Annual Performance Report 2018–19

Regulatory reporting

Southern Water

Ensuring water for life

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Regulatory information and annual performance report

Introduction

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

The Annual Performance Report sets out the performance in 2018–19 of Southern Water's regulated business, as defined under our Licence, in financial terms and against our business outcome and performance commitments.

The Annual Performance Report comprises four sections:

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

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

In addition we have also published a data assurance summary on our website – **southernwater.co.uk/our-reports**. This sets out the results of the data assurance undertaken on our reporting for 2018–19.

Board Statement of Company Direction and Performance

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

Details of our performance against our targets for this business plan period 2015–20 and in particular 2018–19 are provided in the Strategic Report section of our Annual Report and Financial Statements. In addition details of our performance against performance commitments are provided in the performance summary on page 43 of this report.

Preparing for the future

As part of our preparations for the next business plan period 2020–25, we are focusing, in 2019–20, on ensuring that we are doing the basics well. This includes a transformation plan to deliver cost efficiencies which should prepare us to deliver the Business Plan and improve the service we provide to customers and the environment.

During 2019–20 these changes will include:

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

- further embedding our revised company values to drive culture change within the business
- investment in our IT infrastructure to bring services back in house.

Our vision and business plan for 2020–25

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

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

To inform development of our long-term vision we commissioned a groundbreaking report from futurist Peter Kingsley called "Water Futures in the South East: Towards 2050". This report identified six major trends that would affect our business over the next thirty years. These were, global climate and environment, new forms of regional governance, ecosystem thinking, new technologies such as nanoscale filtration, sensors and artificial intelligence, the growth of radical innovation, and the changing cultural values of the public, customers and stakeholders. This work, along with reports from many other organisations including the World Economic Forum provides a clear context for the challenges and opportunities we face, and the need to move beyond conventional water sector thinking to tackle these.

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

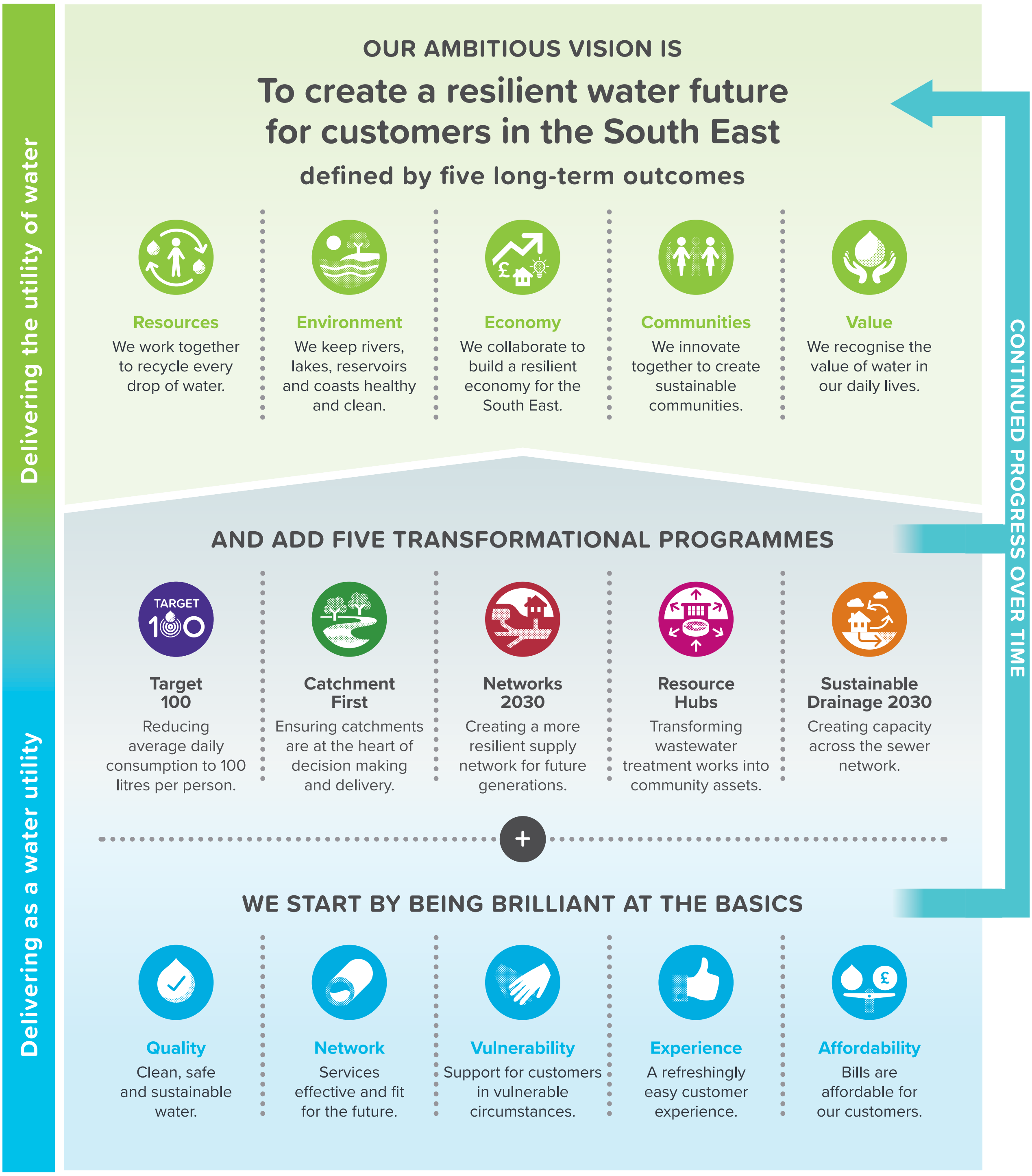
Our stakeholders and customers have also played a key role in shaping our vision and our business plan. Over the course of this five-year business plan period 2015–20, we have carried out a programme to significantly improve how we engage with our customers and stakeholders, and used the insight to put them at the heart of our business. In practice this means building on how we use customer insight to drive decision making across Southern Water, from establishing an insight function, to using customer data to drive continuous improvement initiatives in our operational teams. For the next business planning period 2020–25 we will go much further. We will move beyond listening to active customer participation in the development and delivery of our services. We have already carried out over 42,000 direct interviews with customers and other stakeholders to develop our business plan for 2020–25.

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

This long-term vision forms the ambition for the five-year business plan, covering 2020–25, which we submitted to Ofwat in September 2018. Our customers have told us that as well as thinking about the challenges of the future, they have an expectation that we will continue to deliver on the basics – clean, high quality drinking water and effective wastewater systems.

These twin goals of delivering the basics brilliantly and planning for the future are reflected in our plan which is built around five service-based outcomes and five transformational programmes.

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



Delivering for our customers

Our current five-year business plan, developed in 2014, takes us to 2020. As part of that plan we committed to 33 explicit performance targets for each year of the period, with financial penalties and rewards attached to 21 of these. Our performance against all of these targets is set out in Table 3A on page 43.

The Board and Executive closely monitor performance against these commitments through a business promises dashboard, directing corrective action where performance is not on target. In addition, our independent Customer Challenge Group (CCG) monitors and challenges our performance and publishes an annual report on the delivery of our business plan commitments. The CCG chair regularly attends the Board meeting, providing Board members with an external perspective on our performance and our improvement programmes.

Performance against the targets set in our 2014 business plan has been mixed, with some good performance in a number of areas, but significant challenges in others. For example we have delivered excellent performance in reducing per capita consumption, beating our targets, and providing a strong platform for our industry-leading Target 100 initiative. We have also improved customer service performance very significantly from a relatively poor position in recent years, though we recognise that there is still more to do in this area.

Significant challenges remain however. We need to improve operational performance in respect of our environmental and drinking water performance and resilience. Following historic issues relating to the reporting to our regulators of performance data, it is vital that we focus on ensuring a strong culture of compliance in our business. We must also ensure that we are delivering in the most cost-effective way and spending customers' money on the things that matter most to them.

To address these challenges we have established a company-wide transformation programme, with a number of sub-programmes to address specific areas of improvement. These programmes include

- **Water First** – our long-term improvement programme, developed in collaboration with the Drinking Water Inspectorate (DWI), to embed public health protection at the heart of our water services. It spans our people, processes, systems, culture, training, risk and information management – supported by asset improvements and expanded catchment management.
- **Environment+** – our holistic Environment+ programme is building on work already underway to improve how we manage our risk and assets to improve our performance, capabilities and compliance. It is embedding more collaborative, effective and transparent practices, alongside sustainable improvements to our policies, processes and reporting.
- **Modern Compliance Framework** – we are working with leading experts in ethical business practice to adapt their work into our transformation and guide the development of specific activities under the Modern Compliance Framework.

The Board has been instrumental in the establishment of the transformation programme and is closely tracking progress. Together, these programmes will enable us to get the basics right in this business plan period to deliver our plan through to the next business plan period and beyond.

As well as delivering against the commitments in our business plan, we are changing the way that we engage with customers to ensure that we adapt to changing customer preferences in an agile way. Historically, customer engagement in the sector has been focused on developing a five-year business plan, with less emphasis on ongoing engagement between price reviews.

To ensure that we can meet the challenges of the future we have put in place a new customer engagement and participation strategy. Our approach starts with the customer, looking at all the different ways we engage, bringing teams together and defining our preferred future. Our model is described below:

FUTURES
We co-imagine and co-create the future with customers

1 CUSTOMER EXPERIENCE
We engage customers in improving their customer-service experience

2 LISTENING AND ACTING
We listen to customers and act on what we hear

3 COMMUNITY
We engage customers as citizens in improving the future for water where they live

4 BEHAVIOUR CHANGE
We make it easy for customers to act to help achieve a resilient future for water

5 COMMS
We have a continuous conversation with customers and their representatives

6 CUSTOMER DRIVEN CULTURE
Customers interests are first in all the decisions we make and the actions we take

INSIGHT
We integrate our insight to provide a holistic view with evidence to inform our plans and actions

CUSTOMER ACTIVITY GOES ACROSS ALL THE PILLARS

Aligning performance and rewards

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

We are also strongly incentivised to deliver efficiently. At each price review Ofwat assesses the efficient costs for delivering our business plan. If we are able to beat these, we share the benefits of that outperformance with our customers. Broadly speaking, for every pound that we save, 50 pence is returned to customers via lower bills.

Our employees are incentivised to deliver for customers through a company-wide bonus scheme, 'yourBonus'. 75% of the measures associated with the bonus scheme relate to delivering excellent operational performance and efficient delivery of our plan. It aligns the incentives for all employees with the interests of our customers.

The remuneration of our Executive directors is closely tied to operational performance. Ofwat recently published a set of principles for linking executive pay to performance and we have further revised our executive pay policy to build on the principles in our existing remuneration policy (updated less than 12 months ago), which already considers performance across a balanced set of outcomes for stakeholders. We will maintain a link to things our customers' value; we will continue to report transparently on performance against bonuses; and we will formally review our policy annually.

As well as ensuring the right incentives are in place, it is important that we strike the right balance between providing a fair return to shareholders and investing for customers. We recently updated our dividend policy to incorporate a wide range of measures, including financial and customer performance measures.

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

Ofwat Board Leadership, Governance and Transparency principles

In 2014 Ofwat published its first set of principles on Board Leadership, Governance and Transparency. These principles set out high level expectations of companies' Boards, but crucially, did not prescribe how companies should meet these principles. As part of its Company Monitoring Framework (CMF) Ofwat assesses companies' compliance with these principles. In Ofwat's 2018 CMF, Ofwat concluded that we "Met Expectations" with respect to compliance with the principles.

During 2018, Ofwat consulted on updating its principles and published its conclusions in January 2019. It also plans to introduce a licence condition, requiring compliance with the principles. These updated principles are operational from April 2019, but we are taking steps to ensure that we meet the objectives of the new principles going forward. In our Annual Report and Financial Statements, we set out how we are changing our business to ensure we can meet and exceed these new principles.

Annual risk and compliance statement

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

Customer expectations

In September 2018 we submitted to Ofwat our business plan for the period 2020–25. In developing our plan we spoke to more than 42,000 customers and stakeholders to understand their expectations, preferences and willingness to pay for service improvements. Mobile apps, sophisticated 'willingness-to-pay' research, and 'co-creation' workshops with customers and stakeholders are just some of the tools we have used for the first time in the preparation of our plan. The rigour of this approach was reflected in independent research by the Consumer Council for Water, which showed that 81% of customers found our proposals acceptable and only 4% rated the plan as unacceptable.

A key part of understanding our customers' expectations is being clear on who our customers are. We know that amongst our bill payers different types of customers will have different needs and expectations. Splitting our household customers into segments with similar characteristics helps us to tailor propositions to different customer needs. We have developed customer service-led personas to assist with our retail service delivery, and we are using these personas to evolve our segmentation for the rest of our services.

But, we have also deliberately broadened the definition of who our customers are, beyond just those who pay water bills. As well as bill payers, we consider all of those who interact with the water environment as customers of the services we provide. This includes, for example, the many visitors to our regions beaches and bathing waters, who may not be Southern Water bill payers, but who benefit from the improvements we are making to bathing waters. Engagement with this wider group of water users is fundamental to ensuring we meet the expectations of society as a whole.

We recognise that if we are to meet customers' changing expectations, this engagement must be ongoing and to build on our solid foundation of engagement to date, we have developed a new Customer Engagement and Participation model, which we are now using to underpin all of our future engagement. (See above for details of our new model.)

Our Customer Challenge Group, comprised of independent experts in customer representation and advocacy and environmental stakeholders, has supported and challenged us in the development of both our business plan and our future engagement and participation strategy. They provide an important external perspective on all of the work we do to understand, and deliver services that meet our customers' expectations. They will continue to monitor our delivery of the commitments in our plan and ensure that our delivery is grounded in the expectations of all of our customers and stakeholders.

Statutory and regulatory obligations

Our primary obligations and duties are set out in the Water Industry Act 1991, the Water Resources Act 1991 and our Licence.

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

We have failed to do this in the past, and our historic performance has not been as good as our peers in the industry or as good as our customers might expect. We know we also need to address current and historic challenges from our regulators, Ofwat, the Drinking Water Inspectorate and Environment Agency, regarding our performance, reporting standards and data quality. We set out the details below.

We repeat our sincere apologies to our customers and other stakeholders, and we are working very hard to make improvements in those areas where we have fallen short of the expectations of our customers and wider stakeholders.

The Environment Agency

The Environment Agency has expressed concerns about our performance in a number of areas including pollution incidents, abstraction licences and abstraction metering compliance, and the action being taken to resolve the supply deficit in South Hampshire. We recognise the need to improve in these areas and are transforming certain areas of the business. This includes progress against pollution reduction plans, which have been shared with the Environment Agency. We expect to see a decrease in the number of pollution incidents in the second part of 2019 as these plans are implemented.

Over abstraction events occurred at Newmarket and on the Bewl/Medway scheme during 2018. This was followed by us agreeing an environmental undertaking for the Newmarket over abstraction, which we are in the process of implementing. We are also making improvements in our abstraction monitoring and metering as a result of detailed reviews of on-site monitoring.

We are under investigation by the Environment Agency regarding the historic performance of certain wastewater treatment sites and the reporting of relevant compliance information. We are seeking to work proactively with them to resolve these investigations which are still evolving. At this time, there is no clarity of the findings of these investigations or further action or associated financial impact, if any.

The Environment Agency has recognised that we have made good progress in areas including discharge permit compliance, self-reporting of pollution incidents and our approach to catchment management. Our Environment + programme focuses our improvement activities and is driving internal transformation.

Ofwat

We have also been co-operating with Ofwat in relation to its investigation into the historic management, operation and performance of our wastewater treatment works. For full details of the Ofwat investigation, read visit **southernwater.co.uk/ofwat-investigation**.

That investigation has resulted in Ofwat giving notice that it intends on taking enforcement action against us. Notice of Ofwat's intention to issue Southern Water with a financial penalty amounting to £3 million has been published on its website. The cost of this penalty will not be passed on to our customers. We have also agreed to make direct customer rebates totalling £111.7 million (in 2017–18 prices), which will be paid back to customers, in equal amounts, between 2020 and 2025. We have also agreed an immediate customer bill rebate of £11.2 million (in 2017–18 prices) in financial year 2020–21.

We will also be supplying Ofwat with a number of formal undertakings in relation to the numerous changes we have put in place, and are putting in place, to ensure that the issues identified in the investigation have been stopped and cannot be repeated.

Over the past two years, people have left the business and new, often more experienced, colleagues have been brought on board. A full company restructure, a new executive team and a strengthened Board have also ensured we are making change at pace, transforming our past practices and putting things right.

We have also put new systems in place to safeguard our services and ensure we meet the high standards our customers and regulators expect. Our whistle-blowing procedures have been enhanced and a new set of company values have been embedded. These actions, along with a Modern Compliance Framework, are already successfully changing the culture in Southern Water.

The Drinking Water Inspectorate

Southern Water has been subject to prosecution by the Drinking Water Inspectorate (DWI), the Regulator for drinking water quality in England and Wales. In August 2018, Southern Water pleaded guilty to the supply of water unfit for human consumption from Cooks Castle water service reservoir on the Isle of Wight during 2013. The company was fined £65,000 and additional costs of £44,621.

We remain under enforcement by the DWI via two Final Enforcement Orders under section 18 of the Water Industry Act. The first Final Enforcement Order requires the company to demonstrate compliance regarding scheduling, monitoring and reporting of our water quality sampling programme. We are also subject to a Final Enforcement Order over the delivery of a nitrate scheme at Shoreham water supply works.

During 2018–19 Southern Water has continued to work with the DWI to formulate a legally binding transformation programme. Water First is a collaborative programme designed to improve water quality performance, reduce the level of risk and improve company culture with regard to public health protection. The programme covers a range of improvement initiatives including:

- improvements to the company's catchment and water supply works risk assessment process,
- an increased inspection frequency for water storage assets,
- enhanced training of company personnel in the subject of water quality,

- a novel approach to network management utilising the latest developments in smart networks,
- improvements to the company's information management systems, and
- significant investment in water treatment and storage facilities.

This programme of work is scheduled to continue until 2032.

Reporting our performance

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

We are required to provide the EA with the number, and details, of Category 3 Pollution Incidents, and report wastewater treatment works compliance. In our 2016–17 and 2017–18 Annual Reports we indicated that our external assurers PricewaterhouseCoopers (PwC) were unable to obtain the necessary evidence to support the accuracy of the following wastewater metrics:

- WW1a: Category 3 pollution incidents
- WW1: Wastewater asset health Wastewater treatment works population equivalent compliance
- WW6: Wastewater treatment works numeric compliance.

While issues remain in relation to the accuracy of our Category 3 pollution data, PwC has been able to provide an assurance opinion on these metrics for 2018–19. A significant focus of our assurance has been on wastewater reporting to the EA. This is an area of concern for the business and is a critical part of the improvement plans communicated to Ofwat. A key area of work is focused on wastewater spill and pollution reporting, and supported by detailed end-to-end process reviews of all our wastewater regulatory reporting and business as part of our Environment+ programme.

These improvements are being led by our Risk and Compliance directorate which is ensuring compliance reporting to our regulators is subject to increased internal review and assurance. The process reviews are prompting action plans, which are strengthening first and second-line assurance processes for all our regulatory reporting. Further information on this programme can be found in our Data Assurance Summary 2018–19, which is available at: **southernwater.co.uk/our-reports**.

We continually review performance information against a wide range of measures. Reporting to the Board and the Executive Leadership Team (ELT) focuses on delivery of our regulatory and statutory obligations. This information is provided by way of a detailed performance dashboard, including our business plan promises and additional regulatory targets.

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

Each year we also engage with our customers, employees and stakeholders to help us identify any risks, strengths and weaknesses associated with our reporting. We published the findings of this exercise in November 2018, with an invitation to stakeholders to comment on the findings. The publication set out how we would respond to stakeholders' feedback, detailed how our corporate assurance practices would meet our reporting compliance obligations. Our final Assurance Plan was published on 29 March 2019. It set out how we planned to assure the financial and non-financial information that we publish in our Annual Performance Report.

In line with the Assurance Plan, PwC, as our independent non-financial assurer, completed the audits of our Performance Commitments and Outcome Delivery Incentives. As reported above, PwC has recognised that significant improvements have been made during the year, though some issues remain. Areas of further improvement continue to be required in data quality, further improvements to the control environment and strengthening understanding of the audit and regulatory reporting process. The issues identified will be a focus of the work to be addressed in the forthcoming year. For more detail see our Data Assurance Summary 2018–19.

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

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

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

The RCF framework is subject to external assurance by PwC as part of our annual data submission to Ofwat. As part of our work to improve the robustness and quality of our regulatory reporting we have implemented a number of improvements to strengthen our annual non-financial regulatory reporting processes and controls. This was reflected in observed improvements as reported in the technical audit from our non-financial external assurers (PwC).

Compensation payments are made to customers for failures to deliver against a number of commitments within Southern Water's Customer Charter some of which are covered by the "Water Supply and Sewerage Services (Customer Service Standards) Regulations" as amended in 2017. As part of the year-end reporting assurance process, we have confirmed that the number reported in our Annual Report and Financial Statements is consistent with the number of payments made.

We have included within our transformation plan a review of the processes and controls in relation to these compensation payments. We will be improving the processes for making and recording customer appointments within some functions that undertake tasks on a customer's premises. A team has been set up to review the Customer Charter, policy, procedures and monitoring in relation to appointments, which will focus on identifying past, current and future compliance with the regulations and further improving the customer experience.

While the end-of-year audit of our reporting has highlighted improvements and progress in some areas, we need to work hard to embed changes throughout the organisation. It is important to ensure that data quality issues are the responsibility of everyone, rather than specialist data and assurance teams. In addition, making data assurance a continuous activity rather than just an end-of-year process is an area that requires continued significant focus.

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

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

Managing risks

Save for those matters mentioned on pages 6 to 8 above (where the company has identified shortcomings or potential shortcomings in the monitoring and effectiveness of its water and wastewater compliance controls, its reporting and data integrity, and where the company has set out the steps it is taking or will take to manage, mitigate and/or improve those), the Board confirms that the company has appropriate systems and processes in place to identify, manage and mitigate its material risks.

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

Our approach to managing risk is to incorporate checks at every stage of our business so that they become part of our routine. Our Board is one of the drivers behind promoting a culture of assessing potential risks to every aspect of our business operations. Teams are encouraged to formally and regularly consider any risks in their aspect of the business, how they might impact on outcomes, and ensure that, as far as possible, they are managed to within acceptable levels.

The company's Executive Leadership Team (ELT) conducts a 'top down' identification of potential risks across the business on a quarterly basis. This supplements each directorate's 'bottom up' evaluation, performed quarterly. In addition, consideration of risk is also embedded into key processes such as budgeting, business planning and performance management.

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

All risks are assessed from three perspectives:

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

Assessing risks in this way supports an understanding of the reliance placed on existing controls and mitigation, the worst case scenario for the risk, and how acceptable current levels of exposure are compared to target positions. This helps inform the focus of management oversight and challenge as well as prioritisation of responses.

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

Corporate Risk management is monitored by a dedicated Risk Committee on behalf of our Board. This covers the review of our current risk exposure against the overall corporate risk appetite, tolerance and strategy, and advises the Board on these matters. These duties were transferred from the Audit and Risk Review Committee to the new Risk Committee, which was formed in March 2019, to enable more in depth risk oversight and challenge.

Risks are reviewed each month and the highest are reported to our ELT and the Board as appropriate, with updates to the Risk Committee three times a year. Any new risks added to the database with a maximum score of 25 are passed to a director and the Chief Executive Officer for immediate review.

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

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

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

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

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

The most significant risks facing the organisation are those considered by ELT and the Board to have the greatest potential to disrupt Southern Water's strategic objectives. These are referred to as the principal risks. Details of our principal risks and more information regarding our risk management process are provided under the Risks section on page 103 of the Annual Report and Financial Statements.

Regulatory matters

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

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

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

Ring fencing statement

Under paragraph 3.1 of Condition K of the Licence, the company is at all times required to ensure, so far as is reasonably practicable, that if a special administration order were made, the company would have available to it sufficient rights and assets (other than financial resources) to enable the special administrator to manage the affairs, business and property of the company. In the opinion of the directors, the company was in compliance with that requirement as at 31 March 2019.

Certificate of adequacy (Licence Condition I17 Certificate)

The directors declare that, in their opinion:

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

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

a) management resources; and

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

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

– the company's performance during 2018–19, the liquidity position based on projected operating and capital expenditure and working capital requirements, and headroom against financial covenants, credit ratings and financial risks
– the company's employment policies and strategy
– the company's formal risk management process which reviews, monitors and reports on the company's risks and mitigating controls and considers potential impact in terms of service, compliance, value, people, society and partners
– the company's plans for the remainder of this regulatory period and for the period from 2020–25 as submitted to Ofwat in its Business Plan
– a number of improvements already made to our compliance and reporting processes which include those under the Water First and Environment+ programmes
– historic issues with the reporting of wastewater performance data
– the need to continue making improvements to the monitoring and effectiveness of our water and wastewater compliance controls, reporting and data integrity
– the requirements of the draft Section 19 undertakings currently being finalised with Ofwat.

The directors confirm that all contracts entered into, by the wholesale part of the company, with any associate company include all necessary provisions, and requirements concerning the standard of service to be supplied to the company, to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

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

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

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

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

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

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

The directors approved the regulatory accounting statements (on pages 13 to 60) on 12 July 2019.

Section 35A of the Water Industry Act 1991

The company is required under s35A of the Water Industry Act 1991 to provide a statement that the remuneration paid to executive directors is linked to standards of performance.
This statement is provided within the Directors' Remuneration Report section of the Annual Report and Financial Statements.

Long-term viability statement

In accordance with provision C.2.2 of the 2014 UK Code, the Board has assessed the prospects of the business over a longer period than the 12 months required by the 'Going Concern' provision.

The Board has selected to conduct this review to 31 March 2030 and full details of the assessment and the viability statement are set out within the Strategic Report section on page 101 of the Annual Report and Financial Statements.

Board statement

Save for those matters mentioned on pages 6 to 8 (where the company has identified shortcomings or potential shortcomings in the monitoring and effectiveness of its water and wastewater compliance controls, its reporting and data integrity, and where the company has set out the steps it is taking or will take to manage, mitigate and/or improve those), the Board confirms, that having taken all the steps that they ought to have taken as directors to make themselves aware of any relevant information, the company has:

1) a full understanding of, and is meeting, its obligations and has taken steps to understand and meet customer expectations

2) sufficient processes and internal systems of control to fully meet its obligations

3) appropriate systems and processes in place to allow it to identify, manage and review its risks.

Ian McAulay
Chief Executive Office

Paul Sheffield
Acting Chairman

12 July 2019

Regulatory financial reporting

1A – Income statement for the 12 months ended 31 March 2019

	Note	Statutory £m	Adjustments: Differences between statutory and RAG definitions £m	Adjustments: Non-appointed £m	Adjustments: Total adjustments £m	Total appointed activities £m
Revenue		**740.783**	**103.499**	**10.512**	**92.987**	**833.770**
Operating costs		(624.072)	11.444	(7.595)	19.039	**(605.033)**
Other operating income		0.874	(135.470)	–	(135.470)	**(134.596)**
Operating profit		**117.585**	**(20.527)**	**2.917**	**(23.444)**	**94.141**
Other income		1.248	28.926	–	28.926	**30.174**
Interest income		53.427	–	–	–	**53.427**
Interest expense		(204.838)	(23.014)	–	(23.014)	**(227.852)**
Other interest expense		(4.400)	–	–	–	**(4.400)**
(Loss)/profit before tax and fair value movements		**(36.978)**	**(14.615)**	**2.917**	**(17.532)**	**(54.510)**
Fair value losses on derivative financial instruments		(216.571)	–	–	–	**(216.571)**
(Loss)/profit before tax		**(253.549)**	**(14.615)**	**2.917**	**(17.532)**	**(271.081)**
UK Corporation tax	3	(8.205)	–	–	–	**(8.205)**
Deferred tax		28.870	–	–	–	**28.870**
(Loss)/profit for the year		**(232.884)**	**(14.615)**	**2.917**	**(17.532)**	**(250.416)**
Dividends		(34.855)	–	(2.917)	2.917	**(31.938)**
Tax Analysis						
Current year		8.205	–	–	–	**8.205**
Adjustments in respect of prior years		–	–	–	–	**–**
UK Corporation Tax		**8.205**	**–**	**–**	**–**	**8.205**

Analysis of non-appointed revenue	
Imported sludge	–
Tankered waste	6.598
Other non-appointed revenue	3.914
Revenue	**10.512**

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

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

1B – Statement of comprehensive income for the 12 months ended 31 March 2019

		Adjustments			
	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	Total adjustments £m	Total appointed activities £m
(Loss)/profit for the year	**(232.884)**	**(14.615)**	**2.917**	**(17.532)**	**(250.416)**
Actuarial losses on post-employment plans	(24.200)	–	–	–	**(24.200)**
Other comprehensive income	4.114	–	–	–	**4.114**
Total comprehensive (loss)/income for the year	**(252.970)**	**(14.615)**	**2.917**	**(17.532)**	**(270.502)**

1C – Statement of financial position for the 12 months ended 31 March 2019					
		Adjustments			
	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	Total adjustments £m	Total appointed activities £m
Non-current assets					
Fixed assets	6,051.119	(191.833)	0.413	(192.246)	**5,858.873**
Intangible assets	45.634	(1.368)	–	(1.368)	**44.266**
Investments – loans to group companies	130.042	–	–	–	**130.042**
Investments – other	29.200	–	–	–	**29.200**
Financial Instruments	46.190	–	–	–	**46.190**
Total non-current assets	6,302.185	(193.201)	0.413	(193.614)	**6,108.571**
Current assets					
Inventories	4.747	–	–	–	**4.747**
Trade and other receivables	332.411	–	0.642	(0.642)	**331.769**
Cash and cash equivalents	371.981	–	–	–	**371.981**
Total current assets	709.139	–	0.642	(0.642)	**708.497**
Current liabilities					
Trade and other payables	(235.551)	1.332	(1.055)	2.387	**(233.164)**
Capex creditor	(114.215)	–	–	–	**(114.215)**
Borrowings	(504.468)	–	–	–	**(504.468)**
Current tax liabilities	(12.669)	–	–	–	**(12.669)**
Provisions	(4.200)	–	–	–	**(4.200)**
Total current liabilities	(871.103)	1.332	(1.055)	2.387	**(868.716)**
Net current liabilities	**(161.964)**	**1.332**	**(0.413)**	**1.745**	**(160.219)**
Non-current liabilities					
Trade and other payables	(13.440)	–	–	–	**(13.440)**
Borrowings	(3,151.876)	–	–	–	**(3,151.876)**
Financial instruments	(1,428.228)	–	–	–	**(1,428.228)**
Retirement benefit obligations	(186.663)	–	–	–	**(186.663)**
Provisions	(140.822)	–	–	–	**(140.822)**
Deferred income – grants and contributions	(13.928)	(1.332)	–	(1.332)	**(15.260)**
Preference share capital	(119.863)	–	–	–	**(119.863)**
Deferred tax	(247.662)	–	–	–	**(247.662)**
Total non-current liabilities	(5,302.482)	(1.332)	–	(1.332)	**(5,303.814)**
Net assets	**837.739**	**(193.201)**	**–**	**(193.201)**	**644.538**
Equity					
Called up share capital	0.056	–	–	–	**0.056**
Retained earnings and other reserves	837.683	(193.201)	–	(193.201)	**644.482**
Total equity	**837.739**	**(193.201)**	**–**	**(193.201)**	**644.538**

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

1D – Statement of cash flows for the 12 months ended 31 March 2019					
		Adjustments			
	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	Total adjustments £m	Total appointed activities £m
Operating profit	117.585	(20.527)	2.917	(23.444)	**94.141**
Other income	1.248	28.926	–	28.926	**30.174**
Depreciation	271.904	(8.399)	0.001	(8.400)	**263.504**
Amortisation – grants and contributions	(1.081)	–	–	–	**(1.081)**
Changes in working capital	(10.202)	–	(0.001)	0.001	**(10.201)**
Pension contributions	(13.682)	–	–	–	**(13.682)**
Movement in provisions	133.125	–	–	–	**133.125**
Profit on sale of fixed assets	(0.874)	–	–	–	**(0.874)**
Cash generated from operations	**498.023**	**–**	**2.917**	**(2.917)**	**495.106**
Net interest paid	(153.393)	–	–	–	**(153.393)**
Tax paid	(8.176)	–	–	–	**(8.176)**
Net cash generated from operating activities	**336.454**	**–**	**2.917**	**(2.917)**	**333.537**
Investing activities					
Capital expenditure	(403.611)	–	–	–	**(403.611)**
Grants and contributions	2.292	–	–	–	**2.292**
Disposal of fixed assets	2.106	–	–	–	**2.106**
Other	1.087	–	–	–	**1.087**
Net cash used in investing activities	**(398.126)**	**–**	**–**	**–**	**(398.126)**
Net cash generated before financing activities	**(61.672)**	**–**	**2.917**	**(2.917)**	**(64.589)**
Cash flows from financing activities					
Equity dividends paid	(34.855)	–	(2.917)	2.917	**(31.938)**
Net loans received	304.110	–	–	–	**304.110**
Net cash generated in financing activities	**269.255**	**–**	**(2.917)**	**2.917**	**272.172**
Increase in net cash	**207.583**	**–**	**–**	**–**	**207.583**

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

1E – Net debt analysis at 31 March 2019				
	Interest rate risk profile			
	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Borrowings (excluding preference shares)	946.535	170.000	2,601.152	**3,717.687**
Preference share capital				119.863
Total borrowings				**3,837.550**
Cash				(371.981)
Short term deposits				–
Net debt				**3,465.569**
Gearing				**68.83%**
Adjusted gearing				**66.40%**
Full year equivalent nominal interest cost	57.092	1.923	147.702	**206.717**
Full year equivalent cash interest payment	57.092	1.923	68.107	**127.122**
Indicative interest rates				
Indicative weighted average nominal interest rate	6.03%	1.13%	5.68%	**5.56%**
Indicative weighted average cash interest rate	6.03%	1.13%	2.62%	**3.42%**
Weighted average years to maturity	13.54	–	11.22	**12.16**

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

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

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

Reconciliation of borrowings between table 1C and table 1E	
	£m
1C – Current liabilities borrowings	504.468
1C – Non-current liabilities borrowings	3,151.876
Total Borrowings (table 1C)	**3,656.344**
Debt issue costs	13.011
Bond premium deferred	(8.854)
Deferred gilt lock proceeds	(4.775)
Deferred proceeds	(85.815)
Accrued swap accretion	147.776
Borrowings (table 1E)	**3,717.687**

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

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

1F – Financial flows for the 12 months ended 31 March 2019 and for the price review to date (2012–13 financial year average RPI)						
	12 months ended 31 March 2019					
	%			£m		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	5.58%	3.87%	5.58%	89.952	62.308	62.308
Actual performance adjustment 2010–2015	1.93%	1.34%	1.93%	31.112	21.551	21.551
Adjusted return on regulatory equity	**7.51%**	**5.20%**	**7.51%**	**121.064**	**83.859**	**83.859**
Regulatory equity				1,612.040	1,612.040	1,116.636
Financing						
Gearing	–	1.51%	2.18%	–	24.338	24.338
Variance in corporation tax	–	(0.43%)	(0.62%)	–	(6.890)	(6.890)
Group relief	–	0.43%	0.62%	–	6.890	6.890
Cost of debt	–	(0.14%)	(0.21%)	–	(2.307)	(2.307)
Hedging instruments	–	(0.35%)	(0.51%)	–	(5.684)	(5.684)
Financing total	**7.51%**	**6.22%**	**8.97%**	**121.064**	**100.206**	**100.206**
Operational performance						
Totex out/(under) performance	–	0.39%	0.57%	–	6.324	6.324
ODI out/(under) performance	–	(0.02%)	(0.03%)	–	(0.346)	(0.346)
Retail out/(under) performance	–	(0.64%)	(0.92%)	–	(10.249)	(10.249)
Other exceptional items	–	–	–	–	–	–
Operational performance total	–	**(0.26%)**	**(0.38%)**	**–**	**(4.271)**	**(4.271)**
Total earnings	**7.51%**	**5.95%**	**8.59%**	**121.064**	**95.935**	**95.935**
RCV growth from RPI inflation	**3.06%**	**3.06%**	**3.06%**	**49.328**	**49.328**	**34.169**
Total shareholder return	**10.57%**	**9.01%**	**11.65%**	**170.393**	**145.264**	**130.104**
Net dividend	**4.00%**	**–**	**–**	**64.482**	**–**	**–**
Retained value	**6.57%**	**9.01%**	**11.65%**	**105.911**	**145.264**	**130.104**
Dividends reconciliation						
Gross dividend	4.00%	1.86%	2.69%	64.482	30.055	30.055
Interest received on intercompany loans	–	1.86%	2.69%	–	30.055	30.055
Net dividend	**4.00%**	**–**	**–**	**64.482**	**–**	**–**

1F – Financial flows for the 12 months ended 31 March 2019 and for the price review to date (2012–13 financial year average RPI)						
	Average 2015–19					
	%			£m		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	5.61%	3.18%	5.61%	88.256	49.960	49.960
Actual performance adjustment 2010–2015	2.24%	1.27%	2.24%	35.239	19.948	19.948
Adjusted Return on regulatory equity	**7.85%**	**4.44%**	**7.85%**	**123.495**	**69.908**	**69.908**
Regulatory equity				1,573.190	1,573.190	890.548
Financing						
Gearing	–	2.30%	4.06%	–	36.116	36.116
Variance in corporation tax	–	(0.68%)	(1.20%)	–	(10.720)	(10.720)
Group relief	–	0.68%	1.20%	–	10.720	10.720
Cost of debt	–	0.21%	0.37%	–	3.284	3.284
Hedging instruments	–	0.16%	0.28%	–	2.451	2.451
Financing total	**7.85%**	**7.10%**	**12.55%**	**123.495**	**111.759**	**111.759**
Operational performance						
Totex out/(under) performance	–	1.23%	2.18%	–	19.373	19.373
ODI out/(under) performance	–	(0.03%)	(0.06%)	–	(0.523)	(0.523)
Retail out/(under) performance	–	(1.05%)	(1.86%)	–	(16.526)	(16.526)
Other exceptional items	–	0.16%	0.28%	–	2.492	2.492
Operational performance total	–	**0.31%**	**0.54%**	**–**	**4.816**	**4.816**
Total earnings	**7.85%**	**7.41%**	**13.09%**	**123.495**	**116.575**	**116.575**
RCV growth from RPI inflation	**2.50%**	**2.50%**	**2.50%**	**39.330**	**39.330**	**22.264**
Total shareholder return	**10.35%**	**9.91%**	**15.59%**	**162.825**	**155.905**	**138.839**
Net dividend	**4.00%**	**2.99%**	**5.29%**	**62.928**	**47.117**	**47.117**
Retained value	**6.35%**	**6.92%**	**10.30%**	**99.898**	**108.788**	**91.722**
Dividends reconciliation						
Gross dividend	4.00%	5.47%	9.67%	62.928	86.119	86.119
Interest received on intercompany loans	–	2.48%	4.38%	–	39.002	39.002
Net dividend	**4.00%**	**2.99%**	**5.29%**	**62.928**	**47.117**	**47.117**

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

Commentary regarding table 1F - Financial Flows

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

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

The tables on pages 18 and 19 provide information in a three-column format:

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

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

We also include adjustments relating to our performance in the 2010–15 regulatory period (AMP5). The net increase (1.93%) to shareholder returns is driven by our revenue collection shortfall during AMP5, when shareholders received no dividends.

The adjusted base return of 7.51%, plus inflation of 3.06% on the regulated equity, results in a total shareholder return of 10.57%. This is based on Ofwat's price review approach to determining returns, reflecting an efficient company with the regulatory notional gearing of 62.50%. The equivalent actual total shareholder return, reflecting our average gearing in 2018–19 of 74.03% and actual performance, was 11.65%.

Our actual return of 11.65% differed from the notional return of 10.57% due to financing out-performance of 1.46, and operational under-performance of 0.38%.

The operational performance, covering wholesale totex, retail, and Outcome Delivery Incentives (ODI), is discussed in our RORE narrative (see page 59), albeit in the above table we show the impact before adjusting for tax. The ODI entry above excludes our projected SIM penalty due to performance in AMP6 reflecting Ofwat guidance.

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

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

Our average actual gearing of 74.03% has decreased during the year, as a result of a financial restructuring exercise, this is described on page 96 of our Annual Report and Financial Statements. This is higher than the regulatory assumption of 62.50%, and has the effect of amplifying percentage returns to shareholders. This is partly because the same value of return is applied to a smaller shareholder equity base, representing a greater proportion. This increases the volatility of returns, in both out-performance and under-performance scenarios, with the risk being borne entirely by shareholders.

The price setting process also allows us a return on equity between the notional gearing of 62.50% and our actual gearing of 74.03%, rather than the lower cost of debt. The impact of this relative cost of debt versus equity is estimated in the 'Gearing' returns adjustment of 2.18%.

Our 'Comparison between tax charge and allowance in price limits' (see page 28) provides a detailed narrative on our corporation tax charge and approach to using group relief. In summary, our PR14 determination includes no funding from customers for corporation tax and, having excluded the neutral cashflows relating to the inter-company loan to SWSG, we incurred no tax charge in the current year. The net impact on shareholder returns of corporation tax and group relief is 0.0%.

Our cost of debt, measured by reference to an implied real rate of interest, was higher than the amount allowed in our PR14 determination, reducing returns by 0.21%. Consistent with the guidance notes we have calculated this on a post-tax basis, although this may understate the extent of the under-performance as the tax impact is already captured in our corporation tax entry. If reflected on a pre-tax basis then the underperformance increases marginally to 0.26%.

We have a portfolio of inflation linked swaps that match the cost we pay under our debt instruments to the cash flow we receive from customer bills. We have calculated the impact of these hedging instruments in a manner consistent with the prescribed calculation for cost of debt, by deflating to an implied real rate of net interest. This creates a negative impact for the year of 0.51%, counter to the nominal net receipt actually realised through our swaps, but ensures consistency of approach with the reported impact of our cost of debt. We also report the impact of these hedging instruments on a post-tax basis, aligning with treatment for cost of debt. If reported pre-tax the adverse impact increases to 0.63%.

With the exception of the dividend paid as part of the SWSG intercompany loan (see below) no dividends were paid in 2018–19.

In the four years to date of the current regulatory period, and including the 2.50% average annual inflationary growth of the RCV, the total shareholder return averages 15.59%. Excluding the inflationary RCV return, which is long-term in nature and cannot be immediately realised, the average annual return potentially available to shareholders is 13.09%, exceeding the 7.85% return allowed by Ofwat in the price determination by 5.24%.

The main driver of the additional returns is our gearing, which increases the allowed returns by 4.06% by concentrating them in a smaller shareholder equity base than assumed under Ofwat's price review approach. Our cost of debt, including the impact of our hedging instruments, has also been beneficial, increasing returns by 0.65%. The remaining 0.53% comprises net operational outperformance of 0.26%, and the one-off proceeds (0.28%) from the disposal of our non-household business in April 2017.

The average net dividend of 5.29% exceeds the 4.00% base dividend in the price determination. This reflects the additional 2.24% allowed returns relating to our 2010-15 performance, and the net positive returns relating to performance in the current regulatory period 2015-20.
Of the potential 13.09% return available to shareholders, only 5.29% has been released as dividends, with the remainder being retained in the business.

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

Notes to the regulatory financial statements for the year ended 31 March 2019

1 Accounting policies

a) Basis of preparation

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

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

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

- revenue recognition
- capitalisation of borrowing costs.

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

b) Fixed assets

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

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

Non-infrastructure assets

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

Infrastructure assets

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

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

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

c) Revenue

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

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

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

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

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

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

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

Charging policy

Water and sewerage charges fall into the following three categories:

1) Charges which are payable in full
2) Charges which are payable in part
3) Not chargeable (void properties)

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

Charges payable in full

Charges are payable in full in the following circumstances:

i) Occupied and furnished

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

ii) Unoccupied and furnished

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

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

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

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

iii) Unoccupied and unfurnished

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

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

Charges payable in part

The following charges only are payable in certain circumstances:

- Metered standing charges – Payable on unoccupied, metered properties which are still connected.

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

Not chargeable

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

Definition and treatment of properties

Occupied properties

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

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

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

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

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

Unoccupied properties

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

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

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

New properties

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

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

d) Revenue disclosures

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

(i) The value of household billings raised in the year ended 31 March 2019 for consumption in prior years was £129.4 million. The value of these billings was higher than the metered income accrual made at 31 March 2019. The estimation difference was £1.2 million and this has been recognised in the current year's turnover. This difference is well within our view of acceptable tolerances for accounting estimates.

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

e) Bad and doubtful debts

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

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

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

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

- Where the customer has absconded without paying and strategies to trace their whereabouts and collect outstanding monies have been fully exhausted,
- Where the customer has died without leaving an estate or has left an insufficient estate from which to recover the debt,
- Where the age and/or value of the debt makes it uneconomical to pursue,
- Where county court proceedings and attempts to recover the debt by debt collection agencies have proved unsuccessful,
- Where the customer has been declared bankrupt, is in liquidation or is subject to insolvency proceedings or a debt relief order and no dividend has been or is likely to be received.

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

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

The company's bad debt provisioning and write-off policies have remained unchanged and have been consistently applied during the year. There has been a reduction in the value of debt written off over the past two years. This resulted from a decision to pause the mass write-off process while a number of ongoing projects aimed at reducing bad debt were implemented.

The value of trade and other receivables of the appointed business increased to £331.8 million (2018: £322.2 million). This increase largely results from the change to our tariffs together with a reduction in the provision made against the outstanding debt with certain groups of customers. This follows improvements to our debt recovery process which have resulted in an increase in the likelihood of recovering these outstanding amounts.

f) Price control segments

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

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

Operating expenditure

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

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

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

Fixed assets

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

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

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

Revenues

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

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

g) Contingent liabilities

Environment Agency – wastewater sites

As noted on page 26 to the 2019 Annual Report and Accounts in addition to the Ofwat settlement disclosed in note 2 within other operating income below the company faces investigations from the Environment Agency regarding the performance of certain wastewater sites and the reporting of relevant compliance information. We are working proactively with the Agency to resolve its investigations which are still evolving. Having considered the matter carefully the Board has concluded that it is not possible to make a reliable estimate for any obligation that may arise from these investigations for the following reasons:

- The uncertainty of the nature and rectitude of any charges;
- The uncertainty of the basis for any offence i.e. what level of culpability will be alleged and what level of culpability would be the basis for sentence (culpability being one of the key criteria that determines the level of fine); and
- The uncertainty regarding the environmental harm risked by the commission of any offence i.e. what likelihood of harm will be alleged and what likelihood of harm would be the basis for sentence (likelihood of environmental harm being one of the key criteria that determines the level of fine).

Our board have taken these investigations extremely seriously and have continued to monitor and support the work of our Risk and Compliance directorate, who have continued to deliver a programme of improvements to our non-financial regulatory reporting including the collection, verification, reporting and assurance of data. Further information on this can be found in our Final Assurance Plan 2019, which is available on our website **southernwater.co.uk/our-reports**.

2 Differences between statutory and regulatory reporting

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

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

These are summarised on page 27.

Income statement	Revenue £m	Operating costs £m	Other operating income £m	Other income £m	Interest expense £m
i) CHP income	(3.0)	3.0	–	–	–
ii) Grants and contributions	(28.9)	–	–	28.9	–
iii) Borrowing costs	–	8.4	–	–	(23.0)
iv) Regulatory settlement	135.5	–	(135.5)	–	–
Total	103.6	11.4	(135.5)	28.9	(23.0)

i) Income generated from Combined Heat and Power (CHP) processes, which convert methane into electricity, is recorded as revenue within the statutory accounts. For regulatory reporting this income is reported as a negative operating cost. As a result £3.0 million of revenue has been re-classified as a negative operating cost.

ii) As required by RAG 1.08 section 1.8, grants and contributions received and recognised in the income statement are reported under other income in the Annual Performance Report financial tables. As a result £28.9 million has been transferred from revenue to other income in the income statement. See table 2E for further information.

iii) For statutory reporting, borrowing costs associated with capital expenditure are capitalised. Regulatory reporting does not permit interest to be capitalised. As a result operating costs are reduced by £8.4 million, reflecting the removal of depreciation on interest capitalised and the interest charge has been increased by £23.0 million reversing the element of interest capitalised in the year.

iv) For regulatory reporting purposes the regulatory settlement provision of £135.5 million made in relation to the Section 19 undertakings has been reclassified as other operating income from revenue.

Statement of financial position	Fixed assets £m	Intangible assets £m	Current trade and other payables £m	Deferred income – grants and contributions £m
i) Borrowing costs	(191.8)	(1.4)	–	–
ii) Grants and contributions	–	–	1.3	(1.3)
Total	(191.8)	(1.4)	1.3	(1.3)

i) As borrowing costs cannot be capitalised under regulatory reporting, fixed and intangible assets have been reduced by £191.8 million and £1.4 million respectively, reflecting the removal of cumulative borrowing costs capitalised. There is a corresponding reduction to retained earnings.

ii) Grants and contributions relating to requisitions of £1.3 million classified within current trade and other payables in the statutory accounts have been transferred to deferred income for regulatory reporting.

Statement of cash flows

There is an £8.4 million adjustment made to both operating profit and depreciation relating to the removal of capitalised borrowing costs, together with the re-classification of grant and contributions received in the income statement of £28.9 million from operating profit to other income.

3 Corporation tax reconciliation

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

Corporation tax reconciliation	Appointed £m	Non-appointed £m
(Loss)/profit before tax and fair value movement	(54.5)	2.9
Tax at the UK corporation tax rate of 19%	(10.4)	0.6
Permanent differences	30.5	–
Fixed asset timing differences	7.8	–
Other short-term timing differences	(10.0)	–
Pension cost relief in excess of pension charge	(1.8)	–
Group relief received for nil payment	(7.9)	(0.6)
Adjustment in respect of prior years – current tax	–	–
Tax charge for year	8.2	–

Details of factors affecting future tax charges

A reduction in the main rate of corporation tax to 17% from the 1 April 2020 was enacted in the Finance Act 2016, and deferred tax balances at 31 March 2019 are calculated based on this rate.

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

Comparison between tax charge and allowance in price limits

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

Comparison between tax charge and allowance in price limits	Current tax charge £m	Current tax charge (excluding SWSG loan) £m
i) Final Determination allowance	–	–
ii) Price determination – tax not charged on forecast tax losses	(2.6)	(2.6)
iii) Earnings before interest and tax	(27.0)	(27.0)
iii) Regulatory settlement	27.1	27.1
iv) Net finance costs, including taxable fair value movements	1.9	(6.7)
v) Depreciation and capital allowances claimed	17.6	17.6
vi) Group relief claimed	(16.1)	(7.5)
vii) Change in tax rate	(0.8)	(0.8)
Other	(0.1)	(0.1)
Current tax before payments for group relief and prior year adjustments	–	–
viii) Payments for group relief	8.2	–
Appointed current tax charge	8.2	–

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

ii) For 2018–19 the price determination included taxable losses of £2.6 million and no allowance was provided for these.

iii) Actual earnings before interest and tax are significantly lower than those in the Final Determination. This is almost entirely due to the provision made for the regulatory settlement (see page 7 for further details) together with additional expenditure in our retail services. Revenues, income and wholesale operating costs including infrastructure maintenance and repair costs charged to operating expenditure, were broadly in line with our determination.

iv) Net finance costs are lower as a result of lower interest costs and the inclusion of interest receivable on our derivative financial instruments and interest income on the inter-company loan from SWSG (see fig. 1 on page 100 of the Annual Report and Financial Statements for further explanation). This is partially offset by taxable fair value losses on derivative financial instruments.

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

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

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

Payment was made for the losses at SWSG, totalling £8.2 million, but no payment was made for the benefit of the remaining losses received from other companies in the Greensands group. Capital allowances not claimed are available to Southern Water as a deduction against future taxable profits.

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

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

Taxation policy and strategy

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

Our tax policy is consistent with the overall values and strategy of the company and will consider financial risk, reputational risk, and social responsibilities. Our approach to tax planning is to align to business decisions made in the best interests of customers and stakeholders rather than using tax planning to drive or determine business decisions. Our focus is therefore on compliance, and our tax planning is always aligned with our commercial and economic activity.

Our approach to tax management is compliant with tax laws, rules, regulations and reporting requirements in all of its operations. Management of our tax affairs is carried out by an internal tax team with the support of professional tax advisers and specialist tax support. Professional tax advisers are used in circumstances when additional advice is deemed appropriate (for example, to ensure compliance with new legislation and tax planning). We use specialist tax support in the preparation of our capital allowances.

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

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

Further information is available in our Annual Report and Financial Statements on page 92.

Price control and other segmental reporting

2A – Segmental income statement for the 12 months ended 31 March 2019

	Wholesale						
	Water resources £m	Water network + £m	Water total £m	Wastewater network + £m	Sludge £m	Wastewater total £m	
Revenue – price control		187.204	187.204	586.551		586.551	
Revenue – non price control		4.711	4.711	1.582		1.582	
Operating expenditure	(16.115)	(88.053)	(104.168)	(154.419)	(22.115)	(176.534)	
Depreciation – tangible fixed assets	(5.252)	(53.215)	(58.467)	(162.194)	(19.768)	(181.962)	
Amortisation – intangible fixed assets	(1.679)	(0.718)	(2.397)	(16.538)	(0.016)	(16.554)	
Other operating income	0.047	0.259	0.306	(134.973)	0.071	(134.902)	
Operating profit before recharges			**27.189**			**78.181**	
Recharges from other segments	(0.266)	(7.915)	(8.181)	–	(1.545)	(1.545)	
Recharges to other segments	–	–	–	16.261	–	16.261	
Operating profit			**19.008**			**92.897**	

	Retail			
	Household £m	Non-household £m	Total £m	Wholesale and Retail total £m
Revenue – price control	52.969	0.753	53.722	**827.477**
Revenue – non price control	–	–	–	**6.293**
Operating expenditure	(58.824)	(2.003)	(60.827)	**(341.529)**
Depreciation – tangible fixed assets	(1.999)	–	(1.999)	**(242.428)**
Amortisation – intangible fixed assets	(2.125)	–	(2.125)	**(21.076)**
Other operating income	–	–	–	**(134.596)**
Operating (loss)/profit before recharges	**(9.979)**	**(1.250)**	(11.229)	**94.141**
Recharges from other segments	(6.535)	–	(6.535)	**(16.261)**
Recharges to other segments	–	–	–	**16.261**
Operating (loss)/profit	**(16.514)**	**(1.250)**	(17.764)	**94.141**
Surface water drainage rebates				**0.182**

2B – Totex analysis for the 12 months ended 31 March 2019 – Wholesale water and wastewater	Water resources £m	Water network + £m	Wastewater network + £m	Sludge £m	Total £m
Operating expenditure					
Power	3.787	12.062	31.771	(2.426)	**45.194**
Income treated as negative expenditure	–	–	–	(3.045)	**(3.045)**
Abstraction charges/discharge consents	4.622	0.061	4.015	0.016	**8.714**
Bulk supply/bulk discharge	–	0.334	–	–	**0.334**
Other operating expenditure					
– Renewals expensed in year (Infrastructure)	–	17.977	21.893	–	**39.870**
– Other operating expenditure excluding renewals	6.073	43.827	83.374	26.180	**159.454**
Local authority rates	0.955	11.404	13.366	1.390	**27.115**
Total operating expenditure excluding third party services	**15.437**	**85.665**	**154.419**	**22.115**	**277.636**
Third party services	0.678	2.388	–	–	**3.066**
Total operating expenditure	**16.115**	**88.053**	**154.419**	**22.115**	**280.702**
Capital expenditure					
Maintaining the long term capability of the assets – infrastructure	0.301	7.667	21.860	–	**29.828**
Maintaining the long term capability of the assets – non-infrastructure	6.686	68.444	131.481	16.933	**223.544**
Other capital expenditure – infrastructure	0.811	13.929	52.153	–	**66.893**
Other capital expenditure – non-infrastructure	4.141	17.923	53.026	6.133	**81.223**
Infrastructure network reinforcement	–	0.273	9.100	–	**9.373**
Total gross capital expenditure excluding third party services	**11.939**	**108.236**	**267.620**	**23.066**	**410.861**
Third party services	1.697	1.683	4.185	–	**7.565**
Total gross capital expenditure	**13.636**	**109.919**	**271.805**	**23.066**	**418.426**
Grants and contributions	0.256	9.068	13.645	–	**22.969**
Totex	**29.495**	**188.904**	**412.579**	**45.181**	**676.159**
Cash expenditure					
Pension deficit recovery payments	0.177	4.667	9.778	0.792	**15.414**
Totex including cash items	**29.672**	**193.571**	**422.357**	**45.973**	**691.573**

2C – Operating cost analysis for the 12 months ended 31 March 2019 – Retail	Household £m	Non-household £m	Total £m
Operating expenditure			
Customer services	21.032	–	**21.032**
Debt management	14.910	0.608	**15.518**
Doubtful debts	9.602	1.100	**10.702**
Meter reading	3.209	–	**3.209**
Services to developers		0.295	**0.295**
Other operating expenditure	10.071	–	**10.071**
Total operating expenditure excluding third party services	**58.824**	**2.003**	**60.827**
Third party services operating expenditure	–	–	**–**
Total operating expenditure	**58.824**	**2.003**	**60.827**
Depreciation – tangible fixed assets	1.999	–	**1.999**
Amortisation – intangible fixed assets	2.125	–	**2.125**
Total operating costs	**62.948**	**2.003**	**64.951**
Debt written off	**1.937**	**–**	**1.937**

Movement in costs from 2017–18

Household retail operating expenditure has decreased by £12.6 million to £58.8 million (2018 £71.4 million). This is principally the result of initiatives to improve our bad debt performance. Overall these process changes, which included litigation, have reduced the regulatory bad debt charge by £12.1 million, which is partially offset by increased debt management cost by £2.6 million.

The remaining £3.1 million decrease in costs is due to lower meter reading costs of £1.2 million together with efficiencies of £1.9 million resulting from our transformation programme.

Comparison to the business plan

Household

Total household retail costs of £62.9 million are £13.7 million higher than allowed in the Final Determination.

The increase is due to the following factors:

During 2018–19 the business has continued to increase spend on debt management in order to reduce the cost of bad debt. This includes increased litigation, debt advice visits and consultancy to support improvements to debt management and cash collection processes. This has resulted in a bad debt charge for 2018–19 that is lower than forecast in the business plan.

Over the past two years the business has undergone transformational activities in order to deliver operational efficiencies and these are now being delivered with reductions in our meter reading and customer services costs.

The charge for depreciation and amortisation of tangible and intangible assets for the household retail business is significantly higher than the allowance in the Final Determination. This is because the charge for legacy assets of £3.8 million is included within the wholesale price control in the Final Determination. Depreciation and amortisation, in 2018–19, for assets delivered as part of our capital programme for 2015–20 was £0.3 million. This is lower than the allowance in the Final Determination of £1.0 million.

Non-household

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

General

As well as the specific factors described above, there have been changes to our cost allocations and accounting framework which have affected both household and non-household costs.

The methodology for allocating building services and accommodation costs across business units is different in the current regulatory accounting guidance from the requirements of the business plan and this has resulted in an increased charge to the retail business.

During the first year of this regulatory period, 2015–16, we changed our accounting framework from UK GAAP to Financial Reporting Standards 101 (FRS 101). As a result, certain costs previously capitalised as part of infrastructure renewals expenditure are now treated as operating costs. The jobs previously capitalised included an allocation for the network enquiry cost associated with them. These costs are now treated as operating costs and in accordance with the guidance provided in RAG 2.07 have been included within the retail business units. The impact of the change in accounting framework was not included within retail in our business plan which made the assumption that the changes to infrastructure accounting would only affect wholesale costs. For 2018–19 this resulted in a charge to the retail business of £0.1 million which was not included in our business plan.

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

	Wholesale				Retail		
	Water resources £m	Water network + £m	Wastewater network + £m	Sludge £m	Household £m	Non-household £m	Total £m
Cost							
At 1 April 2018	189.911	1,685.220	5,714.488	550.813	31.405	–	**8,171.837**
Disposals	(1.258)	(2.450)	(7.977)	–	–	–	**(11.685)**
Adjustments	0.364	2.274	(2.475)	(0.163)	–	–	–
Additions	12.308	109.154	260.313	23.096	0.138	–	**405.009**
Assets adopted at nil cost	–	–	8.519	–	–	–	**8.519**
At 31 March 2019	**201.325**	**1,794.198**	**5,972.868**	**573.746**	**31.543**	**–**	**8,573.680**
Depreciation							
At 1 April 2018	(69.066)	(493.553)	(1,670.956)	(232.345)	(18.165)	–	**(2,484.085)**
Disposals	1.247	2.459	8.000	–	–	–	**11.706**
Adjustments	(0.016)	(0.039)	0.042	0.013	–	–	–
Charge for year	(5.252)	(53.215)	(162.194)	(19.768)	(1.999)	–	**(242.428)**
At 31 March 2019	**(73.087)**	**(544.348)**	**(1,825.108)**	**(252.100)**	**(20.164)**	**–**	**(2,714.807)**
Net book amount at 31 March 2019	**128.238**	**1,249.850**	**4,147.760**	**321.646**	**11.379**	**–**	**5,858.873**
Net book amount at 1 April 2018	120.845	1,191.667	4,043.532	318.468	13.240	–	**5,687.752**
Depreciation charge for year							
Principal services	(5.108)	(52.684)	(161.855)	(19.767)	(1.999)	–	**(241.413)**
Third party services	(0.144)	(0.531)	(0.339)	(0.001)	–	–	**(1.015)**
Total	**(5.252)**	**(53.215)**	**(162.194)**	**(19.768)**	**(1.999)**	**–**	**(242.428)**

The net book value of tangible assets includes £623.5 million in respect of assets in the course of construction. During the year we have reviewed the business unit classification of some of our assets and these have been amended through the adjustment row in this table.

Historic cost analysis of intangible assets – Wholesale and retail

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

Historic cost analysis of intangible assets – Wholesale and retail	Wholesale				Retail		
	Water resources £m	Water network + £m	Wastewater network + £m	Sludge £m	Household £m	Non-household £m	Total £m
Cost							
At 1 April 2018	8.480	4.098	88.988	0.155	19.409	–	**121.130**
Disposals	–	–	(2.073)	–	–	–	**(2.073)**
Adjustments	0.007	(0.007)	(2.210)	–	2.210	–	**–**
Additions	1.328	0.765	2.973	(0.030)	0.605	–	**5.641**
Assets adopted at nil cost	–	–	–	–	–	–	**–**
At 31 March 2019	**9.815**	**4.856**	**87.678**	**0.125**	**22.224**	**–**	**124.698**
Depreciation							
At 1 April 2018	(4.829)	(0.428)	(47.061)	(0.051)	(9.060)	–	**(61.429)**
Disposals	–	–	2.073	–	–	–	**2.073**
Adjustments	(0.001)	0.001	–	–	–	–	**–**
Charge for year	(1.679)	(0.718)	(16.538)	(0.016)	(2.125)	–	**(21.076)**
At 31 March 2019	**(6.509)**	**(1.145)**	**(61.526)**	**(0.067)**	**(11.185)**	**–**	**(80.432)**
Net book amount at 31 March 2019	**3.306**	**3.711**	**26.152**	**0.058**	**11.039**	**–**	**44.266**
Net book amount at 1 April 2018	3.651	3.670	41.927	0.104	10.349	–	**59.701**
Depreciation charge for year							
Principal services	(1.678)	(0.711)	(16.538)	(0.016)	(2.125)	–	**(21.068)**
Third party services	(0.001)	(0.007)	–	–	–	–	**(0.008)**
Total	**(1.679)**	**(0.718)**	**(16.538)**	**(0.016)**	**(2.125)**	**–**	**(21.076)**

The net book value of intangible assets includes £11.6 million in respect of assets in the course of construction.

2E – Analysis of capital contributions and land sales for the 12 months ended 31 March 2019 – Wholesale	Fully recognised in income statement £m	Capitalised and amortised (in the income statement) £m	Total £m
Grants and contributions – water			
Connection charges	4.326	–	**4.326**
Infrastructure charge receipts	2.835	–	**2.835**
Requisitioned mains	0.187	0.139	**0.326**
Other contributions (price control)	–	1.517	**1.517**
Diversions	0.320	–	**0.320**
Total	**7.668**	**1.656**	**9.324**
Grants and contributions – wastewater			
Infrastructure charge receipts	9.339	–	**9.339**
Requisitioned sewers	(0.043)	0.133	**0.090**
Other contributions (price control)	0.807	–	**0.807**
Diversions	2.636	–	**2.636**
Other contributions (non-price control)	–	0.773	**0.773**
Total	**12.739**	**0.906**	**13.645**
Value of adopted assets	8.519	–	**8.519**

	Water £m	Wastewater £m	Total £m
Movements in capitalised grants and contributions			
Brought forward	8.570	5.207	**13.777**
Capitalised in year	1.656	0.906	**2.562**
Amortisation (in income statement)	(0.706)	(0.373)	**(1.079)**
Carried forward	**9.520**	**5.740**	**15.260**

There were no disposals of protected land during the year.

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

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

Grants and contributions recognised in the statutory income statement as revenue have been reclassified to other income for regulatory purposes in table 1A. These include the amounts of £7.7 million and £12.7 million disclosed above for water and wastewater respectively together with £8.5 million of adopted assets.

2F – Household – revenues by customer type	Wholesale charges revenue £m	Retail revenue £m	Total revenue £m	Number of customers 000's	Average household retail revenue per customer £
Unmeasured water only customer	2.439	0.293	**2.732**	15.693	**19**
Unmeasured wastewater only customer	81.519	4.018	**85.537**	277.303	**14**
Unmeasured water and wastewater customer	41.373	3.792	**45.165**	112.305	**34**
Measured water only customer	12.370	1.455	**13.825**	69.469	**21**
Measured wastewater only customer	160.492	10.468	**170.960**	620.243	**17**
Measured water and wastewater customer	320.719	32.943	**353.662**	824.631	**40**
Total	**618.912**	**52.969**	**671.881**	**1,919.644**	**28**

2G – Non-household water – revenues by tariff type for the 12 months ended 31 March 2019

	Wholesale charges revenue £m	Retail revenue £m	Total revenue £m	Number of connections 000's	Average non-household retail revenue per connection £
Non-default tariff					
Total non-default tariff	–	–	–	–	–
Default tariffs					
Standard Water – Unmetered	1.124	–	**1.124**	4.041	–
Standard 0-1Ml p.a. Water Metered	11.342	–	**11.342**	42.910	–
Standard 1-5Ml pa Water Metered	20.190	–	**20.190**	5.500	–
Water supplies 5 to 50 Ml	5.726	–	**5.726**	0.351	–
Water supplies 50 Ml and over	6.347	–	**6.347**	0.075	–
Total default tariffs	**44.729**	–	**44.729**	**52.877**	–
Total	**44.729**	**–**	**44.729**	**52.877**	–

	Number of customers 000's	Average non-household retail revenue per customer £
Revenue per customer	**52.877**	–

2H – Non-household wastewater – revenues by tariff type for the 12 months ended 31 March 2019

	Wholesale charges revenue £m	Retail revenue £m	Total revenue £m	Number of connections 000's	Average non-household retail revenue per connection £
Non-default tariff					
Total non-default tariff	–	–	–	–	–
Default tariffs					
Standard Sewerage Unmetered	3.864	–	**3.864**	5.908	–
Standard 0-1Ml pa Sewerage Metered	40.143	–	**40.143**	65.491	–
Standard 1-5Ml pa Sewerage Metered	31.462	–	**31.462**	7.228	–
Wastewater services 5 to 50 Ml	23.518	–	**23.518**	1.179	–
Wastewater services 50 Ml and over	10.362	–	**10.362**	0.078	–
Total default tariffs	**109.349**	–	**109.349**	**79.884**	–
Total	**109.349**	**–**	**109.349**	**79.884**	–

	Number of customers 000's	Average non-household retail revenue per customer £
Revenue per customer	**79.884**	–

2I – Revenue analysis and wholesale control reconciliation for the 12 months ended 31 March 2019	Household £m	Non-household £m	Total £m
Wholesale charge – water			
Unmeasured	18.103	1.124	**19.227**
Measured	123.607	43.605	**167.212**
Third party revenue	–	0.765	**0.765**
Total water	**141.710**	**45.494**	**187.204**
Wholesale charge – wastewater			
Unmeasured	107.228	3.864	**111.092**
Measured	369.974	105.485	**475.459**
Total wastewater	**477.202**	**109.349**	**586.551**
Wholesale total	**618.912**	**154.843**	**773.755**
Retail revenue			
Unmeasured	8.103	–	**8.103**
Measured	44.866	–	**44.866**
Other third party revenue	–	0.753	**0.753**
Retail total	**52.969**	**0.753**	**53.722**
Third party revenue – non-price control			
Bulk supplies – water			**3.191**
Bulk supplies – wastewater			**0.578**
Other third party revenue			**2.193**
Principal services – non-price control			
Other appointed revenue			**0.331**
Total appointed revenue			**833.770**

	Water £m	Wastewater £m	Total £m
Wholesale revenue governed by price control	187.204	586.551	**773.755**
Grants & contributions	9.004	10.236	**19.240**
Total revenue governed by wholesale price control	**196.208**	**596.787**	**792.995**
Amount assumed in wholesale determination	195.759	595.441	**791.200**
Adjustment for in-period ODI revenue	–	–	**–**
Adjustment for WRFIM	–	–	**–**
Total assumed revenue	**195.759**	**595.441**	**791.200**
Difference	**0.449**	**1.346**	**1.795**

Actual wholesale revenue governed by the price control was £1.8 million (0.2%) higher than allowed in the wholesale determination.

When split into service level, the actual wholesale water revenue was higher than allowed revenue by £0.5 million (0.2%) and the actual wholesale wastewater revenue was higher than allowed revenue by £1.3 million (0.2%).

The increased revenue in both water and wastewater relates to higher capital contributions than was assumed when setting tariffs.

The overall higher actual revenue than allowed in the wholesale price control will be adjusted via the Wholesale Revenue Forecasting Incentive Mechanism (WRFIM) when setting the 2020–21 wholesale prices.

2J – Infrastructure network reinforcement costs for the 12 months ended 31 March 2019

	Network reinforcement capex £m	On site / site specific capex (memo only) £m
Wholesale water network + (treated water distribution)		
Distribution and trunk mains	0.273	**6.552**
Pumping and storage facilities	–	–
Other	–	–
Total	**0.273**	**6.552**
Wholesale wastewater network + (sewage collection)		
Foul and combined systems	8.355	**9.893**
Surface water only systems	–	–
Pumping and storage facilities	0.745	**0.990**
Other	–	–
Total	**9.100**	**10.883**

2K – New connections – infrastructure charges reconciliation for the 12 months ended 31 March 2019

	Water £m	Wastewater £m	Total £m
Impact of infrastructure charge discounts			
Infrastructure charges	2.835	9.339	**12.174**
Discounts applied to infrastructure charges	0.020	–	**0.020**
Gross infrastructure charges	**2.855**	**9.339**	**12.194**
Comparison of revenue and costs			
Variance brought forward			–
Revenue	2.855	9.339	**12.194**
Costs	(0.273)	(9.100)	**(9.373)**
Variance carried forward	**2.582**	**0.239**	**2.821**

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

Independent auditor's report

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

Report on the audit of the Regulatory Accounting Statements

Opinion

We have audited certain tables within Southern Water Services Limited's ("the Company") Annual Performance Report for the year ended 31 March 2019 ("the Regulatory Accounting Statements") which comprise:

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

We have not audited the Outcome performance table (tables 3A to 3S), table 1F (financial flows) and the additional regulatory information in tables 4A to 4W.

In our opinion, Southern Water Services' Regulatory Accounting Statements within the Annual Performance Report have been prepared, in all material aspects, in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.08, RAG 2.07, RAG 3.11, RAG 4.08 and RAG 5.07) and the accounting policies (including the Company's published accounting methodology statement, as defined in RAG 3.11, appendix 2), set out on page 67.

Basis for opinion

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

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

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

We draw attention to note 1g in the Regulatory Accounting Statements concerning the uncertain outcome of the investigation from the Environment Agency regarding the performance of certain wastewater sites and the reporting of relevant compliance information. Having considered the matter carefully the Board has concluded that it is not possible to make a reliable estimate for any obligation that may arise from these investigations. As the ultimate outcome of the matter cannot presently be determined no provision for any liability that may result has been made in the Regulatory Accounting Statements. Our opinion is not modified in respect of this matter.

Emphasis of matter – special purpose basis of preparation

We draw attention to the fact that the Regulatory Accounting Statements have been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the Company's published accounting methodology statement, as defined in RAG 3.11, appendix 2) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes.

Accordingly we make no such assessment. In addition, we are not required to assess whether the methods of cost allocation set out in the Methodology Statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA.

The Regulatory Accounting Statements are separate from the statutory financial statements of the Company and has not been prepared under the basis of United Kingdom Generally Accepted Accounting Practice ("UK GAAP"). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

The Regulatory Accounting Statements on pages 13 to 39 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from UK GAAP. A summary of the effect of these departures from Generally Accepted Accounting Practice in the Company's statutory financial statements is included in the tables within section 1.

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

Our opinion is not modified in respect of this matter.

Conclusions relating to going concern

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

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

Other information

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

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

We have nothing to report based on these responsibilities.

Responsibilities of the Directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 12, the directors are responsible for the preparation of the Regulatory Accounting Statements in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement, as defined in RAG 3.10, appendix 2).

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

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

Auditors' responsibilities for the Audit of the Regulatory Accounting Statements

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

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: **www.frc.org.uk/auditorsresponsibilities**. This description forms part of our auditor's report.

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

Report on other legal and regulatory requirements

Opinion on other matters prescribed by Condition F

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

- proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F; and
- the Regulatory Accounting Statements are in agreement with the accounting records and returns retained for the purpose of preparing the Annual Performance Report.

Use of this report

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

Our opinion on the Regulatory Accounting Statements is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2019 on which we reported on 12 July 2019, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Deloitte LLP.

Deloitte LLP

Chartered Accountants and Statutory Auditors
London, United Kingdom

12 July 2019

Performance summary

3A – Outcome performance table — Wholesale water

Performance commitment		Status	Unit	2017–18 performance level – actual	2018–19 performance level – actual	2018–19 Committed Performance Level met?
W1:	Water asset health		category	Stable	Stable	Yes
W2:	Water use restrictions		number	0	0	Yes
W3:	Leakage (five-year average)		megalitres /day	88.7	101.8	–
W4:	Interruptions to supply		mins/prop /year	17	7	Yes
W5:	Drinking water quality - Mean Zonal Compliance (MZC)		%	99.96	99.98	No
W5a:	Drinking water quality - discolouration contacts		number/ 1,000 popn	0.82	0.68	Yes
W6:	Low water pressure		number	243	209	Yes
W7:	Distribution input		megalitres /day	541.00	558.75	No
W8:	Per capita consumption (PCC) (five-year average)		litres per head/day	128.9	129.9	–

3A – Outcome performance table — Wholesale wastewater

Performance commitment		Status	Unit	2017–18 performance level – actual	2018–19 performance level – actual	2018–19 Committed Performance Level met?
WW1:	Wastewater asset health		category	Stable	Stable	Yes
WW1a:	Category 3 pollution incidents[1]		number	131	144	Yes
WW2:	Internal flooding incidents		number	401	389	Yes
WW3:	External flooding incidents		number	7,106	8,255	Yes
WW4:	Sewer blockages		number/per km sewer	0.49	0.52	Yes
WW5:	Odour complaints (Portswood and Tonbridge treatment works)		number	18	54	No
WW6:	Wastewater treatment works numeric compliance		%	98.4	99.7	No
WW7:	Proportion of energy from renewable sources		%	17.2	15.8	–
WW8:	Bathing waters with 'excellent' water quality (part 1)		number	53	57	Yes
WW9:	Bathing waters with 'excellent' water quality (part 2 – additional number of bathing waters)		number	0	5	Yes
WW10:	Bathing waters with 'excellent' water quality (part 3)	N/A 2018–19	£m	N/A	N/A	–
WW11:	Serious pollution incidents (Category 1 and 2)[1]		number	4	7	No
WW12:	Avoiding blocked drains (awareness survey)		%	82	83	Yes
WW13:	Thanet sewers	N/A 2018–19	N/A	N/A	N/A	–
WW14:	Woolston wastewater treatment works[2]	N/A 2018–19	N/A	N/A	N/A	–
WW15:	Millbrook sludge	N/A 2018–19	tonnes	N/A	N/A	–

3A – Outcome performance table — Retail						
Performance commitment		Status	Unit	2017–18 performance level – actual	2018–19 performance level – actual	2018–19 Committed Performance Level met?
R1:	First-time resolution of customer contacts[3]	Red	%	67	65	No
R2:	Dealing with customers' individual needs (awareness survey)	Amber	%	64	64	No
R3:	Awareness of water hardness measures (awareness survey)	Amber	%	55	55	No
R4:	Where your money goes (awareness survey)	Green	%	56	59	Yes
R5:	Billing queries	Red	number	181,361	131,726	No
R6:	Take up of assistance schemes	Green	number	229,843	269,926	Yes
R7:	Value for money (awareness survey)	Green	%	55.1	60.0	Yes
R8:	Service Incentive Mechanism (SIM)	Amber	score out of 100	79	80	–

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

[2] Woolston wastewater treatment works is undergoing a major redevelopment scheme which will enable it to meet the permit conditions. Until the scheme is complete, the works has limited capability to meet all the permit conditions, on this basis the works is classed as a failed works. The nature of the failure is such that it did not trigger an ODI penalty.

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

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

Key

Green	Indicates where we have met or beaten the performance commitment.
Amber	Indicates where we are still on target to deliver the outcomes we promised to customers but we have missed our performance commitment for the year.
Red	Indicates where we have not met our performance target and have not delivered the outcomes we promised to customers. In one case we incurred a penalty for the shortfall.
N/A 2018–19	These performance commitments do not apply in 2018–19.

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

3A – Outcome performance table – Notional reward or penalty accrued at 31 March 2019	2018–19 outperformance payment or underperformance penalty				Total AMP6 outperformance payment or underperformance penalty	
	In-period ODIs (indicator)	In-period ODIs (£m)	ODIs payable at the end of AMP6 (indicator)	ODIs payable at the end of AMP6 (£m)	31 March 2020 forecast (indicator)	31 March 2020 forecast (£m)
W3: Leakage (five-year average)	–	–	–	–	Underperformance payment	(2.7374)
W4: Interruptions to supply	–	–	–	–	Underperformance payment	(0.2870)
W8: Per capita consumption (PCC) (five-year average)	–	–	–	–	Outperformance payment	6.8750
WW5: Odour complaints (Portswood and Tonbridge treatment works)	–	–	Underperformance payment	(1.5800)	Underperformance payment	(1.7380)
WW8: Bathing waters with 'excellent' water quality (part 1)	–	–	–	–	Underperformance payment	(1.4580)
WW9: Bathing waters with 'excellent' water quality (part 2 – additional number of bathing waters)	–	–	Outperformance payment	1.2340	Outperformance payment	1.2340
R8: Service Incentive Mechanism (SIM)	–	–	–	–	Underperformance payment	(36.4000)

3B – Sub-measure performance table

Performance commitment	Status	Unit	2017–18 performance level – actual	2018–19 performance level – actual	2018–19 Committed Performance Level met?
W1: Water asset health		category	Stable	Stable	Yes
Number of mains bursts per year		number	1,844	1,917	Yes
Distribution Maintenance Index (TIM)		%	99.93	99.97	Yes
Coliform compliance at Water Supply Works (WSW)		%	99.98	99.93	Yes
Coliform compliance at Water Service Reservoirs (WSR)		%	99.94	100.00	Yes
Turbidity compliance		number	1	–	Yes
WW1: Wastewater asset health		category	Stable	Stable	Yes
Sewer collapses		number	234	245	Yes
Wastewater Treatment Works (WWTW) population equivalent compliance[1]		%	99.9	100.0	Yes
External flooding – other causes		number	6,734	7,791	Yes

3C – Abstraction Incentive Mechanism (AIM)				
Abstraction site	2018–19 AIM performance megalitres	2018–19 normalised AIM performance number	Cumulative AIM performance 2017–18 onwards megalitres	Cumulative normalised AIM performance 2017–18 onwards number
Otterbourne and Twyford abstraction	(82.80)	(0.04)	36.90	0.08
Total	**(82.80)**	**(0.04)**	**36.90**	**0.08**

Contextual information relating to AIM performance

Otterbourne and Twyford abstraction

We implemented the Otterbourne and Twyford September abstraction incentive mechanism Scheme again in 2018. This was the only AIM scheme operated in 2018. The scheme is focused on supporting the environment of the River Itchen by reducing abstraction at Otterbourne and Twyford sources to within the Environment Agency's proposed September monthly abstraction limit. We monitored the day-by-day abstraction relative to the target monthly limit and the baseline performance measure. According to audited data, we successfully achieved 8 megalitres under the September monthly abstraction limit and 81 Ml under the baseline performance measure.

3D – SIM score table	
	Score
Qualitative Performance	
1st survey score	**4.23**
2nd survey score	**4.32**
3rd survey score	**4.36**
4th survey score	**4.22**
Qualitative SIM score (out of 75)	**61.55**
Quantitative Performance	
Total contact score	**128.26**
Quantitative SIM score (out of 25)	**18.59**
SIM Score	
Total annual SIM score (out of 100)	**80.14**

Rewards and penalties for 2018–19

We have 21 wholesale financial Outcome Delivery Incentives (ODIs) based on our final price determination with Ofwat at the start of this AMP period. We are incentivised to drive performance against these commitments by Ofwat's financial reward/penalty mechanism. Six of these ODIs could attract either a financial reward or a penalty and the remaining 15 could attract a penalty only. The final outcome is based on the results of our business performance each year for the five years of the AMP.

For 2018–19 our performance against these performance commitments has resulted in us incurring a penalty in respect of odour complaints. Odour complaints received at our Portswood wastewater treatment works, in Southampton, have resulted in a penalty of £1.580m. We received 54 complaints in relation to Portswood, following delays in the delivery of an odour management project. This performance compared with a target and penalty threshold of zero complaints, which was the expected result of the investment in odour management. Having now completed the scheme we expect few or no further complaints.

However, we expect to earn a reward of £1.234 million for improving five of the seven beaches in our bathing water improvement programme to 'Excellent' standard one year early. This reward is dependent on these five bathing waters remaining at 'Excellent' standard for the 2019 bathing water season.

On a cumulative basis, for the first four years of the AMP, we have recorded a net penalty of £2.249 million. This is made up of our 'bathing waters' performance commitment in 2015–16, a penalty in 2017–18 for interruptions experienced as a result of the impact of the 'Beast from the East' severe weather in 2018, and the odour penalty incurred in 2018–19, offset by the reward for early delivery of bathing water improvements.

Forecast reward/penalties

We currently expect to meet our performance commitments for the final year of the price control period, with the exception of odour complaints, where we are prudently forecasting a penalty for two complaints in relation to Portswood.

We will also see the outcomes of a number of measures which are based on average performance over the whole five-year price control period.

We expect to incur a penalty for our five-year leakage performance, which we forecast will be higher, on average, than our target of 87 Ml/d, at 91 Ml/d. This results mainly from a significant deterioration in performance in 2018–19, following the impact on our network of the rapid freeze/thaw experienced in 2018.

We also expect a penalty for our SIM performance, despite significant improvements in performance over the last two years. SIM applies for the first four years of this period and has now been replaced by Ofwat's new C-MeX measure of customer service performance.

Our performance in helping customers manage their consumption has been better than forecast and our average per capita consumption over the five years will be significantly below our target. If performance is sustained in 2019–20, this will result in a reward of £6.875m.

Overall for the AMP, we are forecasting the following penalties and rewards:

Forecast reward/(penalties)			
ODI	**Year**	**Forecast**	**Amount £m**
Bathing Waters	2015–16	Penalty	(1.458)
Interruptions to Supply	2017–18	Penalty	(0.287)
Bathing Waters	2018–19	Reward	1.234
Odour Complaints	2018–19	Penalty	(1.580)
Odour Complaints	2019–20	Penalty	(0.158)
PCC	5-yr average	Reward	6.875
Leakage	5-yr average	Penalty	(2.734)
SIM	4-yr average	Penalty	(36.400)
Total net penalty			**(34.511)**

Note: there may be a requirement to alter our forecasts as more information becomes available over time.

Reporting to customers

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

Assurance of performance commitments

As part of our Final Assurance Plan published on 31 March 2019 we stated that we would obtain independent assurance in relation to our 2018–19 performance commitment reporting. PricewaterhouseCoopers LLP has undertaken this work on our behalf and their statement is provided on page 50.

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

The Board of Directors of Southern Water Services Limited ('Southern Water') engaged us to provide limited assurance on the information described below and set out in Southern Water's Annual Performance Report 2019 for the year ended 31 March 2019.

Disclaimer

- PwC accepts no liability (including liability for negligence) to each recipient in relation to PwC's report. The report is provided to each recipient for information purposes only. If a recipient relies on PwC's report, it does so entirely at its own risk;
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- PwC will be entitled to the benefit of and to enforce these terms; and
- These terms and any dispute arising from them, whether contractual or non-contractual, are subject to English law and the exclusive jurisdiction of English courts.

Our conclusion

Based on the procedures we have performed and the evidence we have obtained, nothing has come to our attention that causes us to believe that the Selected Information for the year ended 31 March 2019 has not been prepared, in all material respects, in accordance with the Reporting Criteria.

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

Selected Information

The scope of our work was limited to assurance over the following information in Southern Water's Annual Performance Report 2018–19 (the "Selected Information").

- 3A – Outcome performance table — wholesale water, wholesale wastewater and retail, excluding the following low risk PCs:
  - W2: Water use restrictions
  - WW12: Avoiding blocked drains
  - R2: Dealing with customers' individual needs
  - R3: Awareness of water hardness measures
  - R4: Where your money goes
  - R6: Take up of assistance schemes
  - R7: Value-for-money
- 3B – Sub-measure performance table;
- 3C – AIM table;
- 3D – SIM table;
- 4A – Non-financial information;
- Greenhouse gas emissions – $KgCO_2e$;
- $KgCO_2e$ per person supplied with treated water;
- $KgCO_2e$ per person supplied with wastewater services;
- Odour Complaints (Total);

The Selected Information and the Reporting Criteria against which it was assessed are summarised in our full report which is disclosed online at **southernwater.co.uk/dataassurance-summary** and in Appendix 2 of the Annual Performance Report. Our assurance does not extend to information in respect of earlier periods or to any other information included in the Southern Water Annual Performance Report 2018–19.

Professional standards applied and level of assurance

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

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

Our Independence and Quality Control

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

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

Understanding reporting and measurement methodologies

The Selected Information needs to be read and understood together with the Reporting Criteria, which Southern Water is solely responsible for selecting and applying. The absence of a significant body of established practice on which to draw to evaluate and measure non-financial information allows for different, but acceptable, measurement techniques and can affect comparability between entities and over time. The Reporting Criteria used for the reporting of the Selected Information are as at 31 March 2019.

Work done

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

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

Southern Water's responsibilities

The Directors of Southern Water are responsible for:

- Designing, implementing and maintaining internal controls over information relevant to the preparation of the Selected Information that is free from material misstatement, whether due to fraud or error;
- Establishing objective Reporting Criteria for preparing the Selected Information;
- Measuring and reporting the Selected Information based on the Reporting Criteria; and
- The content of the Southern Water Annual Performance Report 2018–19.

Our responsibilities

We are responsible for:

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

This report, including our conclusions, has been prepared solely for the Board of Directors of Southern Water in accordance with the agreement between us dated 19 December 2018, to assist the Directors in reporting Southern Water's performance and activities. We permit this report to be disclosed in the Southern Water Annual Performance Report 2018–19 for the year ended 31 March 2019, to assist the Directors in responding to their regulatory responsibilities by obtaining an independent assurance report in connection with the Selected Information. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Board of Directors and Southern Water for our work or this report except where terms are expressly agreed in writing.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants
Gatwick

15 July 2019

Additional regulatory information

4A – Non-financial information for the 12 months ended 31 March 2019		
Retail – household	Unmeasured	Measured
Number of void households ('000s)	11.735	25.793
Per capita consumption (excluding supply pipe leakage) litres/head/day	168.17	124.20
Wholesale	Water	Wastewater
Volume (Megalitres/day)		
Bulk supply export	18.217	–
Bulk supply import	0.137	0.663
Distribution input	558.751	

4B – Wholesale totex analysis for the 12 months ended 31 March 2019	Current year		Cumulative	
	Water £m	Wastewater £m	Water £m	Wastewater £m
Actual totex	223.243	468.330	740.198	1,589.914
Less: Items excluded from the menu				
Third party costs	4.681	1.549	17.262	1.649
Pension deficit recovery costs	4.844	10.570	14.257	31.112
Other 'Rule book' adjustments	0.110	15.225	0.660	61.634
Total items excluded from the menu	**9.635**	**27.344**	**32.179**	**94.395**
Add: Transition expenditure				
Transition expenditure	–	–	1.498	14.255
Adjusted actual totex	**213.608**	**440.986**	**709.517**	**1,509.774**
Actual totex – base year prices	**184.480**	**380.851**	**637.410**	**1,361.625**
Allowed totex – base year prices	**148.640**	**369.563**	**630.939**	**1,534.541**

Wholesale totex analysis

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

In 2018–19, our total expenditure (totex) for water of £184.5 million in base year prices (2012–13) was £35.9 million higher than that allowed in our Final Determination (FD) of £148.6 million and our wastewater totex of £380.9 million was £11.3 million higher than the FD allowance of £369.6 million.

Cumulatively our totex for water of £637.4 million was £6.5 million above the FD allowance of £630.9 million and our cumulative wastewater expenditure of £1,361.6 million was £172.9 million below our allowance of £1,534.5 million.

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

Allowed totex variance				
£m (2012–13 prices)	Current year		Cumulative	
Description	Water	Wastewater	Water	Wastewater
i) Rates rebate	–	–	15.4	–
ii) Operating costs	(3.3)	(11.1)	25.0	(8.1)
iii) Infrastructure costs expensed	(2.3)	8.3	6.7	42.8
iv) IRE costs transferred to retail	–	0.1	–	2.6
v) Transferred to non-appointed	–	5.2	–	20.8
vi) Capex	(31.8)	(15.2)	(59.0)	113.4
Other (third party)	1.5	1.4	5.4	1.4
Total	**(35.9)**	**(11.3)**	**(6.5)**	**172.9**

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

ii) In the first four years of this business plan period our operating costs, excluding the impact of the change in accounting for infrastructure maintenance costs, were £16.9 million lower in total than our determination (water £25.0 million lower, wastewater £8.1 million higher).

    Cost reductions have been achieved through more efficient use of power, chemicals and employing our internal staff instead of contractors. Additionally we have delivered a number of procurement savings when renegotiating external contracts and increases to pay have been generally lower than RPI resulting in a saving when these are re-stated in 2012–13 prices.

    2018–19 has seen the continuation of our transformation journey. We have been changing systems and processes, as well as the structure and culture of the business, to ensure we are ready to deliver our Business Plan 2020–25. This transformation programme together with increased leakage activity and the preparation of our Business Plan resulted in additional costs being incurred in 2018–19 which have offset some of the savings made to date.

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

    The result of this accounting variance from our original plan, along with lower levels of infrastructure repair costs incurred, is a favourable variance in totex to date of £49.5 million in relation to infrastructure costs expensed (water £6.7 million, wastewater £42.8 million).

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

v) Our business plan submission included costs within the appointed wastewater business for the haulage and treatment costs of tankered waste. In October 2016, Ofwat issued revised regulatory guidance in RAG 4.06 clarifying that these costs should be classified as part of the non-appointed business. This change in classification results in a cumulative favourable variance of £20.8 million when compared to our allowed wholesale totex.

vi) Our capital investment programme is also lower than set out in our business plan by £54.4 million and this is largely due to the timing of delivery of our investment programme. The cumulative variance for wastewater has been adjusted to reflect the removal of adopted assets as mentioned above.

    In 2018–19 there has been a significant increase in our capital programme, compared to the profile in the business plan, in both water and wastewater and our latest plans expect that to continue for 2019–20.

Rule book adjustments:

When comparing our actual totex to that allowed in the Final Determination we are required to make ‘rule book’ adjustments for certain costs, including fines and investigation costs.

Unfortunately, during 2018–19 we were prosecuted for a failure to notify the DWI of an event at Cooks Castle. This prosecution resulted in a fine of £65,000 and this, together with associated legal costs, is shown as a rule book adjustment in table 4B above.

In addition, as reported in our risk and compliance statement, Ofwat has proposed a fine of £3.0 million following its investigation into our wastewater compliance and reporting. Our provision for this fine, together with the costs incurred during 2018–19 undertaking the investigations of £3.7 million, have also been included within the rule book adjustments.

Within our totex expenditure for wastewater, reported in table 4E, we have included the fair value of adopted sewers, in order to ensure that the capital expenditure reported aligns with the movements in fixed assets. As these assets are adopted at nil cost, we have also made an adjustment for them of £8.5 million, through the rule book adjustment line, in 2018–19 prices.

4C – Impact of AMP performance to date on RCV for the 12 months ended 31 March 2019	Water £m	Wastewater £m
Cumulative totex over/(underspend) so far in the price control period	1.760	(224.766)
Customer share of cumulative totex over/(underspend)	0.858	(112.383)
RCV element of cumulative totex over/(underspend)	0.864	(121.416)
Adjustment for ODI outperformance payment or underperformance payment	–	–
RCV determined at FD at 31 March	1,044.269	**3,990.410**
Projected 'shadow' RCV	**1,045.133**	**3,868.994**

Impact of performance on RCV

Cumulative expenditure for water is broadly in line with the final determination assumption, with a small overspend of £1.8 million to date, resulting in a £0.9 million increase in the shadow water RCV. Expenditure for wastewater is £224.8 million below the level allowed for by Ofwat. This underspend reduces the shadow wastewater RCV by £121.4 million.

In the final year of the price control period we expect to spend more than the Ofwat allowance for both water and wastewater, due to necessary additional capital investment to improve resilience and compliance. This will increase the RCV uplift for water and reduce the level of the RCV reduction for wastewater, compared with that shown above.

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

There are no ODI adjustments to be made through the RCV.

4D – Totex analysis for the 12 months ended 31 March 2019 – Wholesale water

	Water resources		Network +				
	Abstraction licences £m	Raw water abstraction £m	Raw water transport £m	Raw water storage £m	Water treatment £m	Treated water distribution £m	Total £m
Operating expenditure							
Power	–	3.787	–	–	8.649	3.413	**15.849**
Income treated as negative expenditure	–	–	–	–	–	–	**–**
Abstraction charges / discharge consents	4.622	–	–	–	0.061	–	**4.683**
Bulk supply	–	–	–	–	–	0.334	**0.334**
Other operating expenditure							
– Renewals expensed in year (Infrastructure)	–	–	–	–	–	17.977	**17.977**
– Other operating expenditure excluding renewals	0.454	5.619	0.240	0.263	24.255	19.069	**49.900**
Local authority rates	–	0.955	0.131	–	1.632	9.641	**12.359**
Total operating expenditure excluding third party services	**5.076**	**10.361**	**0.371**	**0.263**	**34.597**	**50.434**	**101.102**
Third party services	0.290	0.388	–	–	1.133	1.255	**3.066**
Total operating expenditure	**5.366**	**10.749**	**0.371**	**0.263**	**35.730**	**51.689**	**104.168**
Capital expenditure							
Maintaining the long-term capability of the assets – infrastructure	–	0.301	(0.051)	–	0.001	7.717	**7.968**
Maintaining the long-term capability of the assets – non-infrastructure	0.185	6.501	–	–	42.411	26.033	**75.130**
Other capital expenditure – infrastructure	–	0.811	(0.031)	–	0.363	13.597	**14.740**
Other capital expenditure – non-infrastructure	0.494	3.647	–	–	14.542	3.381	**22.064**
Infrastructure network reinforcement	–	–	–	–	–	0.273	**0.273**
Total gross capital expenditure (excluding third party)	**0.679**	**11.260**	**(0.082)**	**–**	**57.317**	**51.001**	**120.175**
Third party services	0.108	1.589	–	–	1.005	0.678	**3.380**
Total gross capital expenditure	**0.787**	**12.849**	**(0.082)**	**–**	**58.322**	**51.679**	**123.555**
Grants and contributions	–	0.256	–	–	1.416	7.652	**9.324**
Totex	**6.153**	**23.342**	**0.289**	**0.263**	**92.636**	**95.716**	**218.399**
Cash expenditure							
Pension deficit recovery payments	–	0.177	–	0.021	2.231	2.415	**4.844**
Totex including cash items	**6.153**	**23.519**	**0.289**	**0.284**	**94.867**	**98.131**	**223.243**

Unit cost information (operating expenditure)

	Population (thousands)	Licenced volume available	Volume abstracted	Volume transported	Average volume stored	Distribution input volume	Distribution input volume
Volume (Megalitres)		454,554	216,971	83,684	203,826	203,944	203,944
Unit cost (£/Megalitre)		**11.80**	**49.54**	**4.43**	**1.29**	**175.20**	**253.45**
Unit cost (£/population)	**2,549**	**2.11**	**4.22**	**0.15**	**0.10**	**14.02**	**20.28**

4E – Totex analysis for the 12 months ended 31 March 2019 – Wholesale Wastewater

	Network+ Sewage Collection			Network+ Sewage treatment		Sludge			
	Foul £m	Surface water drainage £m	Highway drainage £m	Sewage treatment and disposal £m	Imported sludge liquor treatment £m	Sludge transport £m	Sludge treatment £m	Sludge disposal £m	Total £m
Operating expenditure									
Power	8.895	1.917	1.917	18.370	0.672	0.026	(2.452)	–	**29.345**
Income treated as negative expenditure	–	–	–	–	–	–	(3.045)	–	**(3.045)**
Discharge consents	0.701	0.153	0.153	2.948	0.060	–	0.016	–	**4.031**
Other operating expenditure									
– Renewals expensed in year (Infrastructure)	15.247	3.323	3.323	–	–	–	–	–	**21.893**
– Other operating expenditure excluding renewals	26.202	4.221	4.221	47.506	1.224	4.837	16.367	4.976	**109.554**
Local authority rates	0.063	0.014	0.014	12.914	0.361	–	1.390	–	**14.756**
Total operating expenditure excluding third party services	**51.108**	**9.628**	**9.628**	**81.738**	**2.317**	**4.863**	**12.276**	**4.976**	**176.534**
Third party services	–	–	–	–	–	–	–	–	**–**
Total operating expenditure	**51.108**	**9.628**	**9.628**	**81.738**	**2.317**	**4.863**	**12.276**	**4.976**	**176.534**
Capital expenditure									
Maintaining the long-term capability of the assets – infrastructure	15.112	3.294	3.294	0.160	–	–	–	–	**21.860**
Maintaining the long-term capability of the assets – non-infrastructure	10.646	2.321	2.321	116.193	–	–	16.933	–	**148.414**
Other capital expenditure – infrastructure	34.335	7.484	7.484	2.850	–	–	–	–	**52.153**
Other capital expenditure – non-infrastructure	3.869	0.843	0.843	47.471	–	–	6.133	–	**59.159**
Infrastructure network reinforcement	6.329	1.380	1.380	0.011	–	–	–	–	**9.100**
Total gross capital expenditure (excluding third party)	**70.291**	**15.322**	**15.322**	**166.685**	**–**	**–**	**23.066**	**–**	**290.686**
Third party services	2.282	0.498	0.498	0.907	–	–	–	–	**4.185**
Total gross capital expenditure	**72.573**	**15.820**	**15.820**	**167.592**	**–**	**–**	**23.066**	**–**	**294.871**
Grants and contributions	8.964	1.954	1.954	0.773	–	–	–	–	**13.645**
Totex	**114.717**	**23.494**	**23.494**	**248.557**	**2.317**	**4.863**	**35.342**	**4.976**	**457.760**
Cash expenditure									
Pension deficit recovery	3.183	0.531	0.531	4.980	0.553	–	0.792	–	**10.570**
Totex including cash items	**117.900**	**24.025**	**24.025**	**253.537**	**2.870**	**4.863**	**36.134**	**4.976**	**468.330**

Unit cost information (operating expenditure)

	Population (thousands)	Volume collected	Volume collected	Volume collected	Biochemical Oxygen Demand (BOD)	Biochemical Oxygen Demand (BOD)	Volume transported	Dried solid mass treated	Dried solid mass disposed
Volume (Megalitres)		188,094	41,000	41,000	108,748	15,950	928,687	136	136
Unit cost (£/Megalitre)		**271.71**	**234.83**	**234.83**	**751.63**	**145.27**	**5.24**	**90,162**	**36,547**
Unit cost (£/population)	**4,608.3**	**11.09**	**2.09**	**2.09**	**17.74**	**0.50**	**1.06**	**2.66**	**1.08**

4F – Cost analysis for the 12 months ended 31 March 2019 – Household Retail	Household unmeasured				Household measured				
	Water only £m	Wastewater only £m	Water and wastewater £m	Total £m	Water only £m	Wastewater only £m	Water and wastewater £m	Total £m	Total £m
Operating expenditure									
Customer services	0.501	2.415	6.814	**9.730**	0.496	4.313	6.493	**11.302**	**21.032**
Debt management	0.022	2.457	3.405	**5.884**	0.117	1.524	7.385	**9.026**	**14.910**
Doubtful debts	0.079	1.521	0.570	**2.170**	0.333	2.980	4.119	**7.432**	**9.602**
Meter reading					0.270	0.541	2.398	**3.209**	**3.209**
Other operating expenditure	0.072	1.269	0.668	**2.009**	0.318	2.838	4.906	**8.062**	**10.071**
Total operating expenditure excluding third party services	**0.674**	**7.662**	**11.457**	**19.793**	**1.534**	**12.196**	**25.301**	**39.031**	**58.824**
Third party services operating expenditure	–	–	–	**–**	–	–	–	**–**	**–**
Total operating expenditure	**0.674**	**7.662**	**11.457**	**19.793**	**1.534**	**12.196**	**25.301**	**39.031**	**58.824**
Depreciation – tangible fixed assets									
– on assets existing at 31 March 2015	0.014	0.252	0.133	**0.399**	0.063	0.563	0.974	**1.600**	**1.999**
– on assets acquired since 1 April 2015	–	–	–	**–**	–	–	–	**–**	**–**
Amortisation – intangible fixed assets									
– on assets existing at 31 March 2015	0.013	0.232	0.122	**0.367**	0.058	0.520	0.899	**1.477**	**1.844**
– on assets acquired since 1 April 2015	0.002	0.035	0.019	**0.056**	0.009	0.079	0.137	**0.225**	**0.281**
Total operating costs	**0.703**	**8.181**	**11.731**	**20.615**	**1.664**	**13.358**	**27.311**	**42.333**	**62.948**
Capital expenditure	**0.005**	**0.094**	**0.049**	**0.148**	**0.023**	**0.210**	**0.362**	**0.595**	**0.743**

Other operating expenditure includes the net retail expenditure for the following retail activities which are part funded by wholesale	£m
Household	
Demand-side water efficiency – gross expenditure	**0.090**
Demand-side water efficiency – expenditure funded by wholesale	**–**
Demand-side water efficiency – net retail expenditure	**0.090**
Customer-side leak repairs – gross expenditure	**–**
Customer-side leak repairs – expenditure funded by wholesale	**–**
Customer-side leak repairs – net retail expenditure	**–**

4G – Wholesale current cost financial performance for the 12 months ended 31 March 2019	Water £m	Wastewater £m	Total £m
Revenue	191.915	588.133	**780.048**
Operating expenditure	(104.168)	(176.534)	**(280.702)**
Capital maintenance charges	(86.327)	(299.699)	**(386.026)**
Other operating income	0.306	(134.902)	**(134.596)**
Current cost operating profit	**1.726**	**(23.002)**	**(21.276)**
Other income	6.417	23.757	**30.174**
Interest income	11.363	42.064	**53.427**
Interest expense	(48.459)	(179.393)	**(227.852)**
Other interest expense	(0.936)	(3.464)	**(4.400)**
Curent cost loss before tax and fair value movements	**(29.889)**	**(140.038)**	**(169.927)**
Fair value losses on financial instruments	(46.060)	(170.511)	**(216.571)**
Current cost loss before tax	**(75.949)**	**(310.549)**	**(386.498)**

4H – Financial Metrics	Units	Metric	AMP to date
Financial Indicators			
Net debt	£m	3,465.569	
Regulated equity	£m	1,569.110	
Regulated gearing	%	68.83	
Post tax return on regulated equity	%	(4.86)	
RORE (return on regulated equity)	%	4.68	5.30
Dividend yield	%	0.00	
Retail profit margin – Household	%	(1.49)	
Retail profit margin – Non household	%	(0.80)	
Credit rating	n/a	Baa2, review for downgrade	
Return on RCV	%	2.33	
Dividend cover	dec	0.00	
Funds from operations (FFO)	£m	343.738	
Interest cover (cash)	dec	2.79	
Adjusted interest cover (cash)	dec	1.36	
FFO/debt	dec	0.10	
Effective tax rate	%	15.05	
Free cash flow (RCF)	£m	311.800	
RCF/capex	dec	0.77	
Revenue and earnings			
Revenue (actual)	£m	827.477	
EBITDA (actual)	£m	485.948	
Movement in RORE			
Base Return	%	5.63	5.64
Totex out/(under) performance	%	0.32	0.96
Retail cost out/(under) performance	%	(0.51)	(0.85)
ODI out/(under) performance	%	(0.70)	(0.49)
Financing out/(under) performance	%	(0.01)	0.07
Other factors	%	(0.05)	(0.03)
Regulatory return for the year		**4.68**	**5.30**
Borrowings			
Proportion of borrowings which are fixed rate	%	27.79	
Proportion of borrowings which are floating rate	%	4.43	
Proportion of borrowings which are index linked	%	67.78	
Proportion of borrowings due within 1 year or less	%	13.19	
Proportion of borrowings due in more than 1 year but no more than 2 years	%	0.00	
Proportion of borrowings due in more than 2 years but no more than 5 years	%	17.27	
Proportion of borrowings due in more than 5 years but no more than 20 years	%	51.70	
Proportion of borrowings due in more than 20 years	%	17.84	

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

Totex out/(under) performance:

We share approximately 50% of wholesale totex savings we achieve with customers. In 2018–19 this was a retained post tax saving of £5.9 million, equivalent to an increase of 0.32% in RORE. This value differs from table 4B as a result of adjustments to remove the effect of any timing differences on delivery of the capital programme and the amount shared with customers.

During the development and submission of our PR19 plan in 2018-19 we received clarification of treatment for a number of wholesale totex items. We have adjusted our RORE analysis for prior periods in AMP6 to capture the impact of this revised treatment. The most significant of these changes is to exclude from our actual totex the value of sewer adoptions, as this does not reflect an actual cost to the company. We have also reversed the adjustments we have previously made for tankered waste costs. These changes increase our totex outperformance, and therefore the return on regulated equity.

Prior to the calculation of the amount to be shared with customers, but adjusting for timing differences on delivery of the capital programme as well as a higher proportion of infrastructure maintenance expenditure being treated as capital expenditure, post-tax fast money (i.e. costs recovered through customer bills as they are incurred) under-performance for the year equates to £14.4 million and post-tax slow money (i.e. costs recovered over the long-term through customer bills) out-performance to £24.7 million.

Retail out/(under) performance:

The company share of retail cost under-performance represents the amount by which we are overspending against the PR14 price determination. There is no sharing with customers of the retail expenditure variance, with the result that the £9.6 million post-tax over-spend for 2018–19 reduces RORE by 0.51%.

ODI out/(under) performance:

The impact of our performance on Outcome Delivery Incentives (ODIs) is £13.2 million for 2018–19, reducing RORE by 0.70%. Penalties or rewards are included in the adjusted RORE figures even if they are not payable or receivable until the next AMP. Table 3A provides further details.

Financing out/(under) performance:

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

Other factors:

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

In 2017–18 we recognised a post-tax profit after costs of £9.1 million, on the sale of our non-household retail business to Business Stream. This additional return, equivalent to a 0.13% increase to cumulative average RORE in the AMP, does not form part of the reported RORE figure and is offset by the loss of the non-household operational return from 2017–18 onwards.

4I – Financial derivatives for the 12 months ended 31 March 2019

	Nominal value by maturity (net) at 31 March 2019			Total value at 31 March 2019		Total accretion at 31 March 2019	Interest rate (weighted average for 12 months to 31 March 2019)	
	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Nominal value (net) £m	Mark to Market £m	£m	Payable	Receivable
Interest rate swap (sterling)								
Floating to fixed rate	–	200.000	–	**200.000**	(0.046)	–	–	–
Fixed to index-linked	–	–	1,316.608	**1,316.608**	1,382.084	147.776	1.97%	4.71%
Total	**–**	**200.000**	**1,316.608**	**1,516.608**	**1,382.038**	**147.776**		

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

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

The value of the Mark to Market represents forecast future cash flows for the duration of the derivatives and discounted by prevailing interest rates. This value is extremely volatile given that market interest rates are constantly moving. The liability shown in the table above of £1,382.0 million associated with the Mark to Market valuations of our derivatives is very high at present given the current low interest rate environment. The risk of this Mark to Market value crystalising is extremely remote given that it can only crystalise under certain conditions of a default of our financing covenants, in which case operations of the company are protected and will continue. Further details are available on page 199 of our Annual Report and Finanical Statements.

Data assurance summary

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

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

We have published a separate document that details the completed assurance work performed on our reported information for the 2018–19 financial year. The results, both positive and improvement areas are published in the document entitled 'Data Assurance Summary' which is available on our Southern Water website **southernwater.co.uk/our-reports**.

The main assurance areas for the annual reports are:

Significant Areas for Assurance	Assurance Results for 2018–19
The Annual Report including the Statutory and Regulatory Accounts, cost allocation and segmental reporting	The Annual Report and Financial Statements were audited by Deloitte LLP. Their opinion is included on page 214. The Annual Performance Report (APR), sections 1 and 2, excluding table 1F, were audited by Deloitte LLP. Their assurance statement is included on page 40. Deloitte LLP also performed assurance activities agreed with us on the financial information presented in table 1F and section 4 of the APR and the financial information published in the cost assessment tables alongside this report. No issues were identified.
Ofwat Performance Commitments and Outcome Delivery Incentives (ODIs)	Our technical assurers PricewaterhouseCoopers LLP have issued us with an unqualified limited assurance ISAE 3000 opinion over the reported performance against our high and medium risk Performance Commitments for the Business Plan period 2015–20 in the Annual Performance Report. In addition they performed assurance activities agreed with us in relation to the non-financial cost assessment data which is published separately alongside this report.
Specific assurances related to other regulators' required information (i.e. The Drinking Water Inspectorate and The Environment Agency)	Each specified requirement is detailed in our Data Assurance Summary
PR 19 Business Plan submissions	PricewaterhouseCoopers LLP and Deloitte LLP undertook assurance activities agreed with us in relation to our Business Plan submission and response to Ofwat's initial assessment of our plan.

Appendices

The information in the appendices has not been audited.

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

Services supplied to the associated companies by the appointee

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

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

Services supplied to associated companies by the appointee				
	Company	**Turnover of associate**	**Terms of supply**	**Value £m**
Management charges	Greensands Investments Limited	–	Cost/market price	1.000

Services received by the appointee from associated companies

There were no services supplied by associate companies to SWS.

Group relief received by the appointee

Group relief received by the appointee				
	Company	**Turnover of associate**	**Terms of supply**	**Value £m**
Corporation tax group relief	Southern Water Services Group	–	Cost	8.176
Corporation tax group relief	Greensands Investments Limited	–	No cost	8.492

Allocation of costs between regulated and non-regulated businesses

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

Allocation of costs between regulated and non-regulated businesses		
Service provided by non-appointed business	**Basis of recharge**	**Value £m**
Treatment of imported sludge	Not applicable	–
Treatment of tankered waste	The Mogden Formula was used to calculate the income for tankered waste and the costs were derived from this calculation	6.066
Other	Headcount (FTE) was used to calculate administrative overhead for property searches, accommodation rental and Homeserve costs	0.046

Details of intercompany loans

Loans granted to Southern Water Services Limited

Company	Loan type	Interest rate %	Repayment date	Balance at 31 March 2019 £m
Southern Water Services (Finance) Limited	Fixed rate	6.202	2029	348.598
	Index linked	3.716	2034	237.121
	Index linked	3.716	2034	55.279
	Fixed rate	6.650	2026	348.848
	Index linked	3.826	2023	237.121
	Fixed rate	5.010	2021	349.049
	Fixed rate	5.010	2041	147.027
	Fixed rate	4.510	2052	197.196
	Fixed rate	5.135	2056	292.617
	Fixed rate	6.135	2019	300.000
	Fixed rate	2.790	2031	174.007
	Fixed rate	2.970	2036	74.552
	Index linked	4.086	2033	260.964
	Index linked	3.645	2032	241.502
	Fixed rate	0.000	On demand	30.250
Total				**3,294.131**

Loans granted by Southern Water Services Limited

Company	Loan type	Interest rate %	Repayment date	Balance at 31 March 2019 £m
Southern Water Services (Finance) Limited	Fixed rate	0.000	On demand	110.736
Southern Water Services Group Limited	Fixed rate	7.000	2052	130.042
Total				**240.778**

Dividends paid by Southern Water Services Limited to group companies

Company	**2019 £m**	2018 £m
Southern Water Holdings (ordinary dividend)	–	8.000
Southern Water Holdings (for SWSG loan agreement)	**34.858**	46.061

No ordinary dividend was declared for payment to Southern Water Holdings Limited (SWH) in 2019 (2018: £8.0 million).

A dividend of £34.858 million (2018: £46.061 million) is paid to SWS Holdings Limited to allow SWSG to service its interest obligations on the Southern Water Services Limited/SWSG loan agreement.

Dividend policy

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

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

1. Determination of a base level of dividend, based on an equity return consistent with our most recent Final Determination and our actual level of gearing. This recognises our management of economic risks and capital employed.

2. In assessing any adjustment to the base level of dividend, we will take into account our financial and non-financial performance. This would reflect our overall financial performance as compared to the final Business Plan for 2020–25 as agreed by Ofwat and would explicitly consider a qualitative assessment of customer service levels and how customers share in our successes.

3. We will consider our financial resilience ahead of any dividend decision, and whether any financial outperformance should be re-invested to benefit our customers. This consideration will also include taking into account the interests of our employees, other stakeholders, and our pension schemes.

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

   a) headroom under debt covenants

   b) the impact on the company's credit rating

   c) the liquidity position and ability to fulfil licence conditions

   d) key areas of business risk.

4. We will be transparent in the payment of dividends and will clearly justify the payment in relation to the factors outlined above.

5. We will publish our Dividend Policy annually (as part of the Annual Report and Financial Statements), and highlight any changes.

Comparison of dividend to the PR14 Final Determination

These tests are not applied to the interim dividends of £34.8 million paid to Southern Water Services Group (SWSG), as this dividend payment is instantly offset by a corresponding interest receipt from SWSG and, therefore, does not get distributed to the shareholders of our ultimate parent company, Greensands Holdings Limited (GSH).

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

This potential level of base dividend is calculated as per step 1 of our Dividend Policy. In discussing this potential base dividend and taking into account the remainder of our dividend policy it was decided that we would not make a dividend payment at this time. This decision is a result of a combination of issues that will resolve over the next three to six months with a particular emphasis on our continued PR19 preparations, legacy wastewater compliance issues, and ongoing financial resilience.

Asset transfers

There were no asset transfers during the year.

Appendix 2. KPI definitions and status assessment rules

Responsive customer service

Customer satisfaction – Service Incentive Mechanism (SIM) score

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

Status:
- SIM score higher than industry average
- SIM score below industry average
- SIM score below industry average by more than 10%

Reward/penalty: Reward and penalty based on performance relative to other water companies.

Measurement: SIM score is measured and calculated according to Ofwat's guidance in 'Service incentive mechanism – guidance for collating customer service information for calculating the SIM score' (April 2015).

Unit of measure: Score out of a maximum of 100.

First-time resolution of customer contacts

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

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

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

Measurement: First-time resolution of customer contacts is measured using an approach which was developed for Southern Water's business plan and used to calculate the company performance level in 2013–14.

Unit of measure: Percentage of contacts received.

Percentage of customers who feel our service meets their individual needs

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

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

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

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

Unit of measure: Percentage of customers surveyed.

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

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

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

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

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

Unit of measure: Percentage of customers surveyed.

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

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

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

Reward/penalty: Not applicable.

Measurement: The number of compensation payments made is calculated according to Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 6 Key Outputs Customer Service Standards'.

Unit of measure: Number of payments.

Affordable bills

Customers in genuine hardship with improved support

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

Status:

Status	
Green	More than or equal to 194,700
Amber	Less than 194,700 but forecast for 2019–20 to achieve target of 217,100
Red	Less than 194,700 but forecast for 2019–20 is below target of 217,100

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

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

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

Percentage of customers who feel our services provide value for money

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

Status:

Status	
Green	Greater than previous year
Amber	Equal to or up to five percentage points lower than the previous year
Red	More than five percentage points below the previous year

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

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

Unit of measure: Percentage of customers surveyed.

Better information and advice

Water usage (per capita consumption)

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

Status:

Status	
Green	Average for 2017–18 is below 133.7 litres per head, per day
Amber	Average for 2017–18 is above 133.7 but forecast for 2015–16 to 2019–20 is below 133.7 litres per head, per day
Red	Average for 2017–18 is above 133.7 and forecast for 2015–16 to 2019–20 is above 133.7 litres per head, per day

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

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

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

Number of unwanted billing queries

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

Status:

Status	
Green	Less than 49,000 queries and decrease on previous year
Amber	Less than 49,000 queries but more than the previous year
Red	More than 49,000 queries

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

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

Unit of measure: Number of billing queries.

Better information and advice

Customers who are aware of the causes of blocked drains

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

Status:

Green	Greater than previous year
Amber	Equal to or up to five percentage points lower than the previous year
Red	More than five percentage points below the previous year

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

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

Unit of measure: Percentage of customers surveyed.

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

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

Status:

Green	Greater than previous year
Amber	Equal to or up to five percentage points lower than the previous year
Red	More than five percentage points below the previous year

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

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

Unit of measure: Percentage of customers surveyed.

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

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

Status:

Green	Greater than previous year
Amber	Equal to or up to five percentage points lower than the previous year
Red	More than five percentage points below the previous year

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

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

Unit of measure: Percentage of customers surveyed.

A constant supply of high-quality drinking water

Water quality (Mean Zonal Compliance)

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

Status:

- Equal to 100%
- Less than 100% but greater than 99.95%
- Less than or equal to 99.95%

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

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

Unit of measure: Percentage.

Number of contacts regarding discolouration per 1,000 population

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

Status:

- Less than or equal to 0.82
- More than 0.82 but less than 0.86
- More than 0.86

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

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

Unit of measure: Number per 1,000 population.

Leakage reported

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

Status:

- Average of years from 2015–16 to report year is below 87 megalitres per day
- Average of 2015–16 to report year is above 87 but forecast average for 2015–16 to 2019–20 is below 87 megalitres per day
- Average of 2015–16 to report year is above 87 and forecast average for 2015–16 to 2019–20 is above 87 megalitres per day

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

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

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

Customer minutes lost supply greater than three hours

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

Status:

- Less than or equal to nine minutes/property/year
- More than nine but less than or equal to 12 minutes/property/year
- More than 12 minutes/property/year

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

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

Unit of measure: Minutes/property/year.

A constant supply of high-quality drinking water

Number of properties with low water pressure

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

Status:

Status	
Green	Less than or equal to 257 properties
Amber	More than 257 but less than 296 properties
Red	More than or equal to 296 properties

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

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

Unit of measure: Number of properties.

Number of customers affected by temporary use bans

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

Status:

Status	
Green	No temporary use bans applied during the year
Amber	Temporary use bans applied following two consecutive dry winters
Red	Temporary use bans applied in the year, not preceded by two consecutive dry winters

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

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

Unit of measure: Number of properties affected.

Maintain water asset health

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

Status:

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

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

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

Unit of measure: Rating.

Measurement of components:

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

Removing wastewater effectively

Number of blockages per km per year

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

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

Reward/penalty: Penalty only – annual maximum penalty £1.004 million.

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

Unit of measure: Number per km.

Number of internal flooding incidents

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

Status:
- Less than or equal to 392 for the year
- More than 392 but forecast total for 2015–16 to 2019–20 is less than 2,070
- Forecast total for 2015–16 to 2019–20 is more than or equal to 2,070

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

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

Unit of measure: Number of incidents.

Number of external flooding incidents

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

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

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

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

Unit of measure: Number of incidents.

Number of customer complaints regarding odour

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

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

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

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

Unit of measure: Number of odour complaints.

Removing wastewater effectively

Maintain wastewater asset health

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

Status:

Green	Stable. All components above the upper performance level
Amber	Improvement required. One or more components is below the upper performance level but not below lower performance level
Red	Significant improvement required. One or more components are below the lower performance level

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

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

Unit of measure: Rating.

Measurement of components:

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

Looking after the environment

Wastewater treatment works compliance

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

Status:

Green	100.0%
Amber	Less than 100.0% but more than or equal to 97.7%
Red	Less than 97.7%

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

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

Unit of measure: Percentage of works.

Maintain the number of bathing waters with excellent water quality

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

Status:

Green	More than or equal to 54 bathing waters
Amber	Less than 54 but more than or equal to 48 bathing waters
Red	Less than 48 bathing waters

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

Measurement: Performance is calculated in accordance with the methodology, which is published by Defra, for measuring bathing water quality against the revised Bathing Water Directive. The measure of 'excellent' water quality is no more than 100 Intestinal Enterococci cfu/ml and 250 Escherichia coli cfu/ml in at least 19 out of 20 samples.

Unit of measure: Number of bathing waters.

Looking after the environment

Number of serious pollution incidents (category 1 and 2)

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

Status:
- Less than two incidents
- Equal to two incidents
- More than two incidents

Reward/penalty:	Pollutions may incur fines for each serious pollution incident.
Measurement:	Performance is stated in accordance with the number of pollution incidents, categorised as 1 and 2, reported by the Environment Agency on MD109.
Unit of measure:	Number of incidents.

Number of pollution incidents (category 3)

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

Status:
- Less than or equal to 158 incidents
- More than 158 but less than 175 incidents
- More than or equal to 175 incidents

Reward/penalty:	Penalty only – annual maximum penalty £2.16 million.
Measurement:	Performance is stated in accordance with the number of pollution incidents, categorised as 3, reported by the Environment Agency on MD109.
Unit of measure:	Number of incidents.

Distribution input

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

Status:
- Less than or equal to 526.79
- More than 526.79 but less than 533.97
- More than 533.97 megalitres

Reward/penalty:	Reputational only, no financial reward or penalty.
Measurement:	Performance is calculated in accordance with Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 10 Non-financial measures – water delivered'. The unit of measurement is post-Maximum Likelihood Estimation Distribution Input.
Unit of measure:	Megalitres per day (Ml/d).

Renewable energy usage

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

Status:
- More than or equal to annual target of 16.5%
- Less than 16.5% but the forecast for 2019–20 is more than 16.5%
- Less than annual target and forecast for 2019–20 less than 16.5%

Reward/penalty:	Reputational only, no financial reward or penalty.
Measurement:	The percentage of renewable energy generated out of total operational energy used in the financial year is calculated in accordance with methodology developed for Southern Water's business plan.
Unit of measure:	Percentage.

Looking after the environment

Greenhouse Gas Emissions

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

Reward/penalty: Not applicable.

Measurement: Greenhouse gas emissions are calculated in accordance with the UK Water Industry Research (UKWIR) Carbon Accounting Workbook, which is a standardised approach to estimating operational greenhouse gases to meet the requirements of Ofwat and Defra for carbon accounting.

Unit of measure: Kilograms carbon dioxide equivalent ($KgCO_2e$).

Greenhouse Gas Emissions per person supplied with drinking water

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

Reward/penalty: Not applicable.

Measurement: Greenhouse gas emissions are calculated in accordance with the UK Water Industry Research (UKWIR) Carbon Accounting Workbook, which is a standardised approach to estimating operational greenhouse gases to meet the requirements of Ofwat and Defra for carbon accounting.

Unit of measure: Kilograms carbon dioxide equivalent per person supplied with water ($KgCO_2e$/person).

Greenhouse Gas Emissions per person supplied with wastewater services

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

Reward/penalty: Not applicable.

Measurement: Greenhouse gas emissions are calculated in accordance with the UK Water Industry Research (UKWIR) Carbon Accounting Workbook, which is a standardised approach to estimating operational greenhouse gases to meet the requirements of Ofwat and Defra for carbon accounting.

Unit of measure: Kilograms carbon dioxide equivalent per person supplied with wastewater services ($KgCO_2e$/person).

Appendix 3. Glossary of Regulatory Terms

Appointed business

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

Arm's-length trading

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

Asset Management Plan (AMP)

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

Associate company

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

Final Determination (FD)

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

Financing adjustment

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

K factor

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

Licence

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

Non-appointed business

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

Ofwat

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

Outcome Delivery Incentive (ODI)

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

Periodic review

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

Price control

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

Regulatory Accounting Guidelines (RAG)

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

Regulatory Capital Value (RCV)

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

Retail Price Index (RPI)

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

Service Incentive Mechanism (SIM)

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

Totex

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

Working capital

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

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