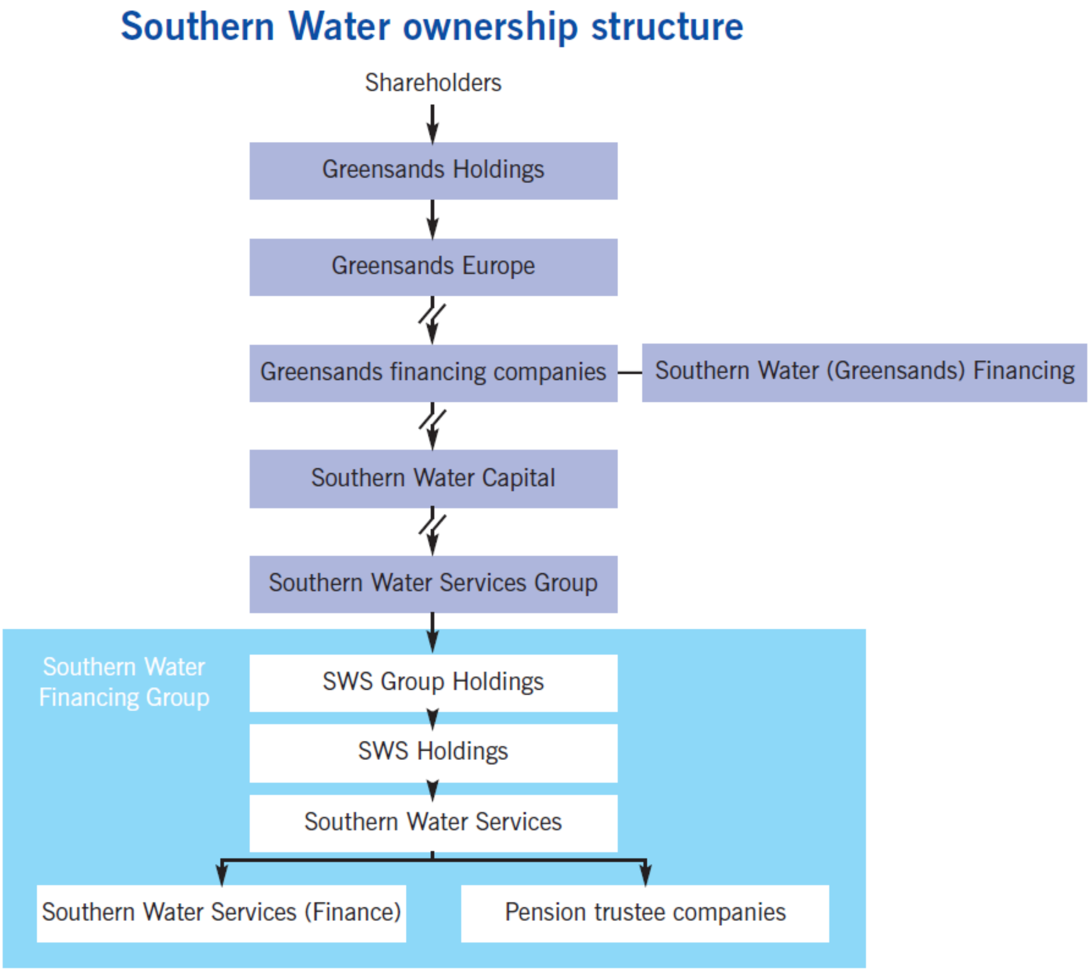
Cash flow

During the period, the group had a net cash outflow of £364.2m (2012–13: inflow of £297.5m). With the exclusion of interest, tax and dividend payments, and issue of long-term debt, the cash flow of the group largely reflects the cash-flow of Southern Water.

Capital structure, liquidity and other financial matters

Capital structure and borrowing covenants

In September 2007, a consortium of infrastructure investors established the Greensands group of companies for the purpose of the acquisition of 100 per cent of the share capital of Southern Water Capital Limited, the then ultimate parent company of Southern Water (See ownership chart below).



The acquisition was financed by £1.9 billion of equity and debt, and the group debt structure comprises two Euro Medium-term Note Programmes.

In April 2011, the acquisition borrowing at the Greensands debt companies was refinanced. A new company, Southern Water (Greensands) Financing Plc, was incorporated into the group and a new long term covenanted financing structure put in place. Southern Water (Greensands) Financing Plc issued a £250.0 million listed bond, out of a £1.0 billion Euro Medium-Term Note programme, and a new £225.0 million bank facility, from which £200 million is drawn. The proceeds were used to refinance the £441.2 million of acquisition debt at Greensands debt holding companies and to provide a £25 million liquidity facility at the holding company level. In addition, £47.8 million of accrued inflation on index-linked swaps to 31 March 2011 was paid out of existing cash balances

Southern Water carried out a refinancing of its regulated business in 2003 with the aim of reducing its cost of capital through a substantial increase in the proportion of debt finance. At the same time a Common Terms Agreement (the CTA) between the members of the Southern Water Financing Group and its debt investors was entered into. The CTA sets out the arrangements for the on-going management of Southern Water's debt issuance programme, including a set of financial covenants, trigger events and events of default. Further details can be found on pages 39 to 41.

Interest rate, liquidity and cash management risk

Southern Water (Greensands) Financing Plc has hedged its exposure to floating rate interest risk on 75 per cent of the £200m drawn bank facility by fixing its LIBOR based interest rate.

Southern Water hedges its exposure to interest rate risk on at least 85 per cent of its outstanding debt liabilities in respect of Class A and Class B debt for the period to the next periodic review and at least 70 per cent in the next period (on a rolling basis) into either index-linked or fixed rate obligations.

Additional funds are raised as required, to ensure that sufficient cash and/or facilities are available to fund the business for at least the next twelve months, and both Southern Water (Greensands) Financing plc and Southern Water have debt covenants to this effect.

The group sets exposure and minimum credit rating limits for deposits of cash balances.

The regulatory framework, under which revenues and the RCV are indexed, exposes the group to inflation risk. This risk is managed through the use of index-linked instruments within the overall debt portfolio.

An analysis of net debt is included in note 22 to the financial statements.

Credit risk

For Southern Water, 82 per cent of the water and wastewater services revenue is received from household customers. The Water Act 1999 prohibits the disconnection of domestic customers for failure to pay water and wastewater charges. An extensive range of collection and recovery methods is employed, as appropriate to the individual circumstances of the customer, to minimise the risk of non-payment. For non-domestic customers, the right to disconnect supplies for non-payment remains and is exercised as appropriate.

The level of provision against non-collection of charges is reviewed on an annual basis, based on the age profile of the debt and the likelihood of recovery. A material increase in uncollected revenue, compared with that assumed in the setting of price limits, may provide grounds for an interim price determination by Ofwat.

Financing Risk

See page 43.

Rating

In connection with the refinancing carried out in April 2011, both S&P and Fitch assigned ratings to Southern Water (Greensands) Financing, a company incorporated on 28 March 2011 for the purposes of raising additional external debt.

Credit ratings for both Southern Water (Greensands) Financing and Southern Water Services are as follows:

Credit rating	Southern Water (Greensands) Financing	Southern Water Services
Standard & Poor's	BB-	Class A debt: A- Class B debt: BBB
Fitch	B+	Class A debt: A- Class B debt: BBB
Moody's		Class A debt: Baa1 (negative outlook) Class B debt: Ba1 (negative outlook) Corporate family rating: Baa2 (negative outlook)

Fitch have also rated Greensands UK Ltd long term issuer default rating at B (positive outlook).

The group is fully in compliance with all of its covenants, and the company has an internal business plan which is expected to stabilise the overall credit rating position.

Corporate Governance

Overview

GSH is essentially a single-purpose entity, being the ultimate holding company for the only operating business in the group, Southern Water. Accordingly, the GSH Board shares and supports the aims of the Board of Southern Water for the long-term success of that company and also its commitment to maintaining high standards of corporate governance. Details of the governance of GSH are listed below, and those of Southern Water are summarised on pages 45 to 49.

Chairman

Our independent non-executive Chairman for the year was Colin Hood, who was also the Chairman of Southern Water. Robert Jennings was appointed as independent non-executive Chairman of Southern Water on 1 April 2014 and subsequently GSH on 28 May 2014, following Colin's decision to leave. The role is to unify and lead the Boards in their respective responsibilities, to encourage and facilitate the contributions of Board members and to ensure adherence to the governance principles and processes of the respective Boards.

Board membership

The GSH Board comprises five members in addition to the Chairman. Two of those members are appointed by a shareholder represented by JP Morgan Asset Management, two are appointed by shareholders represented by UBS Global Asset Management and one is appointed by a grouping of Australasian and Canadian pension funds (the Access Group). Another shareholder is entitled to appoint an observer to attend and take part, but not vote, at Board meetings. Further details of the Board members can be found on page 50.

Board operation

GSH is party to the shareholder agreement between the shareholders in the Greensands consortium. Under that agreement, the GSH Board members, apart from the Chairman, also comprise the Boards of the six subsidiaries down to Greensands Investments. Two of those directors comprise the Board of Southern Water Capital. Apart from the Chairman, no director of GSH is also a director of Southern Water, although two are alternate directors for the shareholder-nominated directors on the Southern Water Board.

The GSH Board meets at least four times a year on its own. The normal business at such meetings is to agree formally any changes in membership, to note any relevant shareholder activity and to approve formally any transfers of shareholdings. The GSH Board is present with the Southern Water Board at the regular monthly meetings of that Board, to consider the operational and financial performance reports of that company. That financial performance does, of course, represent the principal financial performance of the group.

The GSH Board is very mindful of the independence of the directors of Southern Water, but can bring additional knowledge, skills and resources of their nominating shareholders and employers, as well as their own personal skills, experience and knowledge of businesses and business sectors similar to that of Southern Water.

For compliance with Condition P of Southern Water's Licence, the shareholders who are considered to be the Joint Ultimate Controllers of Southern Water have given undertakings to provide all necessary information to that company, not to cause Southern Water to breach any of its obligations and to ensure that there are not less than three independent non-executive directors on the Southern Water Board. Copies of those undertakings are published on Southern Water's website.

GSH does not have any executive directors nor dedicated management employees. Apart from the director appointed by the Access Group, the GSH directors are not remunerated by GSH for their appointments.

Role of the Company Secretary

The Company Secretary is Kevin Hall, who is also Company Secretary of Southern Water. All directors have access to the advice and services of the Company Secretariat team. The Company Secretary is responsible for ensuring that the Board operates in accordance with its governance framework and that there are good information flows to the Board. The appointment and removal of the Company Secretary is reserved to the GSH Board.

Director induction, training and development

GSH directors take advantage of the induction and training opportunities available to Southern Water directors as appropriate. On appointment to the Board, a director will discuss and agree induction coverage and then an appropriate comprehensive and individualised induction pack is provided, which will include information on

Southern Water and the holding group structure, the regulatory framework of Southern Water, customer service and the operation of assets, strategic plans, financial reports, business plans and the governance framework. This and further relevant information is summarised in a directors' handbook.

Board meetings

The Board held five scheduled meetings and one additional meeting during the year. The agenda and papers are sent to the Board members in advance of each meeting. The Board holds its meetings where the Board of Southern Water is meeting that month.

The Board has no standing committees.

Table of attendance at Board meetings

Attendance at scheduled Board meetings in 2013–14			
Colin Hood	6/6	Michael Nagle	5/6
Peter Antolik (resigned 29 May 2013)	1/1	Bronte Somes	6/6
Paul Ryan (appointed 29 May 2013)	5/5		
Keith Budinger	6/6	Martin Roughead	5/6

Colin Hood resigned as independent non-executive Chairman on 1 April 2014, and Robert Jennings was appointed to the position on 28 May 2014.

At the May 2014 Board meeting, Martin Roughead resigned as director and Jeff Woodard was appointed to the Board.

On 29 May 2013 Peter Antolik resigned as director and was appointed as alternate to Paul Ryan, who was appointed as director on the same date.

Annual General Meeting

As ultimate holding company for the group, GSH holds an AGM, and in 2013–14 this was held on 26 November 2013.

2) Southern Water Services Limited

Strategic Report:
Into the future

Planning our services

During the year we developed our Business Plan for 2015–20. It has one overarching aim – to provide the services that our customers and stakeholders have told us they want at a price they can afford.

The plan is different to those we have produced in the past because the commitments we make in it are based on the most extensive programme of customer engagement and research we have ever undertaken.

Through the research, we identified six priorities our customers want us to deliver. We then further developed these into 26 performance commitments – or **promises**.

Our £3.2 billion plan was produced following publication of our 25-year Strategic Statement in 2013. This presents our long-term strategy to deal with future challenges and our ambition to work towards recognition as the UK's leading water company.

During 2013–14, we also published our 25-year Water Resources Management Plan, which sets out how we plan to secure healthy, reliable drinking water for homes and businesses across the South East between 2015 and 2040.

Plans shaped by customers

Over the course of 18 months, we gathered, listened to and acted upon the views of more than 27,000 domestic and commercial customers, nearly 450 community representatives and Southern Water employees.

This engagement and research led our approach to the development of the Business Plan and shaped its contents. This practice is now embedded in our day-to-day work.

During the engagement, we undertook customer workshops and surveys, briefings for interest groups and launched a dedicated Have Your Say website, which was visited by more than 31,000 customers.

We publicised the plan through press, radio adverts and television news, reaching more than one million people, and partnered with the Citizens Advice Bureau to engage harder-to-reach customer groups.

To ensure we had accurately interpreted customers' views in the plan, we published a draft for public consultation.

We were delighted that our work on acceptability indicated that nine out of 10 domestic and commercial customers supported our proposals. A significant minority asked us to do more to keep bills affordable and we addressed this feedback in the final plan, which we submitted to Ofwat in November 2013 for final determination in December 2014.

Our promises

The Business Plan is based around an ambitious set of promises which our employees are focused on delivering. We are confident that by delivering the promises in the plan we will provide a great service for customers between 2015 and 2020.

The plan outlines areas where we intend to lead the water industry and is based on the six key outcomes, below, which customers have told us are their priorities:

- Responsive customer service
- A constant supply of high-quality drinking water
- Removing wastewater effectively
- Looking after the environment
- Better information and advice
- Affordable bills.

We further developed these priorities into 26 promises, or performance commitments, which will be our measure for excellence in customer service in the next five years.
We have ensured the promises are clear and easily understood so that our customers can hold us to account.

They include commitments such as:

- Resolving 90 per cent of customer queries the first time they contact us
- Reducing sewer flooding inside people's homes and businesses by a quarter
- Making sure no serious pollution incidents are caused by our operations
- Further reducing leakage by nearly two million litres of water a day
- Reducing the average daily water use per person by 15 litres.

These promises change the way we measure our performance and will better reflect our customers' experience of the service we provide.

We are committed to openly reporting on our performance and providing financial information such as how much profit we make and how much tax we pay. This will give our customers a better understanding of what we do, how we are performing and the value we provide.

Keeping bills affordable

As we developed the plan, we were fully aware of the tough economic conditions which have made life difficult for some of our customers over the past five years.

As a provider of essential services, we recognise we must maintain bills at an affordable level. We have therefore set ourselves the challenge of delivering nearly £200 million of efficiency savings, equal to more than £20 per year for every household we serve.

It is our own risk to meet this challenge and, even if we fail to make those savings, average customer bills will increase by less than inflation between 2015 and 2020. This compares with a typical increase of 1.4 per cent above inflation in 2010–15.

To help us deliver sustainable improvements at an affordable price, we have strengthened the skills in our asset management team and are appointing a Strategic Solutions Partner to help us access innovative technologies and approaches from across the worldwide water sector.

We have also identified customer promises that link to financial rewards and penalties if we beat or miss a target by specified amounts. These are targeted where customers told us they wanted to see most improvement in our service.

Securing resilient water resources

This year also saw the publication of our Water Resources Management Plan (WRMP). This sets out how we intend to secure resilient and reliable drinking water supplies for 2015–40.

The plan is updated every five years. This time our WRMP is based on an innovative new approach to assessing the potential range of impacts from future changes in weather patterns to help ensure we can cope with more extreme droughts in the future than those we have experienced in the past.

Our industry-leading approach to drought planning was supported by 83 per cent of customers and will reduce the frequency of water restrictions, such as hosepipe bans, to one in every 10 years on average. It will also halve the risk of extreme restrictions, such as standpipes or rota cuts – where water supplies are limited to taps in the street or for a few hours a day – to one in 200 years on average. Customers were very clear in their feedback that they did not find rota cuts or standpipes acceptable.

Strong support was shown for water efficiency, water re-use and working with landowners and farmers to protect the quality of water in rivers. We listened to our customers' views and, as a result, these options feature more prominently than in previous plans.

The first five years of the water resources plan are incorporated into the 2015-20 Business Plan.

Challenges ahead

Our region faces particular long-term challenges – continued high growth and development, water stress, a sensitive environment with increasing tightening of targets, a long coastline and the effects of climate change. We make allowances to meet these demands in our plans and outline how we will tackle the challenges in a sustainable way in order to reduce the potential impact on customer bills.
Our focus is on embracing innovation and collaborative working in areas such as integrated water management, catchment management and water trading.

We will develop a more holistic approach to managing the water environment, looking across the whole water cycle rather than at individual solutions that address specific environmental aspects in restricted geographical areas.

Innovation through partnership

Co-operating with others in strong and innovative partnerships is also a key part of our approach to meeting the challenges ahead and delivering the service our customers have asked for.

Partnerships give customers an alternative perspective on problems, a trusted voice to go to for advice and knowledgeable expertise on complex issues.

We will extend our collaboration with local authorities, environmental groups and customer support groups on issues such as flooding, catchment management and affordability.

For example, we are already working in partnership with the Arun and Rother Rivers Trust on a water trading pilot on the Rother and with the South Downs National Park Authority on the protection of groundwater sources from nitrate infiltration.

Collaboration with our neighbouring water companies is also important and we developed a joint water resources management plan for the South East through the Water Resources in the South East group. This has resulted in bulk transfers to share water resources and joint schemes to promote water re-use in Sussex and Kent.

The Citizens Advice Bureau is already an important partner and we will build on that relationship to introduce a Social Tariff from 2015. The tariff will offer bill discounts from 20 per cent to 90 per cent for households in genuine financial difficulty. This will be supported by water-saving measures, including offering free help and advice to customers.

Customer Challenge Group

During the development of our plans, we were helped and guided by the Southern Water Customer Challenge Group (CCG), a panel of independent representatives from local business, community and environmental organisations and water industry regulators.

The CCG was set up as part of the Price Review process and challenged us on how we gathered the views of customers and used their feedback to shape the plans.

During 2013–14, the group issued a number of formal advice notes to our Board and a report for Ofwat. These can be found on the CCG's website www.swccg.org.uk.

Reform in the water industry

During the year, we actively engaged in debate on reform in the water industry.

The draft Water Bill, which was published in 2012, received royal assent in May 2014 and paves the way for competition for commercial customers from 2017.

As a consequence, our Business Plan was broken down into four elements for the first time – household retail services, non-household retail services, wholesale water services and wholesale wastewater services.

Retail services include customer service, billing and meter reading, while wholesale includes the operation, maintenance and improvement of treatment works, pumping stations and pipe networks.

We continue to play an active role in Open Water, a programme set up to deliver what is needed to implement the wholesale and retail arrangements outlined in the Water Bill. Working alongside representatives from Defra, Ofwat, other water companies and customers, we are exploring how the new market will operate and how businesses and public sector bodies can switch suppliers.

Abstraction licence reform will have a significant effect on the development of our next business and water resource plans and we submitted a response to a public consultation on its future to Defra in March. We are working closely with the regulators to link abstraction reform with wastewater recycling and water trading.

Our promises

We have built our future plans around our customers, their needs and expectations. The six outcomes and 26 promises set out in our draft Business Plan for 2015–20 are shown below. They will form the basis for reporting our performance going forward. To find out more, visit our website at www.southernwater.co.uk/businessplan.

Responsive customer service

- Quick and effective resolution of your queries – 90 per cent resolved first time by 2020. In 2013, this was an average of about 80 per cent
- Improved service to you and your community – increase the number of customers who feel our service meets their individual needs and those of their community
- Improved ranking in our regulator's league table for customer satisfaction – be among the best by 2020. In 2013, we were ranked 19th out of 21 companies
- Direct compensation paid if we let you down – this will be linked to the service standards set out in our updated Customer Charter

A constant supply of high-quality drinking water

- No restrictions on water use, such as hosepipe bans, unless there are at least two dry winters in a row – current record is once every six years
- Reduce leakage by 2020 – target of 86 million litres a day by 2020, equating to a reduction of almost two million litres a day
- No increase in the average time you are without water because of a burst water main, for example – maintain performance of an average of nine minutes per customer per year
- Aim for 100 per cent compliance with drinking water quality standards – at least maintain performance of 99.93 per cent
- No increase in the number of households suffering from persistent low water pressure – currently less than 0.1 per cent of properties we supply (257 households)
- Help reduce the effect of hard water in homes and businesses – increased customer understanding through better information and advice

Removing wastewater effectively

- No increase in the number of blockages in our sewer network – currently 23,000 blockages a year across 39,600 kilometres of sewers
- Significant reduction of 25 per cent in sewer flooding inside your homes and businesses by 2020 – number of incidents brought down from 2,755 to 2,070
- No increase in the number of incidents of sewer flooding affecting outside areas – maintain performance at 9,700 incidents a year
- Reduction of five per cent in complaints about smells from our wastewater treatment works and pumping stations by 2020 – number of complaints brought down from 423 to 403

Looking after the environment

- No 'serious pollution incidents' affecting local rivers, streams and beaches caused by our operations by 2020 – there were 10 such incidents in 2012
- Aim for 100 per cent compliance by our wastewater treatment works with required standards – at least maintain performance at 98.6 per cent
- Increase the number of beaches with 'excellent' bathing water quality by 2020 – 15 per cent increase, up from 41 to 48
- Maintain the proportion of renewable energy we use – renewable energy currently makes up 15 per cent of energy we use
- Reduce the amount of water we take from the environment, despite predicted population growth of four per cent – reduction of 1.4 per cent

Better information and advice

- 10 per cent reduction (15 litres per person, per day) in average water use by 2020 with better advice on saving water, energy and money – we will reduce average water use from 148 litres to 133 litres per person, per day
- Improved advice on how to prevent blocked drains to help reduce blockages – increase the number of customers who know how to help prevent blockages in drains and sewers
- A 50 per cent reduction in bill queries by 2020 – number of bill queries in 2012–13 was 49,000
- Customers provided with better information about what we do, why we do it and what it costs – increase the number of customers who understand how we use the money they pay us

Affordable bills

- Efficiency savings made during 2015 to 2020 to help keep bills as low as possible – £189 million in savings
- 10 per cent reduction (15 litres per person, per day) in average water use by 2020 with better advice on saving water, energy and money – this will reduce average water use from 148 litres to 133 litres per person, per day
- Customers in genuine financial hardship provided with improved support – increase the proportion of customers who take up the support we offer around bills
- Customers provided with better information on how we are providing value for money – increase the number of customers who feel our services provide value for money

Customers

Responsive customer service

Our performance

	2013–14		2012–13
	Target	Achieved	Achieved
SIM score	75	**75.2**	62.2
Quantitative score	33	**32.6**	21.9
Qualitative score	42	**42.6**	40.3

Our customers received a much better service from us in 2013–14. As a result, we achieved our target improvement for the Service Incentive Mechanism (SIM), the metric used by Ofwat to measure how well we serve our customers.

We achieved a score of 75.2 out of 100, a 21 per cent improvement on the previous year. The improvement is the result of investment, training and hard work by our employees, who have put our customers' needs at the heart of everything they do.

The SIM measure is made up of two parts – quantitative and qualitative scores. The quantitative score takes into account written complaints and telephone calls, including the number of times our customers are not able to talk to us if all our lines are busy.
During the year, we received 1.9 million telephone calls and letters or emails from our customers.

Customer surveys

The qualitative score is based on the results of surveys conducted four times a year by Ofwat. The surveys are carried out with 200 of our customers who have contacted us with a query or complaint.

If we are unable to provide the service our customers expect from us, we may compensate them with payments. This is done under the Guaranteed Standards Scheme (GSS), which guarantees the minimum standard of service customers should receive from their water company. The number of events and payments recorded under the GSS and our own voluntary Customer Charter in 2013–14 are shown here.

	2013–14	2012–13
Statutory GSS – number of events	4,380	3,105
Statutory GSS – number of payments made	4,315	2,774
Statutory GSS – payments made £k	433	313
Company Customer Charter – number of payments made	77	59
Company Customer Charter – payments made £k	4	4

The number of GSS payments increased during the year, mainly because of interruptions to customers' water supplies when storms over Christmas 2013 affected power supplies to some of our pumping stations on the Isle of Wight.

Customer improvements

Keeping our promises to customers was the focus of our improvements in 2013–14. The turnaround in our SIM performance was helped by a review of almost every aspect of our work, as well as new training and development programmes for our staff.

Contact centre employees now take part in regular sessions to listen to recordings of their telephone conversations and share feedback with each other. They also record the promises they make to customers when committing to take action or provide updates by an agreed time. 'Resolvers' then work to make sure the promises are delivered and customers are kept up-to-date with developments.

Staffing levels have also increased to support extended hours in the contact centre, making it easier for customers to call us in the evenings and at weekends. Behind the scenes, work progressed on a £13 million upgrade to our billing system, which is scheduled to go live later this year. The new system will also enable customers to access their accounts online for the first time.

During the year, we set up a forum called Your Voice for customers to give their views on our services and let us know how we can improve. The forum enables customers to have their say through focus groups, online questionnaires and email surveys.

Better information and advice

Information initiatives

During 2013–14, we talked to thousands of our customers about the services they would like to receive from us. Many asked for better information and advice about the range of services we provide and a number of initiatives were introduced to make improvements in this area.

We launched our new-look bill after more than a year of research with customers and contact centre agents. The new bill is designed to be clear and easy to understand and we also simplified the information leaflet sent out with it.

New services were introduced on our website, which was visited by more than 1.1 million people, a seven per cent increase on the previous year. Initiatives included Live Chat, which enables customers to discuss their queries online with an agent. The feature was a popular addition, with 1,754 chats in the first two months after its launch in January and 93 per cent of customers saying they would use the service again.

Digital developments

Changes were made to improve online forms as a result of customer feedback and new forms were added. A section was created for customers who receive only wastewater services from us and we refreshed our interactive postcode search feature to include exact water hardness ratings in addition to information about water supply and quality.

Our website was moved to new servers to improve its performance and resilience, especially at times when the site is in high demand – such as during flooding or water supply incidents.

In 2013, we launched a new online annual report in the form of an interactive website, supported by a downloadable pdf. The report is designed to be open, engaging and accessible, combining all of our previous public reports in one place to provide facts and figures about Southern Water as well as details about our operational and financial performance.

We also joined Twitter during the year, opening up a new communication channel for us to share information with our customers and for them to contact us.

Water efficiency

Thousands of our customers were given information and advice about how to save water, energy and money during the year.

As part of our metering programme, 15,444 customers received water and energy audits in their homes from trained advisors – Green Doctors from the charity Groundwork. The Green Doctors also fitted water-saving products, such as water-efficient showerheads and tap aerators. We continued to offer free Save-a-Flush bags, which can save up to one litre of water with every flush, providing 37,878 to customers who requested them.

Ten more members of staff joined our team of Waterwise speakers, who give talks about water to a range of school and community groups. A total of 84 talks were given during the year.

Five-year campaign

During the year, we appointed a water efficiency manager to develop a multi-million pound campaign for 2015–20. This will ensure we continue to help our customers to save water, energy and money when our programme to install meters in the majority of homes across our region comes to an end in 2015.

We also became the first water company to join the Water Using Products Working Group, which is backed by the Government. The group struck an agreement with retailers, manufacturers and builders' merchants to introduce the new Water Label to give customers accurate information about the water efficiency of products such as taps, showers and toilets.

Fat, oil and grease campaign

Our award-winning awareness campaign to help prevent sewer blockages, flooding and pollution reached thousands more customers.

Nearly 75 per cent of blockages in sewers result from items that should not be put down the sink or toilet, such as wet wipes, nappies and fat, oil and grease. Blockages can lead to flooding in homes and gardens. During the year, we cleared 10,858 blockages, many of which were caused by congealed cooking oil and wet wipes.

We gave away thousands of eco-funnels to help households and schools collect their cooking oil to be recycled as bio-fuel. We included information and advice about fat, oil and grease in our community talks and we even adapted a Christmas carol, Jingle Smells, to raise awareness about the dangers of flushing wet wipes down the loo.

Connectright

We joined a partnership with other water companies and the Environment Agency to launch a new website about sewer misconnections.

The Connectright campaign highlights how pollution can happen when sewers are wrongly connected to the surface water network, which is only designed to carry clean rainwater directly to rivers and the sea. The website provides information about how to spot misconnections with advice on how to put them right and also links to plumbers.

Affordable bills

We can help you pay

During the year, we helped 21,502 customers who struggled to pay their water bills. Rising prices in the current economic climate have put pressure on household incomes and 85 per cent more customers received help in 2013–14.

Our Debt Advice Team answered 79,380 calls (a 38 per cent increase from 2012–13) from customers in financial difficulties and 59,092 people visited the advice pages on our website (a 53 per cent increase from the previous year). Overdue bills and bad debt are a key issue for the water industry, adding about £16 to our customers' bills. It's therefore important that we work with our customers to keep debt, and bad debt, to a minimum.

The New Start Scheme allows customers in severe financial hardship to reduce their debt when they make regular payments on their current water bill. The amount they pay is also cleared from their arrears and 4,885 customers joined the scheme in the year. A further 9,546 customers joined a Department for Work and Pensions scheme to repay their debts directly through their benefit payments.

Charity grants

The Southern Water Charitable Trust Fund, a registered charity set up to help customers in financial hardship, awarded grants totalling £168,000 to 413 people during the year.

Now in its sixth year, the fund has paid out in excess of £2.5 million to more than 4,600 customers in need. It has also awarded grants to agencies that offer money advice, such as Citizens Advice or housing associations.

We also helped 6,810 customers through the WaterSure tariff, which gives financial help to households that use large amounts of water for essential purposes. This includes customers on income-related benefits with three children under 19 in full-time education or customers with certain medical conditions.

Metering support

We continued to support our customers who had a water meter installed as part of our five-year metering programme to secure water resources.

To date, 62 per cent of households moving to metered charges have experienced a reduction in their bills averaging £14 a month – a saving of £168 a year. Customers whose bills rise after a meter is fitted are offered our Changeover Tariff, which introduces the increases gradually over three years. A total of 18,998 households have taken this up since it was introduced.

Those customers who are unable to pay the increased charges are also offered our Support Tariff and are put in touch with IncomeMAX, an independent social enterprise, which helps people claim their full benefit entitlements and tax credits. A total of 2,849 customers are on this tariff.

The total we have now secured in benefits and tax credits for our customers has risen to £2 million, with 682 customers offered the Support Tariff during the year.

Social Tariff

Work continued in 2013–14 to develop a Social Tariff for customers who have genuine financial difficulty in paying their water bills. A pilot with 2,000 customers will take place in 2014, with the tariff introduced for all eligible customers in 2015–16.

The pilot will include five levels of support, ranging from 20 per cent to 90 per cent reductions in bills. We are working with Citizens Advice to identify and assess customers who could benefit.

Working more efficiently

We constantly look at ways to run our business more efficiently to deliver a better service and make savings for our customers. During 2013–14, we made almost £16 million of operating efficiency savings, which will help us to keep customer bills lower in the future.

Where possible, we reduce our energy use. We monitor the amount, and cost, of energy used at each of our 458 water and wastewater sites and in our main offices. This helps us to develop effective ways to reduce consumption, such as avoiding peak times when energy costs more.

During the year, we invested in a new system that will improve the management of planned work at our treatment works and on our network. The system will provide a single source of information about our capital projects so that we can produce more efficient and cost-effective work schedules.

An initiative was also introduced to reduce the amount of waste we send to landfill. We worked with our waste contractor, MTS, to recycle solid matter screened from wastewater into compost. As a result, we recycled 30 per cent of this difficult waste, which previously we had to pay to dispose of.

Debt reduction

Debt caused by those who don't pay their water bills has an impact on every customer's bill. We share information about non-paying customers with the credit reference agency Experian. This helps to reduce the amount of money owed to us because a customer's credit rating can be affected if a default is registered on his or her account.

As a result of this action, more than 5,000 customers have so far paid their outstanding debt in full, resulting in the collection of £1.3 million in unpaid bills. If customers have genuine financial difficulty in paying their water bills, we offer help through our Debt Advice Team and with support tariffs.

Services

A constant supply of high-quality drinking water

Water quality

	2013		2012
	Target	Achieved	Achieved
Overall drinking water quality index	99.93%	**99.94%**	99.93%
Disinfection control index	99.99%	**100%**	99.99%
Process control index	99.97%	**99.96%**	99.92%

We continued to supply drinking water of the highest quality to more than two million people. In 2013, we achieved an overall rating of 99.94 per cent, taking us a step closer to our long-term target of 100 per cent compliance.

We carried out more than 222,000 tests of drinking water quality to report to the Drinking Water Inspectorate. A further 216,000 tests were conducted to measure samples against our own standards, which are more stringent than those set by our regulator. Our tests looked for more than 100 substances in samples taken from 90 water treatment works, 204 service reservoirs and customer taps.

For the first time, we achieved a rating of 100 per cent in our disinfection control index. This success follows a £70 million investment in water treatment processes in recent years, including more checks on the quality of water we put into supply.

Taste and smell

There was a significant reduction in the number of taste and smell failures in water samples tested, falling from 52 to 30.

The taste and smell of the water we supply has been an issue in some areas in recent years, particularly around Hastings in East Sussex, where the majority of supplies come from reservoirs. During the year, we installed carbon filters at our water treatment works at Brede and Beauport in East Sussex to help reduce these problems. In our 2015–20 Business Plan, we have also included schemes to add more advanced filters to these works. This will further improve the taste and smell of water supplied in the Hastings area.

Improving our service

We invested more than £30 million in improvements to water supply works during 2013–14. This included upgrades to wells and boreholes, service reservoirs and water supply works. We also flushed 155 kilometres of mains and cleaned 28 service reservoirs, which store water underground before it is pumped to customers’ taps.

Heavy rain, such as we experienced during the year, can affect water quality because it washes more nitrates and pollutants into rivers. To avoid problems associated with this, we instigated new processes to stop abstracting water when possible during and after heavy storms.

New Drinking Water Safety Plans were completed and made available online for staff. These plans identify where and how problems can arise with drinking water quality and cover the entire supply system, from catchment to customers’ taps.

Water supply

	2013–14		2012–13
	Target	Achieved	Achieved
Performance water non-infrastructure	Stable	**Stable**	Stable
Performance water infrastructure	Stable	**Stable**	Stable
Distribution maintenance index (2013 calendar year)	99.96%	**99.94%**	99.94%
Security of supply index (critical period)	100	**100**	100
Security of supply index (annual average)	100	**100**	100

During the summer, we supplied 100 million litres less water than in the summer of 2003, when the weather was similar. We believe this difference is thanks to the efforts of our customers to save water, energy and money after their water meters were installed.

Water resources were in a healthy position during the year. No restrictions were put in place and none are expected in 2014–15.

Fewer burst mains

We recorded 1,517 burst mains during the year, one of the lowest levels in the past 10 years. The average amount of time customers were without water because of bursts was about 11 minutes. This was despite difficulties working in the floods during the winter.

During the year, we replaced 28 kilometres of water mains to help reduce the number of bursts. We also continued investigations into potential new water sources for the future, including re-using water and aquifer storage and recovery, in which water is taken from rivers when flows are high and stored in underground aquifers for use when water is less plentiful.

Metering

We continued our programme to install meters for the majority of our customers by 2015. The total number of meters fitted and brought on charge reached 326,768 with the programme visiting Hove, Horsham, Worthing, Lewes and Hastings in Sussex; Medway and Thanet in Kent; and Eastleigh, Fareham, Winchester and the Test Valley in Hampshire.

By 2015, when the five-year programme comes to an end, we expect nearly 30 million litres of water to be saved each day thanks to our customers being more water-efficient. That's enough water to supply the daily needs of Worthing, Eastbourne and Bognor Regis.

Leakage

	2013–14		2012–13
	Target	Achieved	Achieved
Leakage (million litres of water per day)	89	**85**	81

We continue to deliver one of the lowest levels of leakage per property of water and wastewater companies, working around the clock to find and repair leaks on our 13,753 kilometre network of water mains.

We beat the target set by Ofwat by four million litres of water each day, helped by the milder conditions over the winter. The level was slightly higher than the record low we achieved in 2012–13 when we put extra focus on tackling leaks during the drought.

Our sophisticated water meters automatically detect leaks on customers' supply pipes. During the year, leaks were found in 147 properties where meters were installed. In many cases, free repairs were carried out.

Low water pressure

During our conversations with customers about future service levels for 2015–20, they said they wanted us to keep down the number of homes with low water pressure.

We manage water pressure in our network because, if it is too high, it can cause burst mains and increase leakage, but we also have a duty to maintain a certain level of pressure so our customers can easily use their appliances.

We currently have one of the best performances on water pressure in the water industry, with just 258 households experiencing low pressure in 2013–14.

Removing wastewater effectively

Safely recycling wastewater

	2013–14		2012–13
	Target	Achieved	Achieved
Performance wastewater infrastructure	Stable	**Stable**	Stable

Amid heavy rain and flooding, it was a challenging year to safely recycle wastewater from 4.5 million people across our region.

During the wettest winter on record, communities suffered from flooding caused by high groundwater levels as well as overflowing rivers and excess surface water. Our sewers – which are designed to handle wastewater and not millions of litres of groundwater and floodwater – were also inundated in some areas.

Fewer homes flooded

We invested more than £126 million to improve and maintain our service in 2013–14 and worked around the clock during the bad weather to keep our sewers flowing and prevent flooding incidents. As a result, our performance improved on the previous year, with a reduction in flooding inside homes, businesses and in gardens.

To help achieve this, we have invested £5.5 million to refurbish wastewater pumping stations. This led to a reduction in the number of homes affected by failures in our pumping stations. We also carried out more monitoring, collecting vast amounts of data about our operations to help us predict where problems are likely to occur so we can respond to them more quickly.

During the year, we renovated nine kilometres of sewers and replaced 10 kilometres of sewers and rising mains – the large sewers which connect to our pumping stations and treatment works. We also used cameras to survey 225 kilometres of sewers for blockages, build-ups of fat, oil and grease and damage that could lead to pollution and flooding. As a result, the number of blockages in our sewer network fell by 10 per cent.

Flood protection

We worked around the clock during the winter months, spending nearly £19 million to help protect our customers from flooding following the worst storms to hit the country for decades.

With many parts of southern England under water, our region was also affected by groundwater and river flooding. We worked tirelessly to fulfil our duty to keep the sewers flowing and enable our customers to continue to use their toilets and sinks, removing up to 125 million litres of excess water from our network every day. That's enough to fill 50 Olympic-sized swimming pools. In a UK first, we used mobile biological treatment tanks in order to treat the excess water being removed from our sewers to a higher standard than could previously be achieved before returning it to the environment.

More than 40 areas in our region were affected. The worst hit included St Mary Bourne and Hambledon in Hampshire, Yalding and Nailbourne in Kent and the Rother Valley in Sussex. At its peak, the operation to keep our sewers working cost more than £160,000 a day, with 117 tankers and 44 mobile pumps in use day and night.

Long-term solutions

Our teams worked in partnership with the Environment Agency and local councils to protect homes and businesses. The emergency showed how important it is that we continue to work as part of a multi-agency response team to develop long-term solutions to flooding.

Local authorities are responsible for developing flood management strategies, which identify local organisations with responsibility for flood risk and put partnerships in place to assess and manage this. We are working with all the lead flood authorities in our region and are contributing to these strategies. This includes membership of the Southern Regional Flood and Coastal Committee, which is made up of the Environment Agency and local councils.

As an example, in St Mary Bourne we developed an Infiltration Reduction Plan. This sets out the steps we will take to help prevent flooding should groundwater levels rise in the future. The plan was agreed with the Environment Agency, Hampshire County Council and the local steering group and will be used as a template for other communities at risk of groundwater flooding.

Flood prevention

Some flooding was mitigated by our £6.0 million investment during the year to survey and seal sewers in areas vulnerable to groundwater flooding.

As part of the groundwater infiltration reduction project, we surveyed 40 kilometres of sewers and 800 manholes. In addition, we surveyed 225 kilometres of critical sewers. A total of 19 kilometres of sewers were repaired or replaced during the year and 100 manholes were sealed to reduce infiltration. We also installed flow monitors in sewers to help identify problem sites and surveyed pumping stations and outfalls where water is returned to rivers or the sea. As a result of our ongoing work, 29 properties were removed from our At Risk Flood Register.

We also continued to invest in and maintain more than 17,000 additional kilometres of sewers and lateral drains. These became our responsibility in October 2011 under Government legislation to transfer certain private pipes to wastewater companies in order to establish clear ownership.

Long-term initiatives include our £20 million scheme to radically change the Victorian sewer system in Portsmouth to reduce the risk of sewer flooding. Work continued to lay new pipes and build pumping stations to divert up to 6,000 litres of rainwater per second from the sewers and out to sea. A further £10 million is being invested in storm storage tanks and an emergency outfall to sea at Fort Cumberland to protect the city from severe storms.

Preventing smells

We worked hard to prevent smells from our 368 wastewater treatment works and 2,375 pumping stations.

We strive to be a good neighbour in the communities we serve and spent about £750,000 on planned and reactive maintenance to keep complaints about smells as low as possible during the year. We wrote to residents, warning about possible smells for a short period, when we needed to carry out essential maintenance at our sites and we reacted to complaints as quickly as possible.

At Peacehaven in East Sussex, work was completed on a state-of-the-art odour control system at our new works, which treats 95 million litres of wastewater a day from Brighton and Hove and surrounding areas.

Significant benefits

A scheme to reduce smells at our Peel Common Wastewater Treatment Works in Hampshire also made good progress and will bring significant benefits to people living and working in the neighbourhood. A £1.5 million upgrade at our Tunbridge Wells South Wastewater Treatment Works in Kent also included a new odour control unit.

We received 472 complaints about smells in 2013, which was an increase on our lowest level recorded of 322 in 2012. The increase was mainly because of unforeseen challenges with sludge treatment and maintenance work while the hot, dry summer resulted in less water flowing through our sewers. This can lead to stronger smells.

Over the longer term, complaints about smells have dropped by more than half in the past 10 years and we made a commitment in our Business Plan for 2015–20 to reduce them even further.

Environment

Climate change

Carbon performance

	2013–14		2012–13	
	Target	Achieved	Target	Achieved
Greenhouse gas emissions – ktCO2e	377	**270**	334	286
KgCO2e per person supplied with treated water	-	**25**	-	27
KgCO2e per person supplied with wastewater services	-	**41**	-	40

We were awarded the Carbon Trust Standard in recognition of our efforts to measure, manage and improve our carbon efficiency. It is the third time we have earned the standard for our ongoing efforts to reduce our impact on the environment.

During the year, we were also rated second among similar companies in a Government league table which rates carbon emissions against reductions in energy use. We were in the top two of the 10 water and wastewater companies, and ranked in the upper quartile of 2,000 companies overall in the Carbon Reduction Commitment (CRC) scheme, which is managed by the Environment Agency.

The success is partly down to installing smart electricity meters on our sites. The meters provide more accurate measurements of the amount of electricity we use. This has helped us to adapt the way we operate our works to drive down energy use and minimise our carbon footprint.

Greenhouse gases

During the year, we produced 270 kilotonnes of carbon dioxide and other greenhouse gases. This was similar to 2012–13.

Our target is set on the basis that our emissions will increase by 42 kilotonnes each year as we use more energy to treat water and wastewater to higher standards and to allow for population growth.

We supplied less water during 2013–14, which required less energy. However, the record levels of rain and flooding meant we used large amounts of fuel and energy to tanker and pump stormwater to prevent it overwhelming our sewers and people's homes.

The numbers relating to carbon reporting are unaudited.

Renewable energy

We set ourselves a long-term target during the year to maintain the percentage of energy we use from renewable sources at 15 per cent. This is despite a predicted increase in energy use as we cater for housing and population growth and the effects of climate change in the region.

We have increased the installed capacity of Combined Heat and Power (CHP) generation at our treatment works from 51 million kilowatt hours to 70 million kilowatt hours of renewable electricity. We now have 16 CHP plants which use biogas from the wastewater treatment process to produce renewable energy – providing power and heat to the works, with surplus exported to the National Grid. Overall, the units supply 15 per cent of our energy needs, with the most recent ones installed at Hastings and Ford in Sussex and Sandown on the Isle of Wight.

A new heat exchanger was also installed at the CHP at Budds Farm Wastewater Treatment Works in Hampshire. The exchanger uses water to recover heat from the engine and exhaust systems. The water then warms the treatment tanks and speeds up the bacterial digestion of the waste.

Looking after the environment

Bathing water quality

Every beach in our region met European standards for bathing water quality in 2013. All 83 bathing waters achieved the European 'mandatory' rating during weekly sampling carried out by the Environment Agency between May and September. Nearly 88 per cent also passed the tighter 'guideline' standard, compared with 70 per cent in the previous year.

The quality of bathing water can be affected by factors that are out of our control, such as pollution in water running off roads and land or sewers wrongly connected to drains carrying rainwater. However, our ongoing environmental improvement programmes are continuing to benefit the water along our coastline.

Official opening

Our scheme to bring cleaner seas to Sussex was one of the largest investment projects we've ever undertaken and it was officially opened during the year. The £300 million project included a new treatment works with a green roof at Peacehaven, two pumping stations, an 11 kilometre sewer tunnel and 2.5 kilometre sea outfall. It is the UK's last major scheme to ensure that wastewater treatment meets Urban Wastewater Treatment Directive standards. The scheme was named Major Civil Engineering Project of the Year in the British Construction Industry Awards, beating projects such as the London 2012 Olympic Park.

During 2013–14, we continued to take part in a voluntary trial to alert local authority beach managers when we release stormwater from combined sewer overflows (CSOs) during heavy rain. CSOs are sometimes needed because the water could otherwise back up in our sewers and flood customers' homes and gardens. The alerts allow beach managers to publicise the information for beach-users.

We are providing alerts for 22 beaches as part of the Cleaner Seas Forum Bathing Water Trials, which are led by the Government. The trials are in preparation for 2015, when higher quality standards for bathing water will be introduced under the Bathing Water Directive. We will then be required to provide more public information on water quality for all bathing waters.

Preventing pollution

	2013		2012
	Target	Achieved	Achieved
All pollution incidents (wastewater), Category 1-3	295	**320**	409
Serious pollution incidents (wastewater), Category 1-2	5	**9**	10
Environmental Discharge permit compliance	98.2	**96.0**	96.8%

Despite the wettest winter on record, the number of pollution incidents in our region fell by 22 per cent in 2013. We recorded a total of 320 incidents, with serious events falling to nine. We were recognised by the Environment Agency as one of only two water companies with fewer serious pollution incidents during the year.
There was also a four per cent reduction in incidents related to sewers or combined sewer overflows, falling from 144 in 2012 to 138 in 2013. This followed a 14 per cent reduction in the previous year and is the result of an action plan put in place to improve our performance.

Our improvement work has included the continuation of total care plans for 85 wastewater treatment works and pumping stations and more targeted jetting programmes for sewers. We have also added new processes and checks at our works and pumping stations and, where necessary, increased the capacity and levels of treatment.

Wastewater treatment

	2013–14		2012–13
	Target	Achieved	Achieved
Performance wastewater non-infrastructure	Stable	**Stable**	Marginal

The performance of our wastewater treatment works is critical to ensure the water we recycle to rivers, streams and the sea is of the highest quality. The majority of our works, 266 out of 278, met the stringent conditions set by the Environment Agency during 2013–14.

Where failures occurred, many were because of a challenge we continued to face in meeting iron standards in the cleaned wastewater we recycle back to the environment. We have been working with the Environment Agency to review the standards, which were revised towards the end of 2013, and we are now compliant with them.

During the year, we safely recycled 100 per cent of the solid waste left over after the treatment process. The waste was used to produce bio-solids and sold as farm fertiliser.

Our investment

We invested £119 million during the year to improve wastewater treatment and we spent £50 million on maintenance work.

Our work included a £2 million scheme to use ultraviolet light to disinfect the stormwater which collects in storage tanks during heavy rain before it leaves Chichester Wastewater Treatment Works. This is significantly improving the quality of the flows we release into Chichester Harbour, which is classified as an Area of Outstanding Natural Beauty.

A new treatment tank the length of 10 double-decker buses was built as part of a £25 million investment at Millbrook Wastewater Treatment Works in Southampton to help protect the water quality of the Solent.
A £9 million upgrade at Morestead Road Wastewater Treatment Works in Winchester, Hampshire, was completed while, in Kent, we started a £5 million project to increase the capacity at Whitewall Creek Wastewater Treatment Works to cater for housing growth.

Major improvements

In West Sussex, an £8 million maintenance scheme got under way at East Worthing Wastewater Treatment Works to reduce the risk of flooding in the area and improve operations at the site. We also gained planning approval for our plans to re-develop Woolston Wastewater Treatment Works in Hampshire. The new works, which will be designed to blend in with the surrounding area, will significantly reduce smells from the site and ensure the treated wastewater meets new standards.

Reed beds are often used as an extra stage of cleaning and we refurbished those at Ulcombe Wastewater Treatment Works, near Maidstone in Kent, and at Godshill Wastewater Treatment Works on the Isle of Wight.

Water abstraction

The amount of water we took from the environment to supply to our customers fell to its lowest level since the water industry was privatised in 1989. We abstracted 190,614 million litres of water, with the majority coming from underground aquifers and the remainder from rivers and reservoirs.

The record low amount of water abstracted is because of two factors:

Customers using less water as a result of our metering and water efficiency programmes
Our ongoing work to maintain leakage below our industry target.

Conservation

We strive to protect the environment and our care is recognised in our commitment to maintain certification to ISO 14001.

Compliance with ISO 14001 helps us to identify, manage and mitigate our impact on the environment, prevent pollution and ensure we meet environmental legislation. During the year, we passed our annual five-day audit for certification after inspectors visited five of our water and wastewater sites.

Sites of Special Scientific Interest

As a large landowner in the South East, we own or lease a number of Sites of Special Scientific Interest (SSSIs). More than 80 per cent of these are recognised as being in ‘favourable’ condition, the highest rating for an SSSI.

We started ‘health checks’ at 11 SSSI sites to establish if conservation work is needed to maintain or improve their status to protect them for future generations. Some of the sites, which include former landfill sites or steep slopes, offer protection to rare plants and animals, have a unique geology or are an important wildlife habitat.

Conservation work

Conservation work continued at our Testwood Lakes site, near Southampton, which is managed by the Hampshire and Isle of Wight Wildlife Trust. The trust is in the fourth year of a 10-year Higher Level Stewardship scheme promoted by Natural England. Work during the year included the creation of a large dipping pond, control of invasive species and coppicing. The Lakes recorded a good year for birds, with 125 species noted and common terns seen nesting for the first time. Two new species of orchid were also found flowering.
We carried out our annual ecology survey at our new reservoir site in West Sussex, where we have established a wild flower meadow. The section of river from which we abstract water is close to colonies of the depressed river mussel and greater water parsnip. The results were shared with Natural England, the RSPB and Sussex Wildlife Trust.

Our staff joined a national effort to help combat ‘ash dieback’, a fungus that has devastated ash woodland and spread to the UK. Two hundred elms were also planted on our land as part of our project to grow trees that are resistant to Dutch elm disease. A further 30 were donated to East Sussex County Council to replace elms lost to disease on its land.

We also took action to protect eels discovered at our site at Aylesford in Kent. Eels are becoming endangered, with the number of adults dropping by 80 per cent in the last 60 years. We installed scrapers at our treatment tanks to help clear weed in which the eels become trapped, and encourage them back into the River Medway.

Volunteering help

Our staff helped to clean up Worthing beach as part of the Marine Conservation Society’s BIG Beach Clean and Annual Litter Survey. Volunteers also cleared overgrown vegetation at a farm in West Sussex to make way for new hedgerows and establish a wildlife corridor between two areas of woodland.

Contractors working at our wastewater treatment works in Ockley, Surrey, also gave a boost to wildlife by planting buddleias to encourage butterflies, and work to protect grass snakes on site. In addition, we supported several conservation projects in our communities, including the restoration of a village pond by Climping Conservation Volunteers in West Sussex.

More than 180 days of voluntary work were given by education, conservation and weekend helpers at Testwood Lakes in addition to 494 days by the Friends of Testwood, who work at the site every week to improve the habitats.

Archaeology

The conservation of buildings and historic artefacts is another important aspect of our work to protect the environment. An early 18th century labourer’s cottage, which was dismantled and removed from our Bewl Water reservoir site in 1975, was opened to the public after a restoration project at a museum in West Sussex. Tindalls Cottage was re-erected at the Weald and Downland Open Air Museum, where a collection of traditional buildings tells the stories of the people who lived and worked in them over a 600-year period. The cottage includes furnishings and a garden and sets the scene during the time of the first John Tindall, who lived in it from 1748.

A more recent historical find was a Second World War bunker of national significance, discovered by engineers laying a sewer at a former airfield in Hampshire. The red-brick building, which has a concrete roof and is made up of five rooms, was surveyed by Archaeology South-East and is thought to have been a battle headquarters used during the co-ordination of the airfield’s defence.

The Kent Archaeological Field School unearthed a glimpse into Roman life during an excavation of a villa next to our wastewater treatment works at Wateringbury, near Maidstone. It was the second excavation on the site and led to more significant finds from the 1st century AD through to the 4th century.

Following completion of the Cleaner Seas for Sussex scheme, we are looking forward to artefacts found during construction of the Peacehaven site being made available for public display on conclusion of examination by Archaeology South-East.

About us

Our workplace

Health and safety

In an industry-leading performance, we achieved the longest period in our history without a reportable injury to a member of our staff.

We recorded 417 consecutive days without a RIDDOR – a serious injury which must be reported to the Health and Safety Executive. This is believed to be a first for the water industry and is the result of great focus by our staff on safety at work.

While any injury is one too many, our focus helped us to once again beat our target of 0.39 reportable injuries – and preferably fewer – per 100 employees/contractors during the year. We recorded 0.18, our lowest figure ever.

For the 15th consecutive year, we achieved the Royal Society for the Prevention of Accidents (RoSPA) gold level award and were recognised with an Order of Distinction – the first water company to receive such an accolade.

Aim for Zero Injuries

Our ongoing Aim for Zero Injuries campaign has contributed to this achievement. During 2013–14, initiatives included:

- A two-day health and safety conference for more than 500 staff and contractors
- The creation of a wellbeing group alongside directors from our key suppliers
- Health and wellbeing drop-in sessions with local councils
- An awareness campaign for all staff about the dangers of driving on public roads and on sites during bad weather.

We also continued our campaign to encourage staff to report 'near misses' or hazards at work to help prevent injuries. As in previous years, we donated £2 to charity for each report and, as a result, raised a further £10,224 for Air Ambulance organisations in our region. This equates to about four potentially life-saving missions by air ambulance crews.

Our people

We directly employed 2,090 people in Kent, Sussex, Hampshire and the Isle of Wight as of March 31, 2014 and many more through our suppliers. This included 468 in our UK-based contact centres.

People development

We continued our apprentice scheme, with 44 apprentices graduating from our one-year customer services training scheme and a further 19 from our award-winning water and wastewater operations, mechanical, electrical and ICA apprenticeship programme. Ten apprentices also graduated from our innovative water supply and distribution scheme.

We implemented a Leadership Skills Development Roadmap during the year as part of an initiative to develop talent within the business. This includes a Leaders for Tomorrow scheme for first-line managers, which was completed by 86 employees, and an Inspired Leader Programme for middle managers, completed by 30 staff.

Thirty-two people took part in our week-long Employee Development Programme, which ran for the 44th time in 2013.

We also delivered our Ambassador programme across our operations staff, with 244 employees attending during 2013. This has significantly contributed to our customer service improvements. An initiative to improve processes across the business resulted in 56 people enrolling in the Business Improvement Techniques NVQ, which is recognised as best practice in the UK.

We continued our commitment to training during the year, delivering more than 2,100 training sessions, covering a range of topics from employee development to project management and confined space training.

Employee engagement

We also continued to focus on helping to make our company a better place to work, with the support of engagement champions. We moved a step closer to our aim of being listed in The Sunday Times' Best Companies to Work For listing, with 72 per cent of staff completing our annual employee engagement survey. The score showed a seven per cent increase in the level of staff engagement from the previous year.

More than 300 nominations were also received in the second year of our STAR (Staff Thanks And Recognition) Awards, doubling last year's figure.

Our suppliers

During the year, we supported many hundreds of jobs in the South East through the suppliers we employ to deliver our services to customers and our investment programme.

We continued our Multi-Services Framework agreements with Clancy Docwra, Morrison Utility Services and Barhale Trant Utilities to deliver our core water and wastewater services between 2010 and 2015. 4Delivery also continued to deliver improvements to our treatment works as part of its Single Entity Contract until 2015.

New contracts

In addition, we put contracts out to tender for services during our next Business Plan period, which runs from 2015–20. They include a Strategic Solutions Partner to work with our in-house teams to develop projects to deliver the 26 promises we have made to our customers.

We also issued tenders for partners to develop and deliver capital projects and to provide maintenance and reactive services. Other contracts for 2015–20 include key services for customer engagement, human resources and IT.

The appointed contractors will work alongside us to deliver excellent customer service and maintain our outstanding health and safety record. The majority of new contracts will be awarded in 2014–15 to ensure the right suppliers are in place from 1 April 2015 to deliver the services we have promised our customers in the Business Plan.

Our community

Community and education

We firmly believe in giving back to the communities in which our customers live and work. This was done through a range of initiatives and programmes during the year.

Our work was recognised by the Business in the Community charity, which measures companies against criteria for their community, workplace, marketplace and environment contributions. We scored three stars in 2013–14, increasing our overall score from 86 per cent to 90 per cent and achieving an above-average score in the index.

Learn to Swim

In a region bordered by an extensive coastline, our long-standing Learn to Swim programme helped to teach another 35,000 children this life-saving skill.

The scheme received a high-profile boost from Olympic champion Becky Adlington, who joined our annual seminar for Learn to Swim instructors at a pool in Sussex and took part in a training session with youngsters from Crawley schools. Former Olympic gold-medallist Duncan Goodhew also continued in his role as ambassador for the scheme and presented awards to 50 inspirational children at our annual Learn to Swim Achiever Awards.

The Learn to Swim programme operates at 85 pools and clubs across the South East. Since its launch in 1992, more than 650,000 children have learned to swim through the scheme.

South and South East in Bloom

We continued to sponsor the annual South and South East in Bloom competition, which was bigger and better than ever in 2013. A record number of 366 entries were received from towns, villages and cities across the region, with 115 in the Blooming Schools section.

The themes of the competition are horticulture and gardening, environmental responsibility and community participation. Celebrity gardener Chris Collins presented awards to the winners at a ceremony in Kent.

Education programmes

The young people in our region are our customers of tomorrow, so our education programmes about how to use water wisely are important. A total of 4,571 children in 29 primary schools watched our fun mime play about a family called the Drips. The show, designed for seven to 11-year-olds, conveys the message that we should only use as much water in and around the home as we need to.

We continued to run an education programme for 10 secondary schools during the year. Our Aqua Innovation scheme encourages pupils to develop water-saving ideas and campaigns, which are judged against other schools in a 'Dragon's Den' style final. The year's winning design was a scheme by Thornden School in Hampshire to channel wastewater from baths and showers to a water butt through a series of filters.

More than 1,000 primary school children received whistle-stop lessons in water and wastewater during a Junior Citizen event at Crawley in West Sussex. Staff also volunteered to join the STEM ambassadors' programme, going into schools to help engage young people in Science, Technology, Engineering and Mathematics.

Community campaigns

Other community campaigns during the year included our Sporting Chance programme, which engaged more than 6,200 young people through football and cricket. We worked with Gillingham Football Club in Kent to help disadvantaged children in the Medway area and we ran water efficiency and sewerwise workshops for students in conjunction with Southampton and Portsmouth football clubs. We also joined forces with Sussex Cricket Club to run the Southern Water Ashes competition and promote the health benefits of drinking water.

Our Water Café took to the road to visit 19 community events where we talked to our customers about water and wastewater and gave away free water-saving devices as well as fat traps to recycle fat, oil and grease to prevent drains from getting blocked.

Charity support

We have a long-standing ethos of giving back to the communities in which we live and work through charity fund-raising. During the year, we raised and distributed more than £235,000 to good causes.

The organisations we supported were chosen by our staff and included national charities such as the NSPCC, Macmillan Cancer Support, Cancer Research UK and WaterAid. We also supported regional charities such as the Kent, Sussex, Hampshire and Isle of Wight Air Ambulance trusts, Chestnut Tree House Children's Hospice, near Arundel in West Sussex, and St Barnabas House hospice in Worthing.

Annual events

Our three main annual charity events were our ball, which had a Swinging Sixties theme and raised £85,000; our seventh horse-racing day at Fontwell Park in West Sussex, attended by more than 4,500 people (£35,000); and our WaterAid golf day (£11,000). Other activities included a London to Turin Bike Challenge, Wear a Santa Suit to Work day and a sponsored walk along the South Downs to support The Argus Appeal, which helps disadvantaged children, the elderly and people with disabilities in Sussex.

Each of our directorates was invited to choose a charity for its own staff to support, with every £1,000 raised matched by the company. This resulted in £33,000 being donated to good causes including Chailey Heritage School in East Sussex, the Heart of Kent Hospice, Hampshire Asbestos Support & Awareness Group and Chelsea's Wishes on the Isle of Wight. We also made 68 smaller donations, worth £9,320, to community organisations, schools and to support staff fund-raising initiatives.

Volunteering our time

Our staff spent 502 days helping worthy projects as part of our Community Volunteering Programme. The scheme allows staff to take two days' paid leave each year to volunteer their services for charities, community organisations or environmental work.

Volunteering initiatives included refurbishing a hotel for the partially-sighted, creating a woodland walk for children with life-limiting illnesses and painting a community beach hut.

Access and recreation

As a major landowner in the South East, we are in a privileged position to help our customers enjoy days out and learn more about the environment.

We own four reservoirs – Darwell and Powdermill in East Sussex, Weir Wood in West Sussex and Bewl Water on the Kent/Sussex border. All offer outdoor activities such as public walks, fishing and sailing. Bewl is our largest reservoir and each year more than 150,000 visitors enjoy activities including windsurfing, sailing, fishing, cycling, walking and boat trips.

New wetland habitat

Our Testwood Lakes site, near Southampton, is managed on our behalf by the Hampshire and Isle of Wight Wildlife Trust and we celebrated the 10th anniversary of the partnership.

The site, previously used for extracting gravel, is now a nature reserve covering 130 acres and features bird hides, a sand martin bank, wildlife ponds and an education centre. A new purpose-built pond and dipping platform were created, largely by volunteers, to extend the scope of education visits to the site.

During the year, about 30,000 people visited Testwood Lakes, including schools, community groups, walkers, birdwatchers and nature-lovers. More than 3,850 children and young people took part in visits and holiday activities while 2,691 participated in formal education programmes. The centre expanded its work with baby and toddler sessions and staged a World War II living history programme for primary schools.

Other visitor opportunities in our region included displays of historic pumping machinery at our water treatment works at Brede in East Sussex. The machinery is cared for and displayed by Brede Steam Engine Society and we printed 10,000 promotional leaflets about its work to help spread the word. An Edwardian pumping station is also open to visitors at our waterworks at Twyford in Hampshire.

Sewer tours

Our tours of the Victorian sewer network in Brighton attracted more than 1,500 visitors during the year. High-profile guests included Michael Portillo, as part of his BBC Great British Railway Journey series, actor Alan Cumming and Meridian TV presenter Fred Dinenage. During the guided tours, we added information about the dangers of pouring fat, oil and grease down drains. We also opened the doors of our treatment works to groups of schoolchildren who toured our sites as part of our Aqua Innovation education programme for secondary schools.

Southern Water Financial performance

Financial performance

Accounting policies

The accounting policies of the company, which are consistent with the prior year, are set out on pages 58 to 61.

Profit and loss account

The profit and loss account of Southern Water Services Limited is summarised in Table 1 below.

Table 1	Years ended 31 March		Change
	2014 £m	2013 £m	%
Turnover	**806.2**	778.7	*3.5*
Operating costs before exceptional items	**(246.5)**	(239.4)	*3.0*
Depreciation, net of amortisation	**(234.9)**	(213.4)	*10.1*
Other income	**0.2**	5.1	*(96.1)*
Operating profit before exceptional items	**325.0**	331.0	*(1.8)*
Exceptional item	**(18.8)**	-	-
Operating profit	**306.2**	331.0	*(6.0)*
Profit on disposal of fixed assets	**0.5**	1.0	*(50.0)*
Net interest	**(167.2)**	(152.9)	*9.4*
Profit before tax	**139.5**	179.1	*(19.3)*
Tax	**30.3**	(22.2)	*(236.5)*
Profit after tax	**169.8**	156.9	*8.2*

Turnover increased by 3.5 per cent to £806.2 million (2012–13: £778.7 million) principally because of the average tariff increase on metered and unmetered income of 5.1 per cent. This increase was applied from 1 April 2013 and was based on the annual RPI of 3.0 per cent at November 2012 together with a K factor of 2.1 per cent. We were entitled by Ofwat to increase prices by a K factor of 3.3 per cent, but we voluntarily chose not to implement the maximum allowed price increase because take-up of our metering transitional tariff has been lower than expected. The increase was offset by reduced income from customers switching from an unmetered supply to a metered supply principally as a result of our metering programme.

Operating costs before exceptional items increased by 3.0 per cent to £246.5 million (2012–13: £239.4 million) and the major reasons for this movement of £7.1 million are explained in Table 2.

Table 2 Increase/(decrease) in operating costs	£m
Inflation	8.1
Pension curtailment in 2012–13	9.0
Increased bad debt charge (including inflation £1.3m)	4.1
Peacehaven – operating costs of new site	1.6
Power efficiencies	(3.2)
Contract renegotiations	(7.1)
Process improvements	(2.8)
Pension reduced service cost	(1.0)
Targeted efficiencies	(1.6)
Movement in operating costs	**7.1**

During 2012–13, we undertook a comprehensive review and consultation process relating to the final salary pension scheme, which resulted in the implementation of significant changes to the scheme to ensure its long-term sustainability. This resulted in a one-off, non-cash, curtailment gain of £9.0 million in 2012–13 and a reduction in overall pension service costs of £1.0 million in 2013–14.

Following the completion of our £300 million scheme at Peacehaven, operating costs are now being incurred. These amounted to £1.6 million in 2013–14 in relation to the part of the year that the site was operational. There will be a further increase in operating costs associated with the site next year when there will be a full-year impact.

Other efficiencies have been achieved through business process reviews, contract renegotiations and a focus on maintaining tight budgetary controls. These include initiatives to reduce power and chemical usage and reducing the work issued to external contractors through more efficient use of our own internal resources.

Depreciation increased by 10.1 per cent to £234.9 million (2012–13: £213.4 million) as a result of the continuing significant capital investment programme. New schemes commissioned during the year added £12.3 million to the depreciation charge with the most notable items being the impact of the Peacehaven scheme and water compliance projects. In addition, there was an increase in the infrastructure renewal charge of £6.3 million, reflecting the greater level of capital expenditure on infrastructure assets and private sewers.

Other income reduced to £0.2 million from £5.1 million in 2012–13. This reduction principally results from income for services provided in the disposal of an investment in Veolia Water Southeast Limited held by another group company that was received in 2012–13.

Operating profit before exceptional items for 2013–14 decreased to £325.0 million (2012–13: £331.0 million), a 1.8 per cent reduction as a result of the factors set out above.

During the period from December through to February, the South of England experienced a series of storms and heavy rainfall. The areas most affected included Hampshire, Sussex and Kent which all fall within our operational area. The level of rainfall across the South East was in excess of 260 per cent of the historical average and resulted in significant operational disruption, with many sites without power and lengthy periods of flooding due to the high groundwater levels. As a result of this exceptional weather event, we have incurred significant additional costs for pumping and tankering to alleviate the flooding and to ensure that we continue to serve our customers. We have recorded the costs associated with this event as an exceptional item of £18.8 million within the accounts for 2013–14.

The resultant operating profit for 2013–14 decreased to £306.2 million (2012–13: £331.0 million).

The profit on disposal of fixed assets of £0.5 million (2012–13: £1.0 million) mainly relates to the sale of land and buildings surplus to operational requirements.

Net interest payable of £167.2 million increased by 9.4 per cent (2012–13: £152.9 million). In March 2013 a new £250 million bond was issued in preparation for the repayment of an existing £250 million bond at March 2014. The increase in net interest largely relates to the additional £7.7 million associated with this new loan. In addition, the issue fees associated with the existing loan were written off when this was repaid. These increases were offset by lower indexation on the inflation-linked bonds as a result of lower RPI in 2013–14.

We have recognised a tax credit to the profit and loss account of £30.3 million (2012–13: £22.2 million charge). This differs from the charge that may be expected of £32.1 million, based on the profit before tax of £139.5 million and the current period tax rate of 23 per cent. This is primarily a result of the announcement of the reduction in the rate of corporation tax from 23 per cent to 21 per cent with effect from 1 April 2014, and to 20 per cent from 1 April 2015. A credit of £47.1 million is recognised for the impact of these changes on the deferred tax liability of the company, as described in note 8. A further credit of £10.6 million arises as a result of agreement of prior period tax returns with the tax authority, leading to lower tax liabilities in future periods. The current tax charge for the period is also reduced by £16.0 million as a result of capital allowances arising from our capital investment programme.

The profit after taxation for the year amounted to £169.8 million (2012–13: £156.9 million).

Cash flow statement

The cashflow statement of Southern Water is summarised in Table 3 below:

Table 3	Years ended 31 March	
	2014	2013
	£m	£m
Net cash inflow from operating activities	**543.3**	499.8
Net cash outflow from returns on investment and servicing of finance	**(90.4)**	(81.8)
Taxation	**(22.9)**	(13.7)
Capital expenditure and financial investment		
Purchase of tangible fixed assets	**(382.0)**	(360.1)
Receipt of grants and contributions	**9.9**	10.1
Sale of tangible assets	**0.3**	0.6
Movement on loan to subsidiary	**(15.9)**	(227.1)
Net cash outflow for capital expenditure and financial investment	**(387.7)**	(576.5)
Equity dividends paid	**(43.8)**	(43.2)
Net cash outflow before financing	**(1.5)**	(215.4)
Net cash (outflow)/inflow from financing	**(2.9)**	279.9
(Decrease)/Increase in net cash	**(4.4)**	64.5

Net cash inflow from operating activities increased to £543.3 million for 2013–14 from £499.8 million in 2012–13. This increase mainly results from a change to the payment terms of some of our maintenance contracts, the settlement of an outstanding debtor in respect of the disposal by a group company of its investment in Veolia Water Southeast Limited, additional cash receipts resulting from the price increase on turnover and lower cash expenditure from the operating efficiencies delivered.

The net cash outflow from returns on investment and servicing of finance increased to £90.4 million for 2013–14 from £81.8 million in 2012–13. This increase results from net interest payable on the new £250.0 million bond issued in March 2013 together with additional interest payable, which arises from the impact of inflation on the underlying nominal values of a number of our loans.

In total, tax payments of £22.9 million were made during 2013–14 (2012–13: £13.7 million). These relate to payments for group relief for taxable losses across the Greensands group. Of this, a payment of £13.1 million (2012–13: £13.7 million) was made to Southern Water Services Group (SWSG). This, together with the interim dividend of £43.8 million (2012–13: £43.2 million), is offset by interest received from SWSG of £56.9 million (2012–13: £56.9 million).

The outflow of cash relating to the purchase of tangible fixed assets was £382.0 million (2012–13: £360.1 million). The increase in cash outflow results from the increase in the overall capital programme during the year.

The net cash outflow before financing in 2013–14 was £1.5 million (2012–13: £215.4 million) with the higher outflow in 2012–13 arising from the transfer of funds to Southern Water Services (Finance) (SWSF) in preparation for the repayment of a £250.0 million Class B bond in March 2014.

The net cash outflow from financing of £2.9 million relates to the repayment of accrued indexation on some of our bonds. In 2012–13 there was a £279.9 million inflow principally from the issuance of a new Class B bond.

Balance sheet

The balance sheet of Southern Water is summarised in Table 4 below:

Table 4	Years ended 31 March	
	2014	2013
	£m	£m
Fixed Assets		
Tangible assets	**4,432.0**	4,264.3
Investments	**29.2**	29.2
	4,461.2	4,293.5
Current Assets		
Stocks	**2.0**	1.5
Debtors falling due within one year	**198.0**	416.6
Debtors falling due after more than one year	**812.3**	812.3
Cash at bank and in hand	**135.5**	139.9
	1,147.8	1,370.3
Creditors falling due in one year	**(300.6)**	(505.9)
Net Current Assets	**847.2**	864.4
Creditors falling due after one year	**(3,836.4)**	(3,767.5)
Provisions for liabilities and charges	**(314.7)**	(357.6)
Grants and contributions	**(43.8)**	(46.4)
Pension deficit	**(72.3)**	(72.1)
Net Assets	**1,041.2**	914.3
Capital and reserves	**1,041.2**	914.3

At the end of the year to 31 March 2014, we had fixed assets of £4,461.2 million (2012–13: £4,293.5 million), an increase of £167.7 million from March 2013. This increase largely results from capital investment of £415.5 million offset by depreciation of £237.8 million.

Debtors falling due within one year decreased to £198.0 million (2012–13: £416.6 million). This reduction mainly resulted from a movement in inter-company debtors of £238.0 million following settlement of the Class B bond in March 2014. This was offset by the continued increase in the level of accrued income of £12.9 million resulting from our metering programme.

The repayment of the Class B bond is also the principal reason for the reduction in the level of creditors falling due within one year, which decreased to £300.6 million (2012–13: £505.9 million). This reduction was offset by a change in the payment terms on some of our maintenance contracts and accruals made for costs associated with the flooding events over the winter.

As at 31 March 2014 creditors falling due after one year increased by £68.9 million to £3,836.4 million. This increase principally resulted from inflation on inflation-linked bonds of £72.1 million.

The net pension deficit increased in value to £72.3 million (2012–13: £72.1 million) following the latest actuarial valuation, as described in note 22.

Overall net assets increased from £914.3 million to £1,041.2 million.

Dividend policy

Southern Water aims to deliver a sustainable long-term financial strategy, taking into account the interests of all stakeholders. Our shareholders are long-term investors and fully support the strategy adopted.

Southern Water's dividend policy is to propose dividends having given due consideration to the following financial and performance criteria.

1. Assessment of headroom under debt covenants
2. Assessment of the impact on the company's credit rating
3. Assessment of the liquidity position and ability to fulfil licence conditions
4. Assessment of key areas of business risk
5. Assessment of current year and cumulative distributable reserves
6. Directors' duties under law and Ofwat administered regulatory arrangements

Distribution proposals submitted to the Board will also include an assessment of our performance against the Business Plan, including expected performance over the balance of the regulatory period.

Southern Water's dividend policy and the associated financial and performance criteria are intended to support the credit ratings of the business and ensure continued access to diversified sources of finance.

These tests are not applied to the interim dividends paid to SWSG as the dividend payment is instantly offset by a corresponding interest receipt from SWSG.

The shareholders continue to support the business and no other ordinary dividend was paid or declared in relation to 2013–14 (2012–13: nil), and no dividends were paid to the shareholders of our ultimate parent company, Greensands Holdings Limited.

Taxation

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

All companies within the Southern Water, and wider Greensands, group are UK tax resident, ensuring that each company is subject to UK tax. Tax planning is always aligned with our commercial and economic activity. This practice continues to be recognised by HMRC, which considers us to be a low-risk company.

Our rate of corporation tax against accounting profits (our effective tax rate) is less than the statutory rate of corporation tax published by HMRC because of differences in the way in which some items of expenditure are treated for accounting and tax legislation. This is especially the case with regard to capital investment expenditure, where the UK taxation system recognises the benefit to the economy of investment in UK infrastructure. Since privatisation in 1989, the water industry has been required to make significant capital investment to improve environmental performance and resilience to drought and flooding, maintain existing assets and, in particular for SWS, accommodate population growth in the South East of England. Our taxable profits are lower than our accounting profits as a result of our capital expenditure, with capital allowances being recognised at a faster pace than the depreciation charge of our assets. This has the effect of reducing the amount of tax we pay, the benefit of which is passed to our customers through their bills.

Another aspect of our significant capital investment programme is that we borrow money to finance our capital investment. The interest associated with this borrowing is recognised as both an accounting and tax expense, so reducing profit and further reducing the amount of tax we pay. Again, the benefit of this is passed to our customers through reduced bills.

Our contributions to the Exchequer amounted to £57.1 million. These are explained below:

- Business rates of £24.4 million paid to local authorities (2012–13: £24.2 million) and payments to the Environment Agency of £8.2 million (2012–13: £7.7million), which reduce profits chargeable to corporation tax
- Employment taxes of £21.5 million paid to the Exchequer in PAYE (Pay As You Earn) and National Insurance contributions (2012–13: £20.5 million)
- Carbon Reduction Commitment of £3.0 million levied on our power cost (2012–13: £2.8 million), which reduces profits chargeable to corporation tax

Payments have also been made to other group companies of £22.9 million for tax losses surrendered to the company. Of these, £13.1 million was paid to SWSG and then repaid to Southern Water as interest, with the remainder paid to the Greensands financing companies.

In addition, we will have paid a significant amount of indirect taxation, such as fuel excise duty relating to transport costs and landfill tax in connection with the disposal of waste product from our wastewater treatment processing.

Financial KPIs

Under 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 cash income to net interest cost.

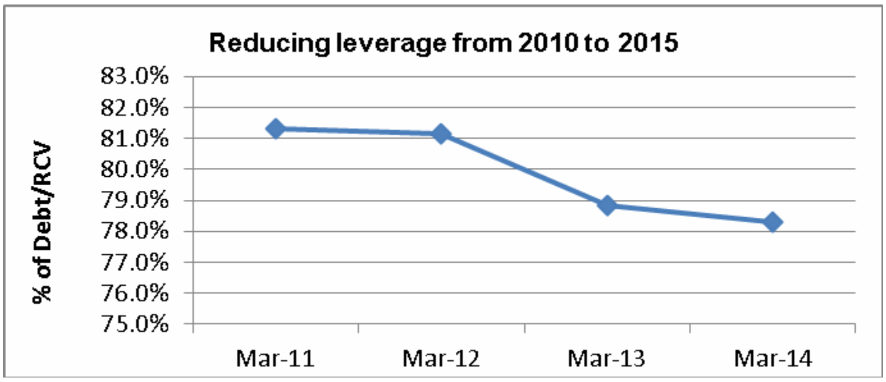
The net debt used in the ratio of net debt to RCV is calculated from our Regulatory Accounts as short and long-term senior borrowings, less cash and short-term deposits. The RCV for each year is set by Ofwat for five-year periods at periodic reviews and reflects forecast growth in the asset base. It is adjusted at each periodic review for any out-performance, shortfalls in outputs or permitted additional investment and for certain asset disposals. The ratio of senior debt to RCV is targeted to be maintained at below 85 per cent, in line with our debt covenants. Senior adjusted cash interest cover (measured as net cash inflow from operating activities less current cost depreciation and the infrastructure renewals charge to senior debt interest) is targeted to be maintained above 1.1 times to meet covenanted levels.

Net debt: RCV	%
2010–11 performance	81
2011–12 performance	81
2012–13 performance	79
2013–14 performance	78
Covenanted lock-up level	<85

Senior adjusted cash interest cover	Times
2010–11 performance	1.4
2011–12 performance	1.6
2012–13 performance	1.5
2013–14 performance	1.6
Minimum target trigger level	1.1

Credit rating	
Standard & Poor's	Class A debt: A- Class B debt: BBB
Fitch	Class A debt: A- Class B debt: BBB
Moody's	Class A debt: Baa1 (negative outlook) Class B debt: Ba1 (negative outlook)

During the current five-year regulatory period from 2010 to 2015, we have faced financial risks such as a material shortfall in revenues compared to those assumed at the time of setting prices for this five-year period, as well as event risks such as the £18.8 million cost associated with the series of storms and heavy rainfall from December through to February. Shareholders have been extremely supportive during this period by voluntarily foregoing dividends in order to ensure we have sufficient cash to maintain our programme to improve performance and to reduce leverage and financial risk as well as to manage these financial KPIs.



Capital structure

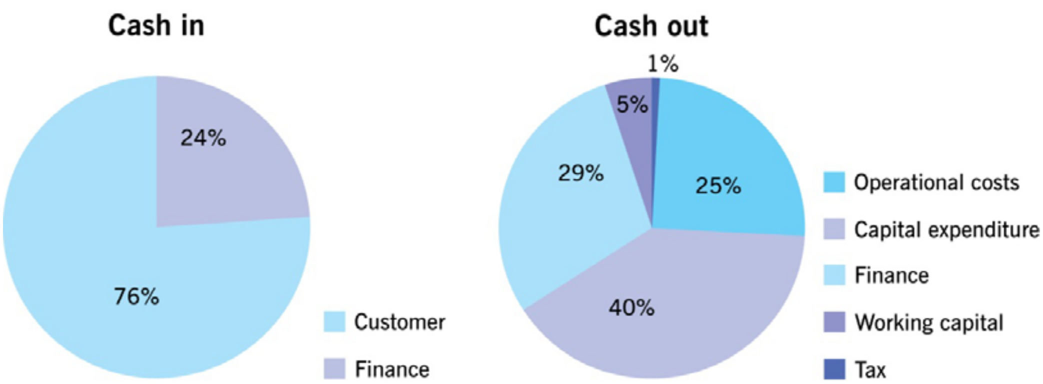
Why Southern Water raises finance

Significant capital investment programmes have been a feature of Southern Water's 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, prior to privatisation, wastewater discharged into our coastal waters was 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.

We raise finance to pay for the construction of new assets. As a shareholder-owned company, we are incentivised to drive efficiency and need to maintain the proportion of assets financed by shareholder equity in order to absorb financial risk and to lay the basis for financing the construction of new assets. New finance is also required to repay loans taken out in previous years.

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

The charts below illustrate the sources and uses of expected cash flows for the current regulatory period April 2010 to March 2015, and demonstrate our requirement to raise finance to fund our capital investment programme. The data is based upon the regulatory price determination, which sets out our obligations and the limits for customer charges for this current five-year price period.



Capital structure and borrowing covenants

We refinanced our regulated business in 2003 with the aim of reducing our cost of capital and gaining access to long-term, secure sources of finance. This was achieved by replacing a short-term parent company loan with a long-term framework for sustainable future financing.

Our financing subsidiary Southern Water Services (Finance) (SWSF) was established for the express purpose of raising debt finance on our behalf. The Southern Water Financing Group (see ownership chart below) was also established at that time to create a financial ring-fence to protect our ongoing operation.

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

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

One of the CTA arrangements is a limit on the indebtedness of Southern Water and SWSF. This limit includes precautionary ‘early warning’ limits, which prevent us from paying dividends. We ensure that we operate with sufficient financial headroom against these limits and have not breached a limit at any time since the 2003 refinancing.

How we finance the business

In note 16 to the financial statements, we provide an analysis of our outstanding debt at 31 March 2014 and 31 March 2013. The majority of our loans are sterling bonds and were issued by our financing subsidiary SWSF and are listed on the UK Stock Exchange.

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. Based on inflation of 2.9 per cent, this proportion of the capital structure will reduce from 36 per cent of the RCV today to 28 per cent of the RCV at 31 March 2020.

We are not restricted to issuing sterling bonds, but will ensure that any other currency loans are fully hedged back to sterling. We also hedge our exposure by ensuring that at least 85 per cent 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 per cent 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 per cent of RCV in any two consecutive years and 40 per cent of RCV within any five-year regulatory period. The maturity profile of loans ranges from within one year 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.

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

We also maintain a £200 million committed bank credit facility, which is used as a liquidity buffer and was undrawn at 31 March 2014 and 31 March 2013.

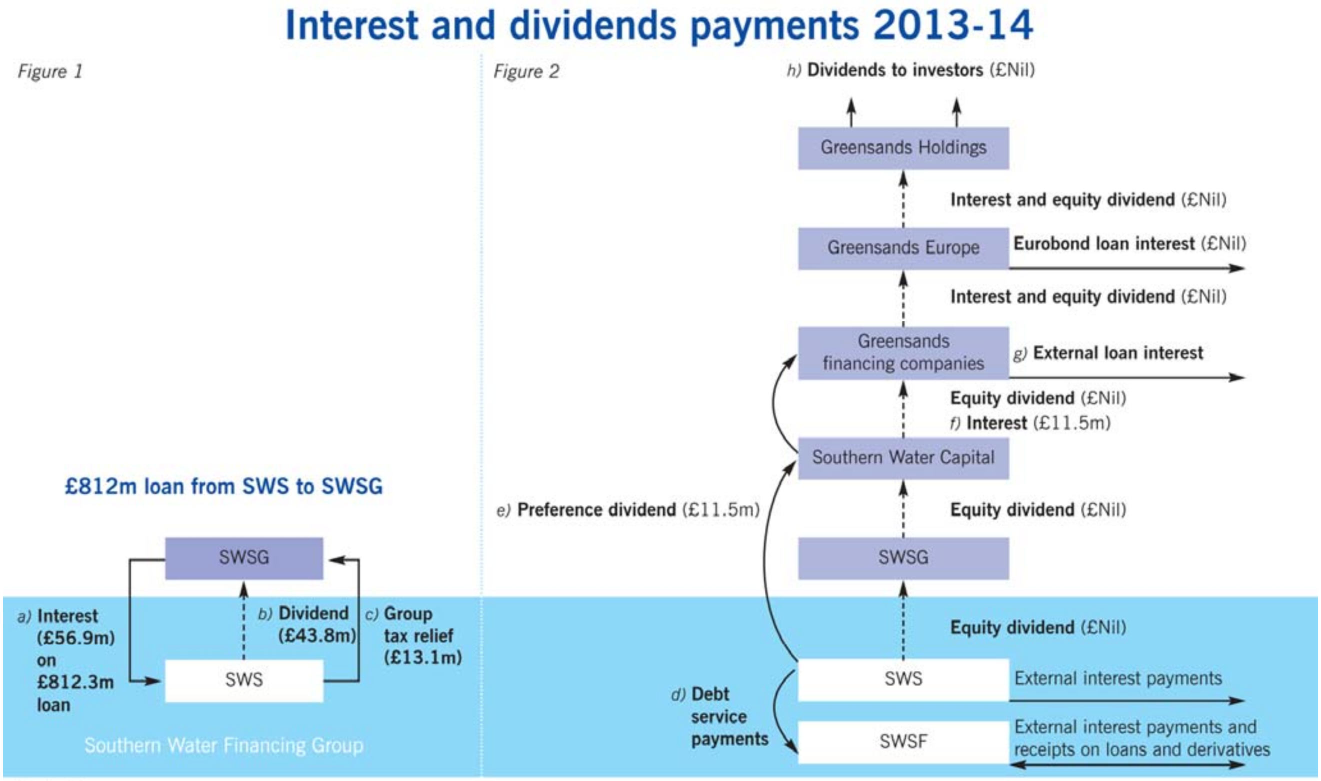
As a result of our liquidity policy, we can have large cash balances. We reduce the risk of losing cash on deposit, from bank or fund failure, by setting maximum limits on cash deposits with any bank or fund. Banks must have, as a minimum, a credit rating of P1 (Moody’s), A1 (Standard & Poor’s) or F1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

In addition to our loans as analysed in note 16, we issued a loan of £812.3 million to SWSG as part of the refinancing in 2003 (note 14). We receive £56.9 million annual interest on this loan, which is financed by dividend and tax payments we make to SWSG. For the year ended 31 March 2014, the dividend was £43.8 million and the tax payment, in respect of the taxable losses incurred by SWSG, amounted to £13.1 million. This loan provides no tax benefit to either us or the Greensands Group, with the tax payment from Southern Water to SWSG simply negating any tax effect of this loan. This is illustrated in figure 1 of the diagram below.

The Greensands companies also have their own loans: a UK-listed bond and bank loan issued by Southern Water Greensands (Financing) (SWGF), represented in the diagrams as Greensands financing companies, and Eurobonds issued by Greensands Europe. The UK-listed bond and bank debt issued by SWGF result in tax losses which can be used within the Greensands Holdings group of companies. All companies within the Greensands

Holdings group are UK tax resident and form a single 'family' of companies for UK tax purposes.

Figure 2 below highlights cash flow movements between Southern Water and the Greensands Holdings group of companies for 2013–14.



Footnote:

a) Interest paid by SWSG to SWS on £812.3m loan.
b) Dividend paid by SWS to SWSG.
c) Payment of group tax relief by SWS for the taxable losses at SWSG.
d) Interest payments from SWS to SWSF on the loans taken out by SWSF on behalf of SWS. This is then used by SWSF to pay the interest on these external loans.
e) Interest payments on the preference shares.
f) Interest payable on an inter-company loan.
g) External interest payable, funded from interest receivable and cash held in the Greensands financing companies.
h) No dividends were paid to investors.

Risks

In order to provide a reliable and consistent service for our customers, it is important that we recognise and monitor risks to our business.

We ensure controls are in place so we can take action to minimise the impact of these risks. To do this, we manage risks through a central database where they are ranked and assigned to a senior manager who is responsible for implementing mitigation plans.

Risks are reviewed each month and the highest are escalated to our Executive Management Team, the Board and the Audit and Risk Review Committee. Any new risks added to the database with a score above a certain level are passed to a director and Chief Executive Officer for immediate review. Key risks during the year, which are listed by category, included:

Future price limits: The process for Ofwat's 2014 Periodic Review began in 2011–12. This will determine price limits for the period 2015 to 2020. The review is significantly changed with the introduction of separate price controls for retail and wholesale services. We submitted our final Business Plan to Ofwat in November 2013 and, in response to feedback and further guidance from Ofwat, will be submitting a revised Business Plan in June 2014. Failure by Ofwat to recognise significant investment needs or other major issues included within our plan may lead to a shortfall in funding for the regulatory period.

Mitigation: We completed extensive development work, including substantial consultation with customers, to produce a high-quality Business Plan. We consulted further with customers on our proposals to revise our plan in response to Ofwat's new guidance. Our plan and its revision were reviewed by our independent Customer Challenge Group, the Board and subjected to assurance testing. We have continued to respond to all Ofwat's consultations on price review methodology and will maintain close dialogue with Ofwat and other regulators on key issues.

Market reform: During the last two years, there has been a significant focus on reform within the water industry. This has included the Government's Water White Paper and Ofwat's Future Price Limits, which focus on changes to the way customer prices are set, the introduction of competition and a greater use of market mechanisms to promote innovation and efficiency. Our economic regulator, Ofwat, is continuing to review and revise the regulatory regime to ensure it is fit for the challenges of the future, including market reform and changes to water company licences.

Mitigation: We have continued to engage constructively with Ofwat and Defra on the proposals for market reform. We are also working with Water UK to ensure that any changes deliver better, more effective, regulation in the interests of our customers and the business. During the year we have taken an active participation in workshops and consultations held by the Open Water programme, which will deliver the market codes, systems and contracts needed to implement the wholesale and retail arrangements outlined in the draft Water Bill.

Compliance with legislation: Southern Water is a highly regulated business with three main regulators: Ofwat, the Environment Agency and the Drinking Water Inspectorate. If we do not meet the regulations set by these bodies, the company could face penalties during the five-year price review that sets our levels of investment and customer bills. We could also face fines, legal action and, in the worst case scenario, the loss of our appointment as a water and wastewater company.

Mitigation: We have procedures in place to comply with legislation and key procedures have been certified to meet high standards, including ISO 9001 and ISO 14001. Awareness training is provided throughout the company for critical issues, such as the Bribery Act and Competition Law, to ensure everyone understands our legal obligations. All sections of the business review their compliance with company procedures through self-assessment every six months and implement improvement plans if necessary.

Operational failures and pollution incidents: Reliable water and wastewater services are essential to maintain public health and protect the environment. Operational failures can lead to interruptions to drinking water supplies, risks to health or severe damage to the environment from pollution. As well as the risk of damage to the environment or distress to customers, incidents like these can also affect our performance rating with Ofwat, lead to prosecution and fines by the Environment Agency or the Drinking Water Inspectorate and cause damage to our reputation.

Mitigation: The majority of our £1.8 billion capital investment programme for 2010–15 is targeted to maintain our water and wastewater sites and networks to reduce the risk of failure and incidents. We have response teams on standby to make sure if there are problems we can minimise the impact to our customers and the environment.

Resilience to drought: The South East is classified as an area of severe water stress and changing weather patterns are predicted to pose an increasing challenge for all water companies in the region in future years.

Southern Water supplies drinking water to more than one million households across Kent, Sussex, Hampshire and the Isle of Wight and it is critical we are able to develop a resilient network to continue to do so now and in the future.

Mitigation: We have secured extra water resources through our new River Arun reservoir in West Sussex to achieve our target for the Security of Supply Index in the region. We have also continued to drive down leakage below our company target and are on track to install water meters for the majority of our customers by 2015, supported by a wide range of water efficiency initiatives. Should a drought occur, as in 2012, we have a Drought Plan which we follow to introduce measures to conserve water and secure additional resources through Drought Permits and Drought Orders and by changing the way in which we operate our sources. During the year, we also updated our Water Resources Management Plan, using an industry-leading approach that allows us to plan for a wider range of droughts than we have seen in the past.

Preventing flooding of our sites and from our network: Changing rainfall patterns, more frequent storms and rising sea levels could all lead to an increased risk of flooding. The serious floods in recent years have also highlighted the need to protect our water and wastewater treatment works and pumping stations from being put out of action in floods.

Mitigation: To help combat this increased risk, we are investing nearly £90 million in flood protection schemes between 2010 and 2015 to increase the capacity of our sewer network. This includes £20 million on sewer improvements in Portsmouth to help protect the city from flood damage during storm conditions after it was extensively damaged in a storm in 2000. Nearly £10 million is also being invested in updating sewer plans, computer models and drainage area plans to look at how our network can cope with changing weather in the future and how we can reduce the risk of flooding to homes and gardens, and £7.2 million to survey and seal sewers identified as vulnerable to groundwater flooding during the wet winter of 2012–13.

Regional growth: The population in the South East has grown considerably during the last 20 years and is expected to grow by a further 16 per cent between 2010 and 2030. The populations of Portsmouth and the Isle of Wight are forecast to be the fastest growing. This presents significant challenges because our region has increasingly scarce water resources, many environmentally important areas and a densely populated coastline, which will require higher standards of protection.

Mitigation: We need to ensure we can supply enough drinking water to cater for a growing population and that we have enough capacity at our wastewater treatment works and in our water mains and sewer network to cope with the extra flows. We continually review population forecasts as part of our forward planning in our five-year Business Plan and our 25-year Water Resources Management Plan. By 2020, we anticipate housing development will have started to grow again as the population increases in line with forecasts. Our future investment plans are developed in consultation with developers and local planners to make sure we have the necessary infrastructure in place to cater for new developments.

Bad debt: Levels of bad debt, which cannot be recovered and have to be written off as a loss, continue to be a significant issue for the water industry. In the current economic climate, there is a risk that the number of customers who do not pay their bills will increase. This puts an additional burden on customers who do pay their bills.

Mitigation: We understand that some customers may experience financial difficulties, particularly in these difficult economic times. We encourage customers who are struggling to make payments to contact our Debt Advice Centre as early as possible. We offer a range of flexible instalment plans and tariffs and also refer those in severe financial hardship to our Charitable Trust, which can give grants. As part of our metering programme, we can offer water and energy audits in the customer's home to help them make savings and a free referral to the community organisation IncomeMAX, which can ensure households are receiving all the benefits and grants they are entitled to. We are proactive in collecting payment from our customers and in helping households to pay their bills and debt. When necessary, we also utilise a leading debt management system to recover overdue payments to keep bad debt to a minimum.

Financing our business: Significant change in interest rates or a reduction in the availability of credit to the water industry could put our ability to finance our capital investment programme at risk in the future. The industry requires ongoing access to capital markets because of negative cash flows, which have been a feature of the water industry since it was privatised in 1989. We only enter into treasury transactions to manage inherent risk and support prudent funding, not to speculate.

Mitigation: We ensure that we maintain sufficient cash reserves and liquidity facilities to finance our operations for at least 12 months. We also ensure the aggregate nominal value of debt maturities (and derivative inflation payments) does not exceed 40 per cent of RCV in any single regulatory period (and 20 per cent of RCV in any 24 months). Exposure to interest rate rises on our current borrowings is also hedged by a subsidiary company, Southern Water Services (Finance), and current borrowings are at either fixed rates or inflation-linked. We raise inflation-linked debt or derivatives to manage company risk relating to fluctuation in inflation and will limit our future source of inflation hedge to inflation-linked debt. Our next material debt maturity is on 31 March 2016. We ensure that sufficient funds are available for our operational and capital investment programme through ongoing monitoring and forecasting of our cash flow and we take steps to manage this when necessary.

Credit ratings: We need to maintain an investment grade credit rating to ensure we can continue to access the capital markets to efficiently finance our capital investment programme and refinance our existing debt maturities. This is required as a condition of our regulatory licence and it is also a primary duty of Ofwat to ensure we can finance our business. In addition, it is a condition of borrowing covenants, where a failure to maintain certain credit ratings could lead to a restriction in dividend payments.

Our current credit ratings are:

- Standard & Poor's: Class A debt, A-; Class B debt, BBB
- Fitch: Class A debt, A-; Class B debt, BBB
- Moody's: Class A debt, Baa1 (negative outlook); Class B debt, Ba1 (negative outlook); Corporate family rating Baa2 (negative outlook).

Mitigation: We have an internal business plan which is expected to stabilise our overall credit rating position. A primary duty of Ofwat when setting prices is to ensure companies can finance their business. If necessary, a company can apply to reset customer prices during the five-yearly regulatory periods through an Interim Determination of K (IDoK). In addition, regular meetings are held with the ratings agencies to provide them with updates on current performance and future projections.

Delivery of our capital investment programme: We have a capital investment programme of £1.8 billion between 2010 and 2015. We are on target to deliver this and some schemes are ahead of schedule; however, we have to continue our focus to complete all of our work on time. If we are unable to deliver significant parts of the programme on schedule, we face a risk to our ability to provide the best service we can for our customers and possible action by the Environment Agency, Drinking Water Inspectorate or Ofwat.

Mitigation: We closely monitor the progress of our programme to ensure we manage any risks to completing the work on time. We work closely with our regulators and other interested parties to resolve issues as they arise.

Southern Water Corporate Governance

Introduction

Southern Water is committed to maintaining high standards of leadership, transparency and governance. It has adopted its own code and has committed to comply with its letter and spirit. The Board of Southern Water (SWS Board) fully accepts its responsibility and accountability to stakeholders for ensuring effective governance processes are in place and followed.

The SWS Board's role is to:

- Ensure that the company's obligations to, and interests of, its stakeholders, including customers and regulators, are known and met appropriately
- Provide effective leadership and collective responsibility for the long-term success of the company, to the benefit of its stakeholders
- Determine overall strategic aims and direction
- Ensure that sufficient resources are available to the Chief Executive Officer and his team to operate, manage and develop the business appropriately
- Ensure that appropriate and effective processes and controls are in place to assess and manage risk.

Southern Water Code of Board leadership, transparency and governance

During the year 2013–14, Jonson Cox, the Chairman of the Water Service Regulation Authority (Ofwat) encouraged water companies to improve their demonstrable governance further. Ofwat published draft principles in September 2013, which became essentially their final principles, published in January 2014 (the Ofwat Principles).

The SWS Board readily adopted Ofwat's suggestion to develop its own code, which was adopted in November 2013. It fully reflects the Ofwat Principles and draws extensively on the appropriate principles of the UK Corporate Governance Code in the Southern Water Code of Board leadership, transparency and governance. SWS has committed to comply with the letter and the spirit of the principles and commitments of the Southern Water Code, and the board of Greensands Holdings, has committed to assist.

The Southern Water Code is published on the Southern Water website.

Southern Water will review its code during 2014–15 and intends to remain at the forefront of maintaining high standards of leadership, transparency and governance.

SWS Board membership

During the year we are reporting, Colin Hood was the independent non-executive Chairman. The Board also comprises two executive directors (the Chief Executive Officer and Chief Financial Officer) and six non-executive directors, of whom four are independent. Following Colin's decision to leave on 1 April 2014, Robert Jennings, one of the four independent non-executive directors was appointed as independent non-executive Chairman.

Robert has continued with the Board evaluation that Colin initiated and believes that, during the year, there comprised a balanced and rounded board, giving independent support and advice as well as providing new ideas and healthy challenge. Southern Water appointed a new Independent Non-executive Director, Paul Sheffield, consequent on Robert becoming Chairman, to continue the balance and leadership that is the Board's role. The presence of six non-executive directors in total, four of whom are independent, and the independent non-executive Chairman ensures that appropriate governance is achieved.

All members of the Board were and are able to allocate the necessary time to the company and its areas of business to discharge their responsibilities effectively.

Chairman

The role of the Chairman of Southern Water 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. The SWS Board recognised the lead that Colin Hood took in particular on corporate governance during his chairmanship and Robert Jennings continues to build on that.

The Chairman discusses and agrees agendas for Board meetings with the Chief Executive Officer and Company Secretary, although any director may sponsor an item to be included on the agenda. The Chairman has authority to act and speak for the Board between its meetings, including engaging with the Chief Executive Officer. The Chairman reports to the Board, chairmen of its committees and individual directors as appropriate on decisions and actions taken between meetings of the Board. Robert also meets with the non-executive directors, without the executive directors present, to consider the performance of the executive directors and to provide feedback. He is continuing to increase open and constructive contact between all members of the Board, in both formal and informal meetings.

Investor representation

The Southern Water investors comprise the Greensands Consortium, the membership of which is explained on the Southern Water website.

Two investors, but not all, are directly represented on the SWS Board, and the Chairman ensures that the views of all investors can be communicated to the Board.

Senior Independent Non-executive Director

David Golden is the Senior Independent Non-executive Director. He chairs the Remuneration Committee and the Health and Safety Committee (chaired by Colin Hood in 2013–14), is a member of the Audit and Risk Review Committee and would chair Board meetings in the event that the Chairman is unable to do so for any reason. David has been a non-executive director for ten years. The SWS Board recognises that his character and judgement show him to be independent and values his continuing contribution during the current quinquennial price review process. He is available to discuss matters or concerns with investors as required.

Independent Non-executive Directors

The four independent non-executive directors are valued members of the SWS Board. As well as meeting the company’s obligation in its licence to have independent non-executive directors, they bring overall independent advice, review and challenge on behalf of all stakeholders, including customers. The independent non-executive directors have been appointed for their individual external expertise and experience in specific areas, such as customer service, the environment, operations, procurement and finance, and for the range of their experience of general corporate management. They meet without the Chairman at least once a year, and appraise the Chairman's performance annually.

The SWS Board considers the four independent non-executive directors to have been and to be independent in character and judgement and persons of standing with relevant experience, collectively having connections with, and knowledge of, the company’s area and understanding of the interests of our customers and how these can be respected and protected.

The standard terms and conditions of the independent non-executive directors are published on the Southern Water website.

Shareholder Representative Non-executive Directors

There are two non-executive directors each of whom is nominated to the SWS Board by one of our two major investors. They bring the extensive knowledge, skills and resources of their nominating investors and employers, as well as their own personal skills, experience and knowledge of businesses and business sectors similar to our own. On the SWS Board, they have all the duties, obligations and rights of a director of Southern Water and act in the best interests of the company. They do not receive any remuneration from Southern Water.

Chief Executive Officer

The Chief Executive Officer of Southern Water, Matthew Wright, is a member of the SWS Board and has all of the responsibilities of a director of the company. In his executive role, responsibility has been delegated to him to achieve the company’s strategy. He is empowered to take all decisions and actions that further the company’s strategy and which, in his judgement, are reasonable within the Chief Executive Officer’s limits set out in the company’s internal controls. The non-executive directors, led by the Chairman, appraise his performance annually.

Chief Financial Officer

The Chief Financial Officer of Southern Water, Michael Carmedy, is a member of the SWS Board and has all of the responsibilities of a director of the company. In his executive role and reporting to Matthew Wright, he has the responsibility to manage the company’s financial affairs and assist the Chief Executive Officer in the delivery of the company’s strategy. His executive performance is reviewed annually by Matthew Wright.

Executive Management Team

Reporting to Matthew Wright, the Executive Management Team supports him in driving the implementation of strategy in the company. The team is committed to do this in a responsible way that takes account of Southern Water's commitment to its customers, the environment, the local communities and all of its other stakeholders and with a view towards the long-term responsible stewardship of the business.

Role of the Company Secretary

All directors have access to the advice and services of the Company Secretary and General Counsel, Kevin Hall, and the Company Secretariat team. The Company Secretary is responsible for ensuring that the SWS Board operates in accordance with the governance framework it has adopted 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 SWS Company Secretary is reserved to the SWS Board.

Director induction, training and development

On appointment to the SWS Board, a director will discuss and agree induction coverage and then an appropriate comprehensive and individualised induction pack is provided, which will include information on the company and holding group structure, the regulatory framework of the company's business, customer service and the operation of assets, strategic plans, financial reports, business plans and our governance framework. This and further relevant information is summarised in a directors' handbook.

Meetings are arranged with members of the Executive Management Team and with external advisers, who provide support to the relevant Board committees the directors may serve on, as well as visits to operational and office sites.

Directors received updates through the year on matters such as changes to the regulatory framework, the Water Bill (now the Water Act 2014) and Defra's Open Water programme, and deepened their knowledge through their leadership of and engagement in the regulatory Price Review 2014 (PR14). They also have access to professional development provided by external bodies and our specialist advisers.

Board evaluation

Colin Hood, as the then Chairman, undertook the annual evaluation of the effectiveness of the Board during January 2014. Each member of the SWS Board and of the GSH Board received a questionnaire, and subsequently had direct discussions with Colin and CEO Matthew Wright. No areas of major concern or weakness were identified, but there was a desire to deepen some areas of experience. On Robert Jennings' appointment as Chairman, he has taken on the process and, with the members of the Nomination Committee, has identified where and how they want to add to the capabilities of the SWS Board during 2014–15. The first recruit from this process has been Paul Sheffield, who was appointed from 1 June 2014 as Independent Non-executive Director.

Led by David Golden, Senior Independent Non-executive Director, in June 2013 the SWS Board completed a review and appraisal of the performance of Colin Hood as Chairman, without his participation. No areas of major concern or weakness were identified.

The SWS Board evaluation during 2014–15 will be externally facilitated.

Board operation

There is good understanding of the principles and processes in place regarding the tasks and activities of the SWS Board, the authority delegated to the Chief Executive Officer and the relationship between them.

The following matters are routinely determined by the SWS Board:

- Business strategy
- Financing strategy
- Business plans
- Approval of annual budgets
- Fixing of principal charges and charges schemes
- Approval of financial statements
- Key regulatory submissions (including, but not limited to, Price Review submissions to Ofwat, Interim Determination of K applications, Risk and Compliance Statement and Regulatory Financial Statements)
- Key customer and stakeholder publications (including, but not limited to, the Annual Report)

- Entering into significant contracts or commitments (including capital schemes over £5 million and disposals over £1 million), in accordance with rules agreed with the Chief Financial Officer
- Approval of dividends
- Commencing into new businesses
- Appointment or removal of auditor
- Appointment and remuneration of independent non-executive directors
- Appointment or removal of the Company Secretary
- Amendment, qualification, addition to or removal from the above.

The Shareholders' Agreement of Greensands Holdings, reserves certain matters by exception to the GSH Board and shareholders. A list of these matters is published on the Southern Water website. During the year 2013–14, no such matters have been decided by the GSH Board or its shareholders.

Good governance requires a clear division of responsibilities between the Chairman and Chief Executive Officer. A statement of these responsibilities is published on the Southern Water website.

SWS Board meetings

The SWS Board held 10 scheduled monthly meetings during the year. The agenda and papers are sent to Board members in advance of each meeting. The monthly financial, performance and economic regulation reports are also distributed for the other two months when there is no scheduled meeting (August and December). The meetings are held at Southern Water's principal office in Worthing, but at least two meetings each year are held in London, to facilitate meetings with investors.

Additionally, ad hoc Board meetings were held to consider, challenge and decide the Business Plan, for PR14, which has been such an important process for the SWS Board during 2013–14 and which continues to engage them in 2014–15.

Directors have access to the advice and services of the Company Secretary and are able to take appropriate independent professional advice for the performance of their duties. Where a director has a concern over any unresolved matter, he/she is entitled to require the Company Secretary to record that concern in the minutes of a meeting. Should the director later resign over the issue, the Chairman would bring it to the attention of the Board.

Attendance at scheduled SWS Board meetings in 2013–14			
Colin Hood	9/10		
Robert Armstrong	10/10	Cheryl Black	10/10
Michael Carmedy	10/10	David Golden	10/10
Robert Jennings	10/10	Matthew Wright	10/10
Paul Moy	10/10	Surinder Toor (resigned 7 March 2014) Mark Walters (appointed 7 March 2014) Peter Antolik (as alternate)	7/9 1/1 2/2

Note – Attendance includes personal attendance and attendance by telephone.

SWS Board committees

Southern Water has established standing committees of the SWS Board with specific responsibilities. They assist by monitoring and reviewing performance and issues in the areas within their respective scopes and by advising and making recommendations to the Board. Specific responsibilities have been delegated to those committees.

The standing committees of the SWS Board that met in 2013–14 are:

- Audit and Risk Review
- Health and Safety
- Remuneration
- Nomination

Each committee has written terms of reference to exercise oversight on behalf of the SWS Board and provide advice in its remit area. These terms of reference are published on the Southern Water website.

Other committees are constituted if and when required for specific matters.

Southern Water has previously appointed a Regulatory Committee. However, given the significance of the regulatory issues and changes taking place or proposed in the regulatory environment in 2013–14, and in particular the PR14 process, such regulatory matters have been discussed and decided by the full SWS Board. Consequently, the Regulatory Committee did not meet during the year. This position will continue to be reviewed by the SWS Board, which itself receives an economic regulation report at each scheduled monthly meeting and for the other two months, as described above, and which has been closely involved in PR14.

Remuneration

The remuneration of the directors of Southern Water is set out in the directors' remuneration report in Southern Water's annual report.

Interests

No director of Southern Water declared a material interest at any time during the year in any contract of significance with the company.

Conflicts of interests

Conflicts or potential conflicts are governed by the Companies Act 2006. The SWS Board does not have power to authorise conflicts. If a conflict should arise, the conflicted director takes no part in discussions or voting on that issue.

Annual General Meeting

Southern Water Services Limited is a private company with single corporate ownership and is not required to hold an Annual General Meeting (AGM). Greensands Holdings Limited, as the ultimate parent company, does hold an AGM, the last being held on 26 November 2013.

UK Corporate Governance Code

As explained above, the SWS Board adopted the Southern Water Code of Board leadership, transparency and governance on 27 November 2013. This underpins its corporate governance and is published on the Southern Water website.

For that part of the financial year from 1 April to 27 November 2013, the company complied with the spirit and letter of the UK Corporate Governance Code to the extent appropriate for a privately owned company. Schedules of compliance with that code as at 31 March 2013, 26 June 2013 and 27 November 2013 are published on the Southern Water website.

Directors' report for the year ended 31 March 2014

The directors of Greensands Holdings Limited (Registered Number: Jersey 98700) present their report and the audited financial statements for the year to 31 March 2014.

Group

Greensands Holdings Limited ("the company") was incorporated on 28 September 2007 as the parent company of Greensands Europe Limited, whose subsidiaries include Greensands Investments Limited.

On 15 October 2007, the company became the ultimate parent company of the Southern Water group of companies, via the acquisition of Southern Water Capital by Greensands Investments Limited.

Principal activities of the company

The company's principal activity is that of a holding company for Greensands Europe Limited and its subsidiaries.

Principal activities of the group

The principal activities of the group are the provision of water supply and wastewater services in the south-east of England.

The trading results reflect the performance of the major trading subsidiary Southern Water Services Limited (Southern Water).

Strategic report

The information that fulfils the requirement of the Strategic Report can be found in the Strategic Report sections on pages 2 to 5 and pages 8 to 44.

Future developments

The information regarding future developments of the company can be found in the Strategic Report sections on pages 2 to 5 and pages 8 to 44.

Results and dividends

The profit and loss account on page 54 shows the group's results and profit for the year. Further details are also available in the Strategic Report section on page 3.

No dividends were paid or declared during the year.

Directors and their interests

The directors who held office during the year ended 31 March 2014 and up to the date of signing the financial statements were as follows:

Robert Jennings	(Appointed as Chairman 28 May 2014)
Colin Hood	(Resigned as Chairman 1 April 2014)
Peter Antolik	(Resigned as director and appointed alternate to Paul Ryan 29 May 2013)
Keith Budinger	
Michael Nagle	
Martin Roughead	(Resigned as director 1 May 2014)
Paul Ryan	(Appointed as director 29 May 2013)
Bronte Somes	
Jeff Woodard	(Appointed as director 1 May 2014)
Craig McAllister	Alternate to Keith Budinger
Paul Moy	Alternate to Bronte Somes
Mark Walters	Alternate to Peter Antolik (ceased 29 May 2013)
Jaron Yuen	(Ceased as alternate to Martin Roughead 1 May 2014)

None of the directors who held office during the financial year had any disclosable interests in the shares of the company or the group.

Research and development

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the group's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £0.5 million (2012–13: £0.5million).

Employees

Employee involvement: The group recognises the importance of its employees and is committed to effective two-way communication and consultation.

The group has established Business Involvement groups to facilitate meaningful consultation between management and employees through elected employee representatives. The groups meet regularly at both a functional and company-wide level. An employee survey is also completed on an annual basis to seek input from employees.

The group 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.

The group publishes its own in-house newspaper, Southern Water News, on a regular basis. General information is posted on the group 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 group.

Equal opportunity: The group's policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The group takes full account of the needs of people with disabilities and follows set policies and procedures to support reasonable adjustments in the workplace.

Health and safety: The group recognises its duties to make proper provision for the health, safety and welfare at work of its employees.

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety. In addition there is a health and safety management review group which ensures that there is an adequate system for meeting the company's responsibilities for health and safety to its staff, customers and members of the public.

The group 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.

Environmental issues

The group 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 group's environmental performance is reported on pages 24 to 27. The group recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

Political donations

No political donations were made.

Land and buildings

In the opinion of the directors, the market value of land is significantly more than its book value. However, it would not be practicable to quantify the difference precisely.

Financial risk management objectives and policies

The group intends to at least maintain its present risk profile, as measured by its investment grade credit rating. The group does not enter into treasury transactions for the purpose of speculation, but only to manage risk inherent in the business or funding on a prudent basis.

Interest Rate Risk - The group hedges its exposure to interest rate risk on at least 85 per cent of its total outstanding debt liabilities in respect of Class A Debt and Class B Debt for the current period to the next Periodic Review and at least 70 per cent in the next period to the subsequent Periodic Review (on a rolling basis) into either index-linked obligations or fixed rate obligations.

Inflation Risk - The regulatory framework, under which revenues and the RCV are indexed, exposes the group to inflation risk. The group manages this risk through the use of index-linked instruments within its overall debt portfolio.

Liquidity risk – The group raises additional funds, as required, to ensure that it has sufficient cash and/or facilities to fund the business for at least the next twelve months.

Cash management risk – The group sets exposure limits for, and deposits cash balances with, organisations whose credit ratings are rated a minimum of Moody’s P1, Standard & Poors A1 or Fitch F1.

Going concern

The directors believe, after due and careful enquiry, that the group 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 2014. Further information is set out in note 1 ‘Going concern’ on page 58.

Qualifying third party indemnity

Following shareholder approval, the group has also provided an indemnity for its directors and the Company Secretary.

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

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the group's transactions and disclose with reasonable accuracy at any time the financial position of the group and enable them to ensure that the financial statements comply with the Companies (Jersey) Law 1991. They are also responsible for safeguarding the assets of the group 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 group's website. Legislation in Jersey 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; and
- the management report, which is incorporated into the directors' 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 they face.

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 group's auditor is unaware; and

(2) He/she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the group's auditor is aware of that information.

Auditor

Deloitte LLP has indicated its willingness to continue in office.

Approved by the Board of Directors and signed by order of the Board.

Kevin Hall
Company Secretary
22 July 2014

Financial statements

Consolidated profit and loss account

For the year ended 31 March 2014

	Note		**2014 £m**		2013 £m
Turnover	1,2,3		**806.2**		778.7
Cost of sales	3				
- before exceptional item		**(479.7)**		(452.9)	
- exceptional item	4	**(18.8)**		-	
			(498.5)		(452.9)
Gross profit			**307.7**		325.8
Administrative expenses	3		**(30.7)**		(29.0)
Other operating income	3		**0.2**		0.2
Operating profit			**277.2**		297.0
Profit on disposal of fixed assets			**0.5**		1.0
Profit on ordinary activities before interest and taxation			**277.7**		298.0
Interest receivable and similar income	7		**5.1**		2.5
Interest payable and similar charges	7		**(328.9)**		(303.9)
Loss on ordinary activities before taxation	4		**(46.1)**		(3.4)
Tax on loss on ordinary activities	8		**41.2**		(13.6)
Loss for the year			**(4.9)**		(17.0)

The above results relate to continuing operations.

The Notes on pages 58 to 82 form part of these financial statements.

Consolidated statement of total recognised gains and losses

For the year ended 31 March 2014

	Note	2014 £m	2013 £m
Loss for the year		**(4.9)**	(17.0)
Actuarial gain/(loss) recognised in the pension fund	23	**3.1**	(7.3)
Movement on deferred tax relating to pension deficit	17	**(2.2)**	1.2
Total recognised gains and losses for the year		**(4.0)**	(23.1)

There are no differences between the loss on ordinary activities before taxation and the loss transferred from reserves for the financial year, and their historical cost equivalents.

Consolidated and company balance sheets

As at 31 March 2014

	Note	Group 2014 £m	Company 2014 £m	Group 2013 £m	Company 2013 £m
Fixed Assets					
Intangible assets – goodwill	9	**85.1**	**-**	91.4	-
Tangible assets	10	**5,607.5**	**-**	5,461.3	-
Investments	11	**-**	**1.0**	-	1.0
		5,692.6	**1.0**	5,552.7	1.0
Current assets					
Stocks	12	**2.0**	**-**	1.5	-
Debtors: amounts falling due within one year	13	**186.6**	**-**	160.6	-
Debtors: amounts falling due after one year	14	**-**	**1,016.6**	-	1,016.5
Cash at bank and in hand	18	**193.4**	**-**	557.6	-
		382.0	**1,016.6**	719.7	1,016.5
Creditors: amounts falling due within one year	15	**(250.2)**	**(31.9)**	(545.3)	(31.9)
Net current assets		**131.8**	**984.7**	174.4	984.6
Total assets less current liabilities		**5,824.4**	**985.7**	5,727.1	985.6
Creditors: amounts falling due after one year	16	**(4,835.1)**	**(59.3)**	(4,688.4)	(59.2)
Provision for liabilities and charges					
Environmental obligations	17	**(0.5)**	**-**	(0.8)	-
Deferred taxation	17	**(313.5)**	**-**	(356.2)	-
Grants and contributions	19	**(43.8)**	**-**	(46.4)	-
Net assets excluding pension deficit		**631.5**	**926.4**	635.3	926.4
Pension deficit	23	**(72.3)**	**-**	(72.1)	-
Net assets including pension deficit		**559.2**	**926.4**	563.2	926.4
Capital and reserves					
Called up share capital	20	**921.9**	**921.9**	921.9	921.9
Share premium account	21	**4.5**	**4.5**	4.5	4.5
Profit and loss account	21	**(367.2)**	**-**	(363.2)	-
Total shareholders' funds		**559.2**	**926.4**	563.2	926.4

The financial statements of Greensands Holdings Limited (Registered Number: Jersey 98700) on pages 54 to 82 were approved by the Greensands Holdings Limited Board and authorised for issue on 22 July 2014 and they were signed on its behalf by

Michael Nagle
Director

Consolidated cash flow statement

For the year ended 31 March 2014

	Note	**2014 £m**	2013 £m
Net cash inflow from operating activities	22	**538.1**	499.7
Returns on investments and servicing of finance			
Interest paid		**(338.4)**	(162.7)
Interest received		**61.0**	2.1
Net cash outflow from returns on investments and servicing of finance		**(277.4)**	(160.6)
Taxation		**(0.1)**	(0.2)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		**(382.0)**	(360.1)
Receipt of grants and contributions		**9.9**	10.1
Sale of investment		**-**	12.7
Sale of tangible fixed assets		**0.3**	0.6
Net cash outflow for capital expenditure and financial investment		**(371.8)**	(336.7)
Net cash (outflow) / inflow before financing		**(111.2)**	2.2
Financing			
Repayment of long term loan/bonds		**(252.8)**	-
Issue of long term loans/bonds		**-**	300.0
Issue costs of new loans/bonds		**(0.2)**	(4.7)
Net cash (outflow) / inflow from financing		**(253.0)**	295.3
(Decrease) / increase in net cash		**(364.2)**	297.5
Reconciliation to net debt			
Net debt at beginning of year		**(4,371.5)**	(4,233.4)
(Decrease) / increase in net cash		**(364.2)**	297.5
Movement in borrowings		**252.8**	(300.0)
Debt issue costs		**0.2**	4.7
Non-cash items		**(150.2)**	(140.3)
Net debt at 31 March	22	**(4,632.9)**	(4,371.5)

Notes to the consolidated financial statements

For the year ended 31 March 2014

1 Accounting policies

The principal accounting policies, which have been applied consistently throughout the current and preceding year, are set out below.

Basis of accounting

The financial statements have been prepared on the going concern basis, under the historical cost convention and in accordance with United Kingdom Generally Accepted Accounting Practice and with the requirements of the Companies (Jersey) Law 1991.

Basis of consolidation

The group financial statements include the financial statements of the company and all of its subsidiary undertakings therefore no discrete profit and loss account is presented by the company. The company is not required to prepare a cash flow statement under Financial Reporting Standard (FRS) 1 (revised).

The results of the subsidiaries are included in the Profit and Loss Account from the date of acquisition. Intra group sales and profits are eliminated fully on consolidation. The acquisition method of accounting has been used to consolidate the subsidiaries.

Going concern

The directors have undertaken a detailed review of the group's liquidity requirements compared with the cash and facilities available, the financial covenant position including projections based on future forecasts, the current ratings and financial risk and have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements. For this reason they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Tangible fixed assets and depreciation

Tangible fixed assets are stated at historic purchase cost less accumulated depreciation and any provision for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use; these include materials, labour and applicable overheads. Interest costs are not capitalised.

i) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) comprise a network of assets covering the group's geographic area.

Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition to fixed assets and is stated at cost after deducting grants and contributions. Staff costs that directly relate to the construction of a specific infrastructure asset are capitalised on the basis of the amount of time spent by individuals on projects.

The depreciation charge for infrastructure assets is the estimated level of annualised expenditure required to maintain the operating capability of the network and is based on the asset management plan determined by the water industry regulator, Ofwat, as part of the price regulation process. The asset management plan is developed from historical experience combined with a rolling programme of reviews of the condition of the infrastructure assets.

ii) Other tangible assets (including over-ground assets, plant and equipment) are stated at cost less accumulated depreciation and any provision for impairment. These assets are depreciated down to their residual values on the straight-line method over their estimated operating lives which are principally as follows:

	Years
Buildings	10 - 60
Operational structures	15 - 80
Fixed plant	10 - 40
Vehicles, computers and mobile plant	3 - 10

Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2014

Tangible fixed assets and depreciation (continued)

iii) Freehold land is not depreciated.

iv) Assets in the course of construction are not depreciated 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.

v) Private Sewers were adopted in October 2011 and have been valued at nil value, as permitted by UKGAAP and by reference to the net present value of the incremental cash flows as a result of the adoption. These assets form part of our infrastructure assets and expenditure associated with them has been treated as described above.

Grants and contributions

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate.

Capital grants and customer contributions in respect of additions to non-infrastructure tangible fixed assets are treated as deferred income and released to the profit and loss account over the estimated operational lives of the related assets in accordance with the provisions of the UK Companies Act 2006, as applicable to the group's subsidiaries.

Grants and capital contributions received relating to infrastructure assets have been deducted from the cost of tangible fixed assets as permitted by Statement of Standard Accounting Practice (SSAP) 4. This is not in accordance with Schedule 1 of the Companies Act 2006 which requires tangible fixed assets to be stated at their purchase price or production cost. The Act does not permit the deduction of contributions.

This departure from the requirements of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have determinable finite lives. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of this treatment on tangible fixed assets is disclosed in note 10.

Leased assets

Where the group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a "finance lease". The asset is recorded in the balance sheet as a tangible fixed asset and is depreciated over its estimated useful life or the term of the lease, whichever is shorter. Future instalments under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the profit and loss account, and the capital element which reduces the outstanding obligation for future instalments.

Rentals payable under operating leases are charged to profit and loss account as incurred.

The sale of income rights relating to aerials masts and sites owned by the group 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 will be credited to other operating income in the profit and loss account over the life of the lease.

Sale and leaseback transactions occur when an asset is sold but use is immediately re-acquired by entering into a lease with the buyer. Where the new lease is an operating lease, the transaction is treated as the disposal of an asset and the operating lease accounted for in accordance with existing policies.

Goodwill and intangible fixed assets

Businesses and interests acquired have been dealt with in the consolidated financial statements using acquisition accounting. Upon the acquisition of a business, fair values are attributed to the identifiable assets and liabilities acquired that reflect the condition at the date of acquisition and any required adjustments made to bring the accounting policies of the businesses acquired into alignment with those of the group. Where the consideration paid exceeds the fair value of the net assets acquired, the difference is treated as goodwill.

In line with FRS 10, goodwill arising on acquisitions is capitalised and amortised through the profit and loss account over its estimated useful economic life, estimated to be 20 years.

Impairment reviews of goodwill are carried out at the end of the first financial year after acquisition and provision is made where there is any indication of impairment.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2014

Fixed asset investments

Investments held as fixed assets are stated at cost, less provision, if appropriate, for any impairment in value other than a temporary impairment in value. The carrying values of fixed asset investments are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Stocks

Stock is held for use in the production of water supply and treatment of wastewater. Stock is held at replacement cost.

Deferred revenue

Deferred revenue includes monies received from customers where the related turnover has not yet been recognised.
Amounts are deferred to the balance sheet and released to the profit and loss account in line with the period of the service provided.

Provisions

An environmental provision is made in accordance with FRS12 for the costs relating to the decommissioning of abandoned sites. No reimbursement is expected.

Taxation

The taxation charge in the profit and loss account is based on the profit for the year as adjusted for disallowable and non-taxable items using current rates and takes into account tax deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred taxation is provided on all timing differences that have originated but not reversed by the balance sheet date, calculated at the rate at which it is expected the tax will arise in accordance with Financial Reporting Standard 19 “Deferred Tax” (“FRS 19”). Deferred taxation balances are not discounted. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

Turnover

Turnover represents the income receivable (excluding value added tax) in the ordinary course of business for goods and services provided and, in respect of unbilled charges, includes accrued income.

Turnover relates to services provided in the year and excludes payments received in advance which are recorded as deferred revenue.

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.

Turnover includes an estimate of the consumption between the date of the last meter reading and the period-end. The unbilled income accrual is based on estimated usage from the last meter reading date through to the end of the reporting period. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff.

Bad debts

The bad debt provision is calculated by applying recovery rates to an aged debt profile to ensure that the age of debt not covered by the provision is an accurate reflection of the recoverability of debt.

Research and development

Expenditure on research and development is charged to the profit and loss account as it is incurred.
Expenditure on fixed assets relating to development projects is written off over the expected useful lives of those assets.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

Pensions

The group operates a defined benefit pension scheme. An independent actuary conducts a valuation this pension scheme every three years.

In accordance with FRS 17 the pension deficit has been recognised on the balance sheet and operating and financing costs of pension and post-retirement schemes are recognised separately in the profit and loss account.

Pension scheme assets are measured using market value. Pension scheme liabilities are measured using the projected unit actuarial method and are discounted at the current rate of return on a high quality corporate bond of equivalent terms and currency to the liability. The increase in the present value of the liabilities of the group's defined benefit pension schemes expected to arise from employee service in the period is charged to operating profit. The expected return on the scheme's assets and the increase during the year in the present value of the scheme's liabilities arising from the passage of time are included in other finance income. Actuarial gains and losses are recognised in the consolidated statement of total recognised gains and losses.

Service costs are systematically spread over the service lives of the employees and financing costs are recognised in the period in which they arise. The costs of past service benefit enhancements, settlements and curtailments are also recognised in the period in which they arise.

The differences between actual and expected returns on assets and liabilities during the year, including changes in actuarial assumptions, are recognised in the statement of total recognised gains and losses.

The group also operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the group in an independently administered fund. Group contributions to the scheme are charged to the profit and loss account in the period to which they relate.

Capital instruments

Interest-bearing borrowings are recorded at the proceeds received, net of direct issue costs. Finance charges are accounted for on an accruals basis in the profit and loss account and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

The issue costs of capital instruments have been amortised over the life of the financial instrument to which they relate.

Premiums received on issue of debt instruments are credited to the profit and loss account over the term of the debt at a constant rate on the carrying amount.

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 profit and loss account in the year in which it arises.

Financial instruments

Derivative transactions include interest rate, currency and index-linked swaps that are only used for non speculative purposes. These derivatives are entered into for the purpose of matching or eliminating risk from potential movements in interest and currency rates and RPI associated with the long term borrowing requirements of the group (see note 18). All derivatives, being non speculative, are accounted for on an accruals basis.

Provisions are made for losses, if appropriate, in the event that it is expected that any portion of a financial instrument will not be a hedge of the long term borrowing requirements of the group.

Interest rate and currency swaps are used to manage interest rate profiles and mitigate exchange risks. When matched with primary financial instruments, the net position is measured at the hedge rate and presented within creditors on the balance sheet. Income, costs, gains, losses and expenses are recognised within net interest payable in the profit and loss account over the life of the instruments.

Greensands Holdings Limited does not adopt FRS 25, 'Financial Instruments: Disclosure and Presentation' or FRS 26 Financial Instruments: Recognition and Measurement.

2 Segmental analysis

The directors believe that the whole of the group's activities constitute a single class of business. The group's turnover is generated wholly from within the UK.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2014

3 Classification of turnover and revenue costs

Turnover represents the income receivable for providing water supply and wastewater services and is generated wholly in the United Kingdom.

Cost of sales reflects the direct costs of providing water supply and wastewater services. Administrative expenses comprise the indirect costs of the business. Other operating income relates to rents receivable and dividends received from investments.

4 Group loss on ordinary activities before taxation

	2014 £m	2013 Restated* £m
Group loss on ordinary activities before taxation is stated after charging/(crediting):		
Employee costs	**37.9**	35.9
Pension curtailment gain	**-**	(9.0)
Employee costs(note 6a)	**37.9**	26.9
Depreciation on		
- owned assets	**257.9**	236.8
- assets held under finance leases	**1.4**	0.8
	259.3	237.6
Amortisation of goodwill	**6.3**	6.3
Rentals under operating leases – vehicles	**2.2**	3.5
Research and development expenditure	**0.5**	0.5
Release of grants and contributions (note 19)	**(2.9)**	(2.8)
Exceptional item (see note (a) below)	**18.8**	-

During the year, the group's auditor earned the following fees:

	2014 £m	2013 Restated* £m
Fees payable for the audit of the group	**0.2**	0.2
Fees payable for other services pursuant to legislation	**0.1**	0.1
Fees payable for all other services to the group	**2.0**	0.1
Total audit and non-audit fees	**2.3**	0.4

Fees in respect of other non-audit services of £2.0 million in 2013–14 relate to taxation advisory services, and consultancy services in relation to a number of business improvement projects and the PR14 Business Plan.

(a) The exceptional item of £18.8m relates to costs incurred in dealing with the high groundwater levels and storms experienced in the winter of 2013–14. It includes tankering and pumping costs to remove the water as well as repairs to equipment as a result of the damage caused.

5 Profit of parent company

The profit for the financial period dealt with in the financial statements of the parent company is £nil (2012–13: £nil).

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

6 Employee information

	2014 £m	2013 Restated* £m
(a) Group employee costs		
Wages and salaries	**65.9**	60.7
Social security costs	**6.1**	5.6
Pension costs - Defined contribution	**1.4**	1.0
- Defined benefit	**5.0**	6.5
- Curtailment gain**	**-**	(9.0)
Total employee costs	**78.4**	64.8
Less: charged as capital expenditure	**(40.5)**	(37.9)
Charged to the profit and loss account	**37.9**	26.9

Employee costs that are charged as capital expenditure are those directly related to the construction or acquisition of assets.

*The prior year has been restated to include other pay allowances which were previously omitted. This is a note disclosure adjustment only and has no impact on the overall financial statements.
**During 2012–13 a curtailment gain arose from changes made to the benefits accruing to employee members of the Southern Water Pension scheme, these changes are detailed in note 23.

The company has no employees and did not bear any employee costs.

For directors' emoluments see note 26.

(b) Average number of persons employed by activity
The average monthly numbers of persons employed by the company during the year was:

	2014 Number	2013 Number
Operations	**1,079**	1,055
Customer services	**480**	461
Corporate centre	**467**	422
	2,026	1,938

7 Interest

	2014 £m	2013 £m
Interest payable and similar charges		
Interest payable on loans	**307.5**	276.7
Interest rate swap receipts	**(54.8)**	(45.4)
Total interest payable on other loans	**252.7**	231.3
Indexation	**72.1**	76.9
Amortisation of issue costs	**11.4**	3.9
Amortisation of gilt lock proceeds	**(0.1)**	(0.1)
Amortisation of bond premium	**(9.6)**	(9.6)
Other finance expense (note 23)	**2.4**	1.5
Total interest payable and similar charges	**328.9**	303.9
Interest receivable		
Other interest receivable	**5.1**	2.5
Total interest receivable	**5.1**	2.5

A large proportion of the payment of interest payable on loans falls due on 31 March. Where this date is not a business day, the interest is paid on the next following business day.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2014

8 Group tax on loss on ordinary activities

	2014 £m	2013 £m
Current tax:		
UK corporation tax on losses of the year	**0.1**	**-**
Total current tax	**0.1**	**-**
Deferred tax:		
Origination and reversal of timing differences	**16.1**	24.2
Pension cost relief in excess of pension cost charge	**0.1**	5.9
Impact of corporation tax rate change	**(47.0)**	(15.4)
Impact of rate change on pension charge	**1.2**	0.4
Adjustment to opening tax estimates	**(11.7)**	(1.5)
Total deferred tax	**(41.3)**	13.6
Total tax on loss on ordinary activities	**(41.2)**	13.6

The rate of current tax charge on loss on ordinary activities varied from the standard rate of corporation tax due to the following factors:

	2014 £m	2013 £m
Loss on ordinary activities before tax	**(46.1)**	(3.4)
Current tax:		
UK corporation tax rate at 23% on loss for the year (2012–13: 24%)	**(10.6)**	(0.8)
Timing differences	**(16.2)**	(24.3)
Pension cost relief in excess of pension cost charge	**(0.1)**	(5.9)
Permanent differences	**27.0**	31.0
Current tax charge for year	**0.1**	-

Factors that may affect future tax charges:

On 20 March 2013 the UK Government announced a reduction in the main rate of corporation tax from 23 per cent to 21 per cent effective from 1 April 2014, and to 20 per cent effective from 1 April 2015. These rate changes were enacted in Finance Bill 2013 during the period, and deferred tax balances have been calculated using these reduced rates. A £47.0m credit is recognised in the profit and loss account in the year to reflect the reduction in the deferred tax liability as a result of the rate change. In addition, charges of £1.2m in the profit and loss account and £1.5m in the statement of total recognised gains and losses are recognised to reflect the reduction in the deferred tax asset relating to the pension deficit.

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

Deferred tax liabilities have not been discounted.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

9 Group goodwill

Group	**£m**
Cost:	
At 1 April 2013 and 31 March 2014	**126.2**
Amortisation:	
At 1 April 2013	34.8
Charge for the year	6.3
At 31 March 2014	**41.1**
Net book amount:	
At 31 March 2014	**85.1**
At 31 March 2013	91.4

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2014

10 Fixed assets and capital commitments

The group tangible assets are shown below. The company has no tangible assets.

(a) Group tangible assets

	Freehold land & buildings £m	Plant & machinery £m	Infra-structure assets £m	Assets in the course of construction £m	Other £m	Total £m
Cost or valuation:						
At 1 April 2013	1,635.3	1,557.7	2,326.5	605.3	407.8	**6,532.6**
Additions	0.4	57.3	67.0	249.8	41.0	**415.5**
Transfers	54.3	231.0	154.4	(459.6)	19.9	**-**
Grants & contributions	-	-	(9.7)	-	-	**(9.7)**
Disposals	(0.2)	(1.4)	(0.6)	-	(25.3)	**(27.5)**
At 31 March 2014	1,689.8	1,844.6	2,537.6	395.5	443.4	**6,910.9**
Depreciation:						
At 1 April 2013	310.5	307.5	292.1	-	161.2	**1,071.3**
Charge for the period	58.8	80.2	74.5	-	45.8	**259.3**
Disposals	-	(1.4)	(0.6)	-	(25.2)	**(27.2)**
At 31 March 2014	369.3	386.3	366.0	-	181.8	**1,303.4**
Net book value:						
At 31 March 2014	**1,320.5**	**1,458.3**	**2,171.6**	**395.5**	**261.6**	**5,607.5**
At 31 March 2013	1,324.8	1,250.2	2,034.4	605.3	246.6	5,461.3

Of the additions and transfers to infrastructure assets, the amount spent on infrastructure renewals net of contributions during the years ended 31 March 2014 and 31 March 2013 was £76.8m and £78.2m, respectively. The associated contributions were £2.6m for the year ended 31 March 2014 and £2.6m for the year ended 31 March 2013.

For the years ended 31 March 2014 and 31 March 2013, the net book value of infrastructure assets is stated after deducting grants and contributions of £55.6m and £45.9m respectively.

Freehold land is stated at a value of £98.1m at 31 March 2014 (2012–13: £98.1m), and is not depreciated.

Other assets relate primarily to computer equipment, meter reading devices and motor vehicles.

Assets held under finance leases have been capitalised and included in plant and machinery:

	Group 2014 £m	Group 2013 £m
Cost	**18.6**	16.3
Aggregate depreciation	**(12.7)**	(11.4)
Net book amount	**5.9**	4.9

Outstanding payments and interest associated with this lease are not material.

(b) Group Capital Commitments	**2014 £m**	2013 £m
In respect of contracts placed	**124.0**	184.7

The company has no capital commitments.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2014

11 Investments

	Group 2014 £m	**Company 2014 £m**	Group 2013 £m	Company 2013 £m
Greensands Europe Limited				
At 1 April and 31 March	**-**	**1.0**	-	1.0
Other external investments (see below)				
At 1 April	**-**	**-**	12.7	-
Impairment	**-**	**-**	-	-
Disposal	**-**	**-**	(12.7)	-
At 31 March	**-**	**-**	-	-
Total investments	**-**	**1.0**	-	1.0

The group disposed of its holding in Veolia Water Southeast Limited in August 2012 for £12.7m.

12 Stocks

	Group 2014 £m	Group 2013 £m
Raw materials	**1.6**	1.0
Work in progress	**0.4**	0.5
	2.0	1.5

The company does not hold any stock.

13 Debtors: amounts falling due within one year

	Group 2014 £m	**Company 2014 £m**	Group 2013 £m	Company 2013 £m
Trade debtors	**79.3**	**-**	76.9	**-**
Unbilled income	**75.6**	**-**	62.7	**-**
Prepayments	**13.7**	**-**	11.9	**-**
Other debtors	**18.0**	**-**	9.1	**-**
	186.6	**-**	160.6	**-**

14 Debtors: amounts falling due after one year

	Group 2014 £m	**Company 2014 £m**	Group 2013 £m	Company 2013 £m
Amounts owed by other Greensands Group undertakings	**-**	**1,016.6**	**-**	1,016.5

All amounts owed by group undertakings are unsecured. Of this amount £897.5m accrued interest at 0.01 per cent for the year ended 31 March 2014. The remaining balance is interest free and repayable on demand. The directors have confirmed that neither of these balances will be called upon for 12 months from the date of these financial statements.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2014

15 Creditors: amounts falling due within one year

	Group 2014 £m	**Company 2014 £m**	Group 2013 £m	Company 2013 £m
Loans and other borrowings (see note 16 (ii))	**-**	**-**	250.0	-
Trade creditors	**21.0**	**-**	19.4	-
Amounts owed to group undertakings	**-**	**31.9**	-	31.9
Capital creditors and capital accruals	**106.5**	**-**	73.7	-
Corporation tax	**0.1**	**-**	-	-
Other taxation and social security	**2.7**	**-**	2.3	-
Other accruals and deferred revenue	**113.3**	**-**	193.6	-
Premium deferred on issue (note 16 (vii))	**9.6**	**-**	9.6	-
Debt issue costs	**(3.1)**	**-**	(3.4)	-
Deferred gilt lock proceeds (see note 16 (v))	**0.1**		0.1	
	250.2	**31.9**	545.3	31.9

16 Creditors: amounts falling due after one year

	Group 2014 £m	**Company 2014 £m**	Group 2013 £m	Company 2013 £m
Loans and other borrowings:				
Loans from group undertakings	**-**	**59.3**	-	59.2
Long term borrowings	**4,736.0**	**-**	4,590.5	-
Debt issue costs	**(38.3)**	**-**	(49.1)	-
Premium deferred on issue (note (vii) below)	**115.2**	**-**	124.8	-
Deferred gilt lock proceeds (see note (v) below)	**5.3**	**-**	5.3	-
Obligations under finance leases	**1.6**	**-**	1.2	-
Total loans and other borrowings	**4,819.8**	**59.3**	4,672.7	59.2
Deferred revenue (note (vi) below)	**15.3**	**-**	15.7	-
Total creditors falling due after one year	**4,835.1**	**59.3**	4,688.4	59.2

	Group 2014 £m	Group 2013 £m
Repayments fall due as follows:		
Between two and five years	**150.0**	150.0
After five years not by instalments	**4,586.0**	4,440.5
	4,736.0	4,590.5

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

16 Creditors: amounts falling due after one year (continued)

An analysis of the external loans is shown below:

Loans	**Group 2014 £m**	Group 2013 £m
Class A £350m 6.192% fixed rate 2029	**350.0**	350.0
Class A £150m 3.706% index linked 2034	**210.2**	203.8
Class A £35m 3.706% index linked 2034	**49.7**	48.2
Class A £350m 6.640% fixed rate 2026	**350.0**	350.0
Class A £150m 3.816% index linked 2023	**210.2**	203.8
Class A £350m 5.000% fixed rate 2021	**350.0**	350.0
Class A £150m 5.000% fixed rate 2041	**150.0**	150.0
Class A £200m 4.500% fixed rate 2052	**200.0**	200.0
Class A £300m 5.125% fixed rate 2056	**300.0**	300.0
Class A £300m 6.125% fixed rate 2019	**300.0**	300.0
Artesian £165m 4.076% index linked 2033	**231.3**	224.1
Artesian £156.5m 3.635% index linked 2032	**214.0**	207.5
	2,915.4	2,887.4
Fixed swapped to Index-linked – (note (i) below)	**(1,318.2)**	(1,318.2)
Index-linked swaps – (note (i) below)	**1,578.8**	1,537.4
Total Class A debt	**3,176.0**	3,106.6
Class B £250m 4.51% fixed rate 2022	**250.0**	250.0
£250m 8.500% Guaranteed Secured Fixed Rate Notes 2019	**250.0**	250.0
£225m Facility Agreement 2016 – Libor plus 4% (note (iii) below)	**200.0**	200.0
Eurobonds 12% 2021 (note 27)	**710.0**	633.9
Capex facility 6 month LIBOR plus 3%	**150.0**	150.0
Debt issue costs (note (iv) below)	**(38.3)**	(49.1)
Premium deferred on issue (note (vii) below)	**115.2**	124.8
Deferred gilt lock proceeds (see note (v) below)	**5.3**	5.3
Obligations under Finance Leases	**1.6**	1.2
	4,819.8	4,672.7

Class A and Class B loans are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertaking of each of Southern Water Services Limited, Southern Water Services (Finance) Limited ('SWSF'), SWS Holdings Limited, and SWS Group Holdings Limited. In the case of Southern Water Services Limited, this is to the extent permitted by the Water Industry Act 1991 and Licence.

In respect of the specific instruments above:

(i) As at 31 March 2014, SWSF was party to various swap agreements converting a total of £1,318.2m (book value) of Class A debt from the original fixed interest rate to a real interest rate linked to RPI (Retail Price Index) plus capitalised inflation on the nominal value of the underlying Class A debt.

The table below analyses the total value of swaps entered into by SWSF as at 31 March 2014:

Loan	Book value of Class A debt swapped	Fixed interest rate	Index Linked interest rate	Book value of Class A debt plus capitalised RPI
Class A £350m 6.192% fixed rate 2029	£349.3m	6.192%	3.340%	£395.1m
Class A £350m 6.640% fixed rate 2026	£141.9m	6.640%	3.699%	£159.1m
Class A £350m 5.000% fixed rate 2021	£177.0m	5.000%	2.060%	£199.1m
Class A £150m 5.000% fixed rate 2041	£150.0m	5.000%	0.500%	£201.1m
Class A £200m 4.500% fixed rate 2052	£200.0m	4.500%	0.060%	£262.1m
Class A £300m 5.125% fixed rate 2056	£300.0m	5.125%	0.480%	£362.3m
	£1,318.2m			£1,578.8m

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

16 Creditors: amounts falling due after one year (continued)

(ii) The Class B debt of £250m was repaid in March 2014. Up until the point of repayment interest was charged at 7.879 per cent.

(iii) Of the £225m Facility Agreement, £200m has been drawn, with the remaining £25m providing a liquidity facility for future interest payments. The group has entered into swap agreements that have converted £150m of the £200m drawn on the £225m Facility Agreement from a floating rate of Libor plus 4 per cent (4.62 per cent from 1 April 2014), to a fixed rate of 2.909 per cent.

(iv) Debt issue costs represent issue fees paid by SWSF and Southern Water (Greensands) Financing Plc. 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 loan advances noted above. As at 31 March 2014 debt issue costs amounted to £41.4m (2012–13: £52.5m) of which £3.1m (2012–13: £3.4m) represents the short-term amount which is disclosed separately in note 15.

(v) Prior to the issue of the Class A £300m bond in the year to 31 March 2008, SWSF entered into a gilt lock agreement, resulting in the receipt of £6.3m, which was advanced to Southern Water along with the proceeds of the bond issue. The proceeds have been deferred and are being released to the profit and loss account over the life of the loan.

(vi) Deferred revenue relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by Southern Water. The income will be credited to the profit and loss account evenly over the life of the lease.

(vii) The deferred bond premium represents the additional book value of certain of the group's bonds which were issued in 2003, and arose when a number of the group's swap instruments were effectively closed out and the resulting loss was rolled forward into the pricing of those bonds. The premium is being amortised over the lives of the relevant bonds.

17 Provision for liabilities and charges

		Group 2014 £m	Group 2013 £m
(a)	**Environmental obligations**		
	Provision as at 1 April	**0.8**	0.8
	Utilised in year	**(0.3)**	-
	Provision at 31 March	**0.5**	0.8

The environmental provision relates to costs for the decommissioning of abandoned sites. No reimbursement is expected. The period over which the provision will be utilised cannot be determined thus the provision is not discounted. Discounting the provision would not materially affect its value.

(b)	**Deferred taxation**		
	Accelerated capital allowances	**333.0**	378.3
	Other timing differences	**(19.5)**	(22.1)
	Deferred taxation at 31 March	**313.5**	356.2

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

17 Provision for liabilities and charges (continued)

Movement in deferred tax provision:	**Group 2014 £m**	Group 2013 £m
Deferred tax provision as at 1 April	**356.2**	349.0
Origination and reversal of timing differences	**16.1**	24.2
Adjustment to opening tax estimates	**(11.8)**	(1.5)
Impact of corporation tax rate change	**(47.0)**	(15.5)
Deferred tax provided at 31 March	**313.5**	356.2

Group losses of £10.4m (2012–13: £27.1m), with a deferred tax asset of £2.1m (2012–13: £6.2m) have not been recognised in the accounts due to the uncertainty of suitable taxable profits in the foreseeable future on which to utilise these losses.

On 9 April 2014 agreement was reached with HMRC regarding the proportion of interest on the Eurobond issued by Greensands Europe Limited to the group's shareholders which HMRC would accept as being deductible for tax purposes under transfer pricing regulations. Prior to this agreement, the accounting position reported for the group for all years up to and including the 31 March 2013 had been prepared on the basis that no deductions would be permitted, as discussions with HMRC had not been concluded.

Following the agreement, the total amount of accrued interest for the years ended 31 March 2008 and onwards that is now expected to be deductible is £112.0 million. No tax benefit has been recognised in respect of these, as there is uncertainty over the availability of suitable taxable profits against which these may be offset.

The deferred tax asset of £18.1m (2012–13: £21.6m) relating to the pension deficit has been deducted from the pension deficit and so has not been included in this balance. An analysis of the movement in the deferred tax relating to the pension deficit is shown below.

No provision has been made for potential deferred tax liability on fair value adjustments made to the fixed assets recognised on acquisition. Such tax would only become payable if a contract was entered into to sell the related assets.

The total amount of deferred tax un-provided is £235.0m (2012–13: £275.2m). At present it is not envisaged that any such tax will become payable in the foreseeable future.

The company has no provisions for liabilities and charges.

Deferred tax asset relating to pension deficit	**2014 £m**	2013 £m
At 1 April	**21.6**	26.6
Deferred tax charge in profit and loss account	**(0.1)**	(5.9)
Deferred tax charged to the statement total recognised gains and losses	**(0.7)**	1.8
Impact of rate change:		
Charge in profit and loss account	**(1.2)**	(0.4)
Charged to the statement total recognised gains and losses	**(1.5)**	(0.5)
At 31 March	**18.1**	21.6

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

18 Financial instruments

Derivative activity is undertaken by subsidiaries in the group, Greensands Senior Finance Limited, Southern Water (Greensands) Financing Plc and Southern Water Services (Finance) Limited ("SWSF"), as determined by the Board, which considers the overall risk profile of the group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. No derivatives are undertaken for trading purposes, or to benefit from price fluctuations.

No derivative activity is undertaken by the company.

The SWSF business consists of lending to other group companies and raising external finance.

Fair values of hedging instruments (as described in the table below) have not been recognised in the financial statements as the group does not adopt FRS 25, 'Financial Instruments: Disclosure and Presentation' or FRS 26 Financial Instruments: Recognition and Measurement. The fair value in respect of these instruments has been disclosed on page 73.

All fair values are based on arms length transactions in normal market conditions. Where available, market values have been used to determine fair values.

The fair value of the group's long term borrowings has been estimated based on quoted market prices for the same or similar debt where possible. Where prices did not exist, the fair value has been estimated based on the calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates.

For foreign currency and interest rate swap agreements the fair value has been estimated based on market valuations at the balance sheet dates.

The group has no material un-hedged monetary assets and liabilities denominated in a currency different from the local currency of the particular operation.

The table below describes the main activities and risks which lead to the use of derivatives.

Activity	Risk	Type of hedge in place
Floating rate borrowing / financing	Increased interest expense due to increases in interest rates	Interest rate swaps which fix the amount of interest payable.
Currency rate borrowing / financing	Increased currency losses due to increases in exchange rates	Currency rate swaps which fix the exchange rates.
Indexation	The regulatory framework, under which revenues and the RCV are indexed, exposes the group to inflation risk	Index-linked instruments

For the purposes of the notes below, short term debtors and creditors have been excluded, on the basis that their fair values are not considered to be different to book value.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

18 Financial instruments (continued)

Interest Rate Risk profile of financial liabilities

Currency	Total £m	Index Linked financial liabilities £m	Fixed rate financial liabilities £m	Variable rate financial liabilities £m
GBP	4,590.5	2,424.8	1,770.7	395.0
At 31 March 2013	4,590.5	2,424.8	1,770.7	395.0
GBP	**4,736.0**	**2,494.2**	**1,846.8**	**395.0**
At 31 March 2014	**4,736.0**	**2,494.2**	**1,846.8**	**395.0**

The balance above includes the debt raised in external finance markets (described further in note 16).

	Fixed rate financial liabilities	
Currency	Weighted average interest rate %	Weighted average time for which rate is fixed Years
GBP		
31 March 2013	8.5	7.8
GBP		
31 March 2014	**8.2**	**6.9**

The group held the following financial assets:

	2014 £m	2013 £m
GBP Cash	**193.4**	557.6

The above financial assets attract interest at floating rates.

Fair values of financial assets and financial liabilities

The following table provides a comparison by category of the carrying amounts and the fair values of the group's financial assets and financial liabilities at 31 March 2014. Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties. Where available, market values have been used to determine fair values.

	Book value 2014 £m	**Fair value 2014 £m**	Book value 2013 £m	Fair value 2013 £m
Long term borrowings	**(4,736.0)**	**(4,906.9)**	(4,590.5)	(4,949.4)
Cash at Bank and in Hand	**193.4**	**193.4**	557.6	557.6
Derivative financial instruments held to manage interest rate profile				
Interest Rate and index linked Swaps	**(260.6)**	**(1,105.3)**	(219.2)	(1,107.5)

There is no expectation these losses will be realised within 5 years as the group expects to hold these instruments until maturity. In the event of any repayment of associated debt, the intention is to match the liability with a new debt instrument.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

19 Grants and contributions

	Group £m
At 1 April 2013	46.4
Receivable in period	0.3
Released to profit and loss account	(2.9)
At 31 March 2014	**43.8**

Grants and contributions relate to non-infrastructure assets.

20 Share capital

	Group and Company 2014 £m	Group and Company 2013 £m
Allotted, called up and fully paid		
921,874,025 Ordinary shares of £1 each	**921.9**	921.9
	921.9	921.9

21 Reconciliation of shareholders funds

Group	Called up share capital £m	Share Premium account £m	Profit and loss account £m	Total £m
At 1 April 2013	**921.9**	**4.5**	**(363.2)**	**563.2**
Loss for the year	-	-	**(4.9)**	**(4.9)**
Actuarial gain on pension scheme	-	-	**3.1**	**3.1**
Movement on deferred tax relating to pension asset	-	-	**(2.2)**	**(2.2)**
At 31 March 2014	**921.9**	**4.5**	**(367.2)**	**559.2**
At 1 April 2012	921.9	4.5	(340.1)	586.3
Loss for the year	-	-	(17.0)	(17.0)
Actuarial loss on pension scheme	-	-	(7.3)	(7.3)
Movement on deferred tax relating to pension asset	-	-	1.2	1.2
At 31 March 2013	921.9	4.5	(363.2)	563.2

Company	Called up share capital £m	Share Premium account £m	Profit and loss account £m	Total £m
At 1 April 2013	**921.9**	**4.5**	-	**926.4**
Profit for the year	**-**	**-**	-	**-**
At 31 March 2014	**921.9**	**4.5**	**-**	**926.4**
At 1 April 2012	921.9	4.5	-	926.4
Profit for the year	-	-	-	-
At 31 March 2013	921.9	4.5	-	926.4

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2014

22 Notes to the cash flow statement

Cash flow from operating activities	2014 £m	2013 £m
Continuing operations		
Operating profit	**277.1**	297.0
Depreciation charge	**259.2**	237.7
Amortisation of goodwill	**6.3**	6.3
Amortisation of grants & contributions	**(2.9)**	(2.8)
Decrease/(increase) in stocks	**(0.4)**	0.4
Increase in debtors	**(19.6)**	(12.0)
Increase/(Decrease) in creditors	**21.4**	(15.5)
Decrease in environmental provision	**(0.3)**	-
Difference between pension charge and cash contributions	**(2.7)**	(11.4)
Total net cash inflow from operating activities	**538.1**	499.7

Analysis of Net Debt:

	At 1 April 2013 £m	Cash flows £m	Other non-cash £m	At 31 March 2014 £m
Cash deposits	557.6	(364.2)	-	**193.4**
	557.6	(364.2)	-	**193.4**
Debt issue costs net of deferred gilt lock proceeds	47.1	0.2	(11.3)	**36.0**
Debt due within one year	(259.6)	250.0	-	**(9.6)**
Debt due after one year	(4,715.3)	2.8	(138.6)	**(4,851.1)**
Finance leases	(1.3)	-	(0.3)	**(1.6)**
	(4,371.5)	(111.2)	(150.2)	**(4,632.9)**

23 Pensions

The group accounted for pension costs during the year under FRS 17. These disclosures show a net FRS 17 deficit (after deferred tax) of £72.3m (2012–13 deficit: £72.1m). The deficit has arisen mainly as a result of lower expected future returns on investments and turbulence in the stock market, including low interest rates. The net FRS 17 deficit has increased due to a reduction in the related deferred tax asset, although the underlying deficit before tax has improved slightly. These movements are analysed below.

The company has no defined benefit or defined contribution pension schemes.

Pension schemes operated

The group principally operates two schemes, 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 assets of the scheme are held separately from those of the group. 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).

2. A second company stakeholder scheme, which is a defined contribution scheme, is also available to all employees.

Contributions made to the defined contribution scheme for the year ended 31 March 2014 amounted to £1.4m (2012–13: £1.0m). No contributions were outstanding at either year end.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

23 Pensions (continued)

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 2010 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:

	2010 SWPS % per annum (pa)
Return on investments: pre-retirement	7.2
Return on investments: post-retirement (pensioner/non-pensioner)	5.2/5.25
Salary growth	5.2
Pension increases on the excess over guaranteed minimum pensions (where capped at 5% pa)	3.8

The assets of the scheme had a market value of £479.6m at 31 March 2010. This was sufficient to cover 81 per cent of the scheme's benefits.

Expected employer and employee contributions to the defined benefit scheme for 2014–15 are £21.0m and £0.3m respectively under the current Schedule of Contributions. An actuarial valuation as at 31 March 2013 is currently underway, and a new Schedule of Contributions will be agreed as part of this valuation, which could result in a different level of contributions being paid.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

23 Pensions (continued)

FRS 17 – assumptions, asset, liability and reserves disclosures

The formal actuarial funding valuation was carried out as at 31 March 2010 and updated to 31 March 2014 by a qualified independent actuary. The major assumptions used by the actuary are set out in the table below.

	2014	2013	2012
	% pa	% pa	% pa
Price inflation (RPI)	**3.2**	3.2	3.0
Price inflation (CPI)	**2.3**	2.3	2.1
Rate of increase in salaries (plus an age-related promotional scale)	**2.5**	2.5	3.0
Rate of increase of pensions in payment (MIS* members only)***	**2.3**	2.3	2.1
Rate of increase of pensions in payment (Old section** members only)***	**3.2**	3.2	3.0
Rate of increase of pensions in payment (all other members)***	**3.1**	3.1	3.0
Rate of increase for deferred pensions (MIS* members only)***	**2.3**	2.3	2.1
Rate of increase for deferred pensions (all other members)***	**3.1**	3.1	3.0
Discount rate	**4.5**	4.4	4.8
Expected return on assets	**5.1**	4.7	5.4

* 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 cent cap on increases that apply to other sections of the Scheme.

*** In excess of any Guaranteed Minimum Pension (GMP) element.

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. For 2013–14, the group has used the post-retirement mortality assumptions based on the standard SAPS mortality tables together with future improvements in line with the medium cohort projections with a 1 per cent per annum underpin, modified to reflect actual experience.

	2014	2013
	Years	Years
Longevity at age 65 for current pensioners		
Male	**22.9**	22.7
Female	**25.0**	24.6
Longevity at age 65 for future pensioners		
Male	**24.7**	24.6
Female	**26.9**	26.4

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

23 Pensions (continued)

The assets and liabilities in the schemes and the expected rates of return at 31 March 2014 and 31 March 2013 were:

	Rate of return 2014	Rate of return 2013	**Value at 2014 £m**	Value at 2013 £m
Equities	**7.1%**	6.8%	**256.6**	261.7
Government bonds	**3.1%**	2.8%	**132.3**	128.8
Non-Government bonds	**4.0%**	4.1%	**183.9**	178.0
Cash	**2.9%**	3.2%	**8.7**	7.5
Total market value of Plan assets			**581.5**	576.0
Total value of Plan liabilities			**(671.9)**	(669.7)
Accrued deficit in the Plan			**(90.4)**	(93.7)
Related deferred tax asset			**18.1**	21.6
Net pension liability			**(72.3)**	(72.1)

a) The equity investments and bonds which are held in plan assets are quoted and are valued at the current bid price following the adoption of the amendment to FRS 17.

Reconciliation of the present value of the scheme liabilities	**2014 £m**	2013 £m
At 1 April	**669.7**	616.1
Current service cost	**5.0**	6.5
Interest cost	**29.1**	29.2
Member contributions	**0.3**	0.3
Actuarial (gain)/loss on liabilities	**(7.5)**	50.3
Benefits paid	**(24.7)**	(23.7)
Curtailments	**-**	(9.0)
Scheme liabilities at 31 March	**671.9**	669.7

Sensitivity analysis of scheme liabilities

The sensitivity of the present value of the scheme liabilities to changes in the principle assumptions used is set out below.

	Change in assumption	Impact on scheme liabilities (%)		Impact on scheme liabilities (£m)	
Discount rate	+/- 1%	-/+	15	-/+	94
Rate of inflation*	+/- 1%	+/-	13	+/-	90
Rate of increase in pensions in payment	+/- 1%	+/-	11	+/-	75
Mortality	+/- 1yr	+/-	2	+/-	13

*A change in inflation is assumed to be reflected in a change in the assumed rates of deferment revaluation and pension increase (on pension in excess of GMP).

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

23 Pensions (continued)

Reconciliation of the fair value of the scheme assets	**2014** **£m**	2013 £m
At 1 April	**576.0**	519.8
Expected return on assets	**26.7**	27.7
(Loss)/gain on assets	**(4.4)**	43.0
Employer contributions	**7.6**	8.9
Member contributions	**0.3**	0.3
Benefits paid	**(24.7)**	(23.7)
Bid value of scheme assets at 31 March	**581.5**	576.0

The actual gain on scheme assets was £22.2m (2012–13: £70.7m).

Analysis of amounts charged to operating profit are as follows	**2014** **£m**	2013 £m
Employer's current service cost	**5.0**	6.5
Expected return on pension scheme assets	**(26.7)**	(27.7)
Interest on pension scheme liabilities	**29.1**	29.2
Curtailments	**-**	(9.0)
Total P&L expense/(credit) before deduction for tax	**7.4**	(1.0)

Analysis of the amounts recognised in STRGL	**2014** **£m**	2013 £m
Actuarial return less expected return on pension scheme assets	**(4.4)**	43.0
Experience gain arising on scheme liabilities	**-**	1.1
Gain/(loss) on change of assumptions (financial and demographic)	**7.5**	(51.4)
Total gain/(loss) recognised in STRGL before adjustment for tax	**3.1**	(7.3)

The cumulative amount of actuarial losses recognised in the statement of total recognised gains and losses is £136.6m (2012–13: £139.6m).

Analysis of the movement in the schemes' deficit during the year	**2014** **£m**	2013 £m
Deficit in the scheme at 1 April	**(93.7)**	(96.3)
Employer's contributions	**7.6**	8.9
Employer's current service cost	**(5.0)**	(6.5)
Cost of curtailments	**-**	9.0
Other finance expense	**(2.4)**	(1.5)
Actuarial gain/(loss)	**3.1**	(7.3)
Deficit in the scheme at end of year	**(90.4)**	(93.7)
Deferred tax relating to scheme deficit	**18.1**	21.6
Net deficit at 31 March	**(72.3)**	(72.1)

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

23 Pensions (continued)

History of gains and losses for the year to 31 March 2014 are as follows	2014	2013	2012	2011	2010
a. Experience adjustment on planned assets					
Amount (£m)	**(4.5)**	(43.0)	0.5	(1.1)	(83.6)
b. Experience adjustment on scheme liabilities					
Amount (£m)	**-**	1.1	4.9	(6.0)	12.9
c. Total amount recognised in the STRGL					
Fair value of assets at year-end (£m)	**581.5**	576.0	519.8	500.6	480.2
Actuarial value of liabilities at year-end (£m)	**(671.9)**	(669.7)	(616.1)	(560.7)	(589.0)
Deficit in scheme at year-end (£m)	**(90.4)**	(93.7)	(96.3)	(60.1)	(108.8)

The assets have been valued at bid value as per FRS 17 amendment.

24 Contingent liabilities

Contractors submit claims to Southern Water 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's valuation.

Neither the company nor the group had any contingent liabilities for capital claims at the year-end (2012–13 £nil).

25 Financial commitments

As at 31 March 2014 and 2013, the group had annual commitments under non-cancellable operating lease agreements in respect of vehicles and land and buildings for which the payment extends over a number of years as follows:

	Land and Buildings		Other	
	2014	2013	**2014**	2013
	£m	£m	**£m**	£m
Expiring within one year	**-**	-	**-**	-
Expiring between two and five years	**0.1**	-	**0.1**	-
Expiring after more than five years	**1.4**	1.3	**-**	-
	1.5	1.3	**0.1**	-

Operating leases are charged to the profit and loss account over the lease term.

The company has no such commitments.

26 Directors' emoluments

One director received £30,000 (2012–13 £30,000) paid by the group for services as a director of Greensands Holdings Limited. One other director received £15,000 (2012–13 £15,000) paid by one of the ultimate shareholders.

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

27 Related party transactions

The major shareholders in Greensands Holdings Limited as at 31 March 2014 are IIF International SW UK Investments Limited and The Northern Trust Company.

The transactions and balances with the group's related parties (i.e. the shareholders), as defined by Financial Reporting Standard 8 and the extent of the transactions with them are summarised below.

	2014 £m	2013 £m
Eurobond interest		
IIF Int'l SW UK Investment Ltd	**22.3**	19.9
Phildrew Nominees Ltd	**11.9**	10.6
Britel Guernsey Investments Ltd	**-**	2.7
National Nominees Ltd	**4.4**	5.0
State Street Australia Ltd	**-**	2.1
STC Funds Nominee Pty Limited	**2.4**	2.1
The Northern Trust Company	**17.8**	15.9
Sky Brace Investments Ltd	**3.6**	3.2
Sumaya Investments Ltd	**3.6**	3.2
Retail Employees Superannuation Pty Ltd	**-**	1.8
Nambawan Super Limited	**0.3**	0.3
JP Morgan Nominees Australia	**1.2**	1.1
Hermes GPE Infrastructure Fund LP	**3.0**	-
SW Holdings LP	**1.0**	-
Simcoe Yeoman Water Ltd	**4.6**	-
Total Eurobond interest payable to related parties	**76.1**	67.9

Loans and other borrowings greater than one year:

	2014 £m	2013 £m
Eurobonds – Shareholder loans		
IIF Int'l SW UK Investment Ltd	**105.3**	105.3
Phildrew Nominees Ltd (UBS IIF)	**20.1**	20.1
Phildrew Nominees Ltd (UBS IINF)	**2.8**	2.8
Phildrew Nominees Ltd (UBS II4F)	**22.2**	22.2
Phildrew Nominees Ltd (UBS IIUSTEF)	**11.1**	11.1
Britel Guernsey Investments Ltd	**-**	14.0
National Nominees Ltd - Motor Trades association of Australia Super Fund	**16.8**	16.8
State Street Australia Ltd – (as custodian for Sunsuper super fund)	**-**	11.2
STC Funds Nominee Pty Limited as trustee of the SW Unit Trust	**11.2**	11.2
National Nominees Ltd – Prime Super	**4.2**	4.2
National Nominees Ltd - Statewide Super Pty Ltd	**-**	5.6
The Northern Trust Company (as custodian for Future Fund Investment Company No.2 Pty Ltd)	**84.2**	84.2
Sky Brace Investments Ltd	**17.1**	17.1
Sumaya Investments Ltd	**17.1**	17.1
Retail Employees Super Pty ltd	**-**	9.5
Nambawan Super Limited as trustee for the Nambawan Superannuation Fund	**1.7**	1.7
JP Morgan Nominees Australia	**5.6**	5.6
Hermes GPE Infrastructure Fund LP	**14.0**	-
SW Holdings LP	**4.8**	-
Simcoe Yeoman Water Ltd	**21.6**	-
Accrued interest	**350.2**	274.2
Total Eurobonds – Shareholder loans	**710.0**	633.9

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2014

28 Principal subsidiaries

As at 31 March 2014 the company held 100 per cent of the ordinary share capital of Greensands Europe Limited. Greensands Europe Limited's principal subsidiaries are listed below.

Company	Class of share capital	Proportion of shares held	Activity
Greensands UK Limited	Ordinary	100%	Non-trading activities
Southern Water (Greensands) Financing Plc	Ordinary	100%	To raise debt finance
Greensands Junior Finance Limited	Ordinary	100%	To raise debt finance
Greensands Senior Finance Limited	Ordinary	100%	To raise debt finance
Greensands Investments Limited	Ordinary	100%	Non-trading activities
Southern Water Capital Limited	Ordinary	100%	Non-trading activities
Southern Water Investments Limited	Ordinary	100%	Non-trading activities
Southern Water(NR) Holdings Limited	Ordinary	100%	Non-trading activities
Southern Water(NR) Limited	Ordinary	100%	Non-trading activities
SWS Group Holdings Limited	Ordinary	100%	Non-trading activities
SWS Holdings Limited	Ordinary	100%	Non-trading activities
Southern Water Limited	Ordinary	100%	Intermediate parent company for Southern Water(NR) Group
Southern Water Services Limited	Ordinary	100%	Supply of Water and Wastewater Services
Southern Water Services Finance Limited	Ordinary	100%	To raise debt finance
Southern Water Services Group Limited	Ordinary	100%	Non-trading activities
Southern Water Industries Limited	Ordinary	100%	Dormant
Southern Water Services Finance plc	Ordinary	100%	Dormant
Bowsprit Holdings Limited	Ordinary	100%	Dormant
Monk Rawling Limited	Ordinary	100%	Dormant
Bowsprit Property Development Limited	Ordinary	100%	Property Development
EcoClear Limited	Ordinary	100%	Dormant
Southern Water Executive Pension Scheme Trustees Limited	Ordinary	100%	Dormant
Southern Water Pension Trustees Limited	Ordinary	100%	Dormant

All subsidiaries have been included in Greensands Holdings Limited's consolidated financial statements.

Independent Auditor's report to the members of Greensands Holdings Limited

We have audited the financial statements of Greensands Holdings Limited for the year ended 31 March 2014 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated and company balance sheets, the consolidated cash flow statement and the related notes 1 to 28. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Article 113A of the Companies (Jersey) Law 1991. 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.

Respective responsibilities of directors and auditors

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. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

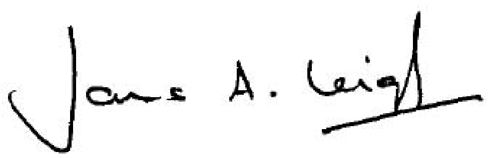
In our opinion the financial statements:

- give a true and fair view of the state of the group's and the company's affairs as at 31 March 2014 and of the group's loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been properly prepared in accordance with the Companies (Jersey) Law 1991.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies (Jersey) Law 1991 requires us to report to you if, in our opinion:

- proper accounting records have not been kept, or proper returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations we require for our audit.



James Leigh
for and on behalf of Deloitte LLP
Chartered Accountants
London, United Kingdom
29 July 2014