Annual Performance Report

Regulatory reporting 2020–21

from Southern Water

Contents

Regulatory information and annual performance report

Introduction

Our Annual Performance Report sets out the performance in 2020–21 of Southern Water's regulated business, as defined under our Licence[1], in financial terms and against our business outcome and performance commitments.

This Annual Performance Report comprises four sections:

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

The additional information required under RAG 3.12, covering the more technical tables in sections 4 to 9 including tables 4B, 4L and 4M, has been published alongside this document as an appendix to the Annual Performance Report and can be found at **southernwater.co.uk/our-reports**.

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

In addition a new requirement for this year is a board statement on the accuracy and completeness of data and information. This is supported by the publication of 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 2020–21.

Board Statement of Company Direction and Performance

In the sections below we, as the Board of Southern Water, describe how we set the direction of the company and ensure it is delivering performance that meets customers' and stakeholders' expectations. In particular, we describe how the company developed the longer-term vision and Business Plan for the period 2020–25 and how it has continued to engage with customers in the delivery phase of the plan, ensuring that our response to the COVID-19 pandemic reflected the needs of our customers. We also describe how we, the Board, monitor performance and risk, how we have performed against our business plan objectives during 2020–21 and how performance affects the returns to shareholders and the pay of our executive team.

Our vision and business plan for 2020–25

The purpose of Southern Water is to provide water for life to:

- enhance health and wellbeing,
- protect and improve the environment,
- sustain the economy.

To deliver that purpose, we have set out an ambitious vision to create a resilient water future for customers in the South East.

Our vision and purpose reflect careful consideration and analysis of the key influences on our sector and within our region including:

- 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

This vision is reflected in our business plan for the current regulatory period, 2020–25, which sets out how we will improve services to customers and deliver significant benefits to the environment.

This five-year plan was rooted in our careful consideration of the critical driving forces and high impact uncertain variables within the region we operate, factors such as a forecast 25% increase in population by 2050, a 35% fall in river flows and an increase in the severity and frequency of extreme droughts. This long-term analysis was published in the ground-breaking document 'Water Futures for the South East: Towards 2050'[2].

Our stakeholders and customers also played a key role in shaping our vision and our business plan for the period 2020–25. We carried out over 42,000 direct interviews with customers and other stakeholders to inform our strategy and develop our business plan. In the development of our business plan 2020–25, our customers told us that as well as thinking about the challenges of the future, they have an expectation that we will continue to deliver on the basics – clean, high quality drinking water and effective wastewater systems. These twin goals of delivering the basics brilliantly and planning for the future are reflected in our plan which is built around five service-based outcomes and five transformational programmes.

[1] 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.

[2] southernwater.co.uk/media/default/PDFs/water-futures.pdf

Our plan for this period, agreed with Ofwat in December 2019, will see 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 18% in real terms.

One year in to the regulatory period, delivery of the plan is now well under way through an Execution Plan designed to deliver our business plan and a subsequent Business Continuity Plan which prioritised customer service and support during the COVID-19 pandemic. As we deliver our plans, we are committed to continuing to engage with our customers and stakeholders to ensure that not only are we delivering the improvements that we have committed to, but we do so in a way that continues to meet their needs and preferences.

The extraordinary circumstances of the past year, which has been dominated by responding to the challenges of the COVID-19 pandemic[3], have underlined the need for us to engage with our stakeholders and customers continually. Customers have become far more aware of the essential services we provide, of the communities and neighbourhoods in which they live, and of those who might need access to additional support. It is important that as our customers' circumstances change, the service we provide continues to meet their needs. Over the past year we have therefore focused much of our engagement on ensuring we understand our customers' differing needs, and how these have changed during the pandemic.

We have also needed to adjust our approach to engaging with customers, making more use of digital engagement platforms and online forums to gather insight. We have used innovative approaches such as 'audience journalism' where the lead respondent shares key points within their household to feedback insight from whole families and groups of friends.

This commitment to ongoing engagement and co-creation with our customers and stakeholders forms the bedrock of our customer participation strategy. Our strategy is rooted in 12 Participation Principles that are the guiding framework for customer engagement, designed with our company values at their heart.

- **Doing the right thing** – We start by thinking about participation first, so that it is easy and accessible for customers to engage. We are inclusive in our approaches, ensuring that we explore the diversity and different experiences of our communities. We then integrate multiple sources of insight and bring it together defining one clear voice of the customer.
- **Always improving** – We innovate in our approaches and are open to challenge to find new and engaging methods for customers to participate. We design approaches that are iterative so customers can get closer to the detail of our industry and share learning from others.
- **Succeeding together** – We collaborate with others, sharing best practice by partnering and building relationships over time. We share plans to link up different programmes of activity that allow customers to have an ongoing and two-way dialogue on our current performance and future plans.

As well as ensuring we understand customers' changing short-term needs, we also continue to engage on more strategic issues, including development of our Water for Life Hampshire programme, which is our programme to deliver significant additional resilient, sustainable water supplies to that region. In February 2021 we launched our first consultation on our plans, which included a virtual exhibition for customers and stakeholders to explore the challenges and contribute to co-creating solutions for the region.

And, as we begin the process for developing our next business plan for the 2025–30 period, we launched two new customer groups:

- Water Futures 2050 (our young person's group); and
- Water Futures 2030 (our household customer panel).

These groups provide a central hub for members to provide insight, help us develop clear materials for engagement with other customers and challenge our strategic plans. These hubs help to connect the range of engagement activity and ensure customer insight can feed in at every stage quickly, efficiently and through best practice guidance as set out by the Consumer Council for Water (CCW).

[3] See our Annual Report for more details of how in response to COVID-19 we revised our business continuity plan to deliver against the four priorities of: (i) Maintaining provision of essential services at all times; (ii) Protecting the health, safety and wellbeing of our employees, including our supply chain, and our customers; (iii) Providing the maximum practicable level of assistance to our vulnerable customers; and (iv) Protecting the financial stability of our business

Delivering for our customers

Our business plan for 2020–25 includes some ambitious targets to improve the service that we provide to customers. These include:

- A 15% reduction in leakage and a 23% reduction in water supply interruptions
- A 20% reduction in both internal and external sewer flooding incidents and a reduction in the number of pollution incidents from over 400 per year to fewer than 80
- Generating 24% of our energy from renewable sources
- Further increasing the number of beaches achieving Good and Excellent water quality status
- Improving the health of the rivers in our region

Over the past 18 months we have been investing in our systems and processes to set us up to deliver these ambitious targets. We have put in place a new Integrated Business Planning (IBP) framework and embedded the Risk and Value process to ensure we are driving the maximum benefits from our capital projects. Following review and challenge by the Board, in March 2021 the board approved the second iteration of our Execution Plan (EP21) which has been developed through our IBP process and sets a clear path to delivery of our promises to customers within the very tight financial envelope set by Ofwat for the 2020–25 period.

Details of our performance against our targets for the first year of this business plan period 2020–21 are provided in the Strategic Report section of our Annual Report and Financial Statements. In addition details of our performance against our commitments are set out in Table 3A on page 55.

Reflective of the very significant performance challenges that Ofwat set within its final determination (the basis on which our plan for 2020–25 was approved), during the current year we have incurred significant penalties under Ofwat's Outcome Delivery Incentive (ODI) regime. Penalties for missing performance targets in this first year totalled £47 million (including forecast penalties for C-MeX and D-MeX), which will be reflected in reductions in customer future bills. Two-thirds of these penalties arise from just three ODIs: wastewater treatment works compliance (£19 million); Pollution incidents (£8 million); and customer performance, C-MeX (£5 million).

While this is clearly a disappointing outcome our EP21 plan charts a clear pathway to meeting all of our very challenging performance targets by the end of the five year period, with a forecast of small ODI rewards by the fourth year of the period (2023–24). This step-change in performance will be enabled by the transformational operational and asset management improvements delivered over the last few years. It will also be underpinned by the delivery of three significant new programmes which the Board approved over the last year – Network Digitisation; Logistics Optimisation; and, Dynamic Asset Maintenance (on page 6).

Specific improvement plans are in place to address the three areas which accounted for the bulk of our 2020–21 ODI penalties.

- Wastewater treatment works compliance improvements will be driven through our new 'Go to Green' process, which was mobilised in September 2020 and embeds new ways of working which put compliance at the heart of our operations.
- Our Pollution Incident Reduction Plan, which we first published in September 2020 and refreshed in June 2021 details our analysis of the root causes of our pollution incidents and the remedial measures we are putting in place to address pollution.
- C-MeX improvements will be addressed by our Velocity customer service improvement programme, which has already delivered some positive progress in reducing the need for customer calls, improving first time contact resolution and increasing the proportion of digital transactions.

The Board and the Executive Leadership Team (ELT) closely monitor the delivery of strategic programmes and track the resulting performance against our regulatory commitments through a refreshed performance dashboard. In addition our Operations Committee, focuses on tracking performance through leading indicators, identifying corrective actions where necessary and driving our focused performance improvement plans.

Over the next few months we will also establish our new Environment and Climate Challenge Group. The group will comprise senior stakeholders from across the region and will provide advice and challenge to the company and the board on the development of our strategic plans including our Water Resources Management Plan, Drainage and Wastewater Management Plan and our 2025–30 business plan, as well as the delivery of our business plan improvements.

Strategic programmes to drive performance

To supplement the ongoing work to address some of the weaker areas of performance, which we describe above, to support our continuous service improvement and delivery of our performance commitments to customers, we have initiated three strategic programmes to drive performance. The three programmes are:

i) **Network Digitisation and Cognitive Control:** This is an extensive programme to add monitoring to our waste network and assets and link these with a full-time proactive control centre; across our water networks, we will build on to the significant monitoring in place, creating a 'Calm Network' operating approach.

ii) **Logistics Optimisation:** This will integrate the movement of resources, materials, and parts across the entire business, reducing asset downtime, improving response capability, and business efficiency.

iii) **Dynamic Asset Maintenance:** This programme has two key aspects: (i) targeting poorly performing assets, bringing their reliability and performance back into line; and, (ii) shifting from reactive to a proactive and predictive maintenance regime, using asset data and insight to drive maintenance interventions to reduce customer and environmental impact.

Taken together with our Operational Asset Management programme, these three programmes will drive asset management efficiency and effectiveness over this business plan period and put us on a much stronger footing heading into the next five-year period (2025–30). They will enable us to deliver ODI and outcome performance benefits and improved asset resilience.

Aligning performance and rewards

Ofwat has put in place mechanisms that provide financial and reputational incentives for us to deliver more of what our customers want for less.

We have 47 performance commitments, agreed as part of the price review process, that we report on annually (see Section 3 of this report). Reporting our performance in this way to stakeholders provides a reputational incentive to meet our commitments.

In addition, 31 of our performance commitments include financial penalties and rewards associated with delivering for our customers. If we beat our targets, delivering more of what customers want, we can earn rewards, which means shareholders enjoy higher returns. 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. As noted above, for the 2020–21 reporting year we have incurred total penalties of £47 million.

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

Our employees are incentivised to deliver for customers through a company-wide bonus scheme, 'yourBonus'. A majority of the measures associated with the bonus scheme relate to delivering excellent customer and environmental service while the remainder are focused on efficient delivery of our plan. The bonus earned by each employee is dependent on the delivery of these company-wide objectives as well as their individual performance rating. The scheme aligns the incentives for all employees with the interests of our customers. These arrangements are also subject to external assurance as part of the undertakings given to Ofwat in 2019 in relation to historic misreporting of our wastewater performance (Section 19 Undertakings).

Our executive remuneration policy was updated last year and, following consultation with Ofwat, it now more closely links executive remuneration with overall company performance for customers, stakeholders and communities. For 2020–21, under our updated remuneration policy, at least 50% of variable pay was directly linked to customer outcomes (and in practice this will be significantly more). The key performance measures include performance on our ODIs, C-MeX and developer service performance D-MeX, health, safety and wellbeing, net zero, employee engagement and cash flow.

To ensure sustainable improvements in performance, it is our policy to defer 50% of the earned bonus of the executive, so performance can be measured over the long term. The scheme allows for the possibility of a reduction or clawback of bonuses already earned, or those deferred, to ensure performance outcomes are measured over the longer term. Full details of our executive remuneration policy and details of its application in respect of 2020–21 are set out in our annual report **southernwater.co.uk/our-performance/reports/annual-reporting**.

As well as ensuring the right incentives are in place, it is important that we strike the right balance between providing a fair return to shareholders and investing for customers. Our updated dividend policy for the 2020–25 period incorporates a wide range of measures, including financial and customer performance measures. It also explicitly considers the financial resilience of the company and whether any financial outperformance should be re-invested to benefit our customers.

The Board has resolved that the company will not pay dividends until it is clear that to do so would not be detrimental to the company's financial position.

Ofwat Board Leadership, Governance and Transparency principles

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

In February 2021 Ofwat published its annual report on how companies are meeting the principles, based on the information provided in their 2019–20 annual reporting. Our development of metrics to provide indicative measures of our company culture was cited by Ofwat in its review as an example of good practice. In preparing our 2020–21 reporting we have taken account of Ofwat's general findings as well as taking specific steps to address the two issues Ofwat highlighted as requiring further explanation. These concerned the relationship between board accountability and the existence of a small number of shareholder-reserved matters and the detail of the metrics used to determine executive remuneration (which were still under review at the time of publication of our 2019–20 remuneration report).

In addition, we have strengthened the work we do to satisfy Condition P of our Licence. This requires us to demonstrate that the Board has made appropriate diligent enquiry into the activities of the business and can evidence that the company will, for at least the next 12 months, have sufficient financial resources and facilities, management resources and methods of planning and control in place to meet our statutory duties. The Condition P requirements are also a key part of our Section 19 Undertakings to Ofwat in connection with our historic misreporting (see page 10), and was subject to external assurance from our external auditors (Deloitte LLP).

Annual risk and compliance statement

The annual risk and compliance statement describes the steps we have taken to understand and meet our customers' expectations and to ensure we meet our statutory and regulatory obligations, as well as the expectations of our key regulators, Ofwat, the Environment Agency and the Drinking Water Inspectorate. It also sets out how we manage and mitigate any compliance risks identified.

Customer expectations

Our Business Plan for the period 2020–25 was based on the results of engagement with more customers than ever before (over 42,000 direct interviews). To drive a deeper understanding of customers we used innovative techniques such as ethnographic mobile apps and integrated 'willingness to pay' surveys to provide a single triangulated view of our customers' preferences.

As we have moved in to the delivery phase of our plan we have continued to engage extensively with customers to ensure that our plans and approach to delivery continue to meet their needs and expectations. While the effects of the COVID-19 pandemic have meant we have had to be more innovative in our engagement methods, as we could not meet customers face-to-face, our engagement has continued. Indeed, we have gained experience in using alternative techniques for engagement – such as virtual exhibitions and 'audience journalism' through which we capture views from whole families and groups of friends – which have enabled us to reach more customers than we might have done using traditional methods. As the restrictions lift, we will continue to take forward many of these new approaches.

Through the pandemic we have seen significant changes in the way that our customers use water, with much more water being used in the home as many people were unable to attend their workplaces and an increasing emphasis on hand washing for hygiene and infection control. Our customers have become much more aware of the essential nature of the service that we provide and the impact of interruptions to supply is magnified. We have also seen that more customers have struggled to manage their finances as a result of the impacts of the pandemic. This has driven our focus on understanding and responding to customers differing and changing needs, including providing significantly more financial support for customers struggling to pay their bills. The Board's insight in to the challenges faced by many of our customers has been enhanced by the presence on the board of Dame Gillian Guy, the Chief Executive of Citizens Advice for more than 10 years.

As well as focusing on the impact of the pandemic on our customers' priorities, over the past year we have engaged extensively with customers on our plans for ensuring long-term sustainable water supplies in Hampshire, including launching our mobile exhibition in February 2021. In addition, we have launched two new forums – Water Futures 2050, a young person's group, and Water Futures 2030, a new household customer panel. These build on the success of our Customer Action Groups. They will provide a central hub for members to provide insight, help us develop clear materials for engagement with other customers and challenge our strategic plans. They help to connect the range of engagement activity and ensure customer insight can feed in at every stage quickly, efficiently and through best practice guidance as set out by the Consumer Council for Water (CCW).

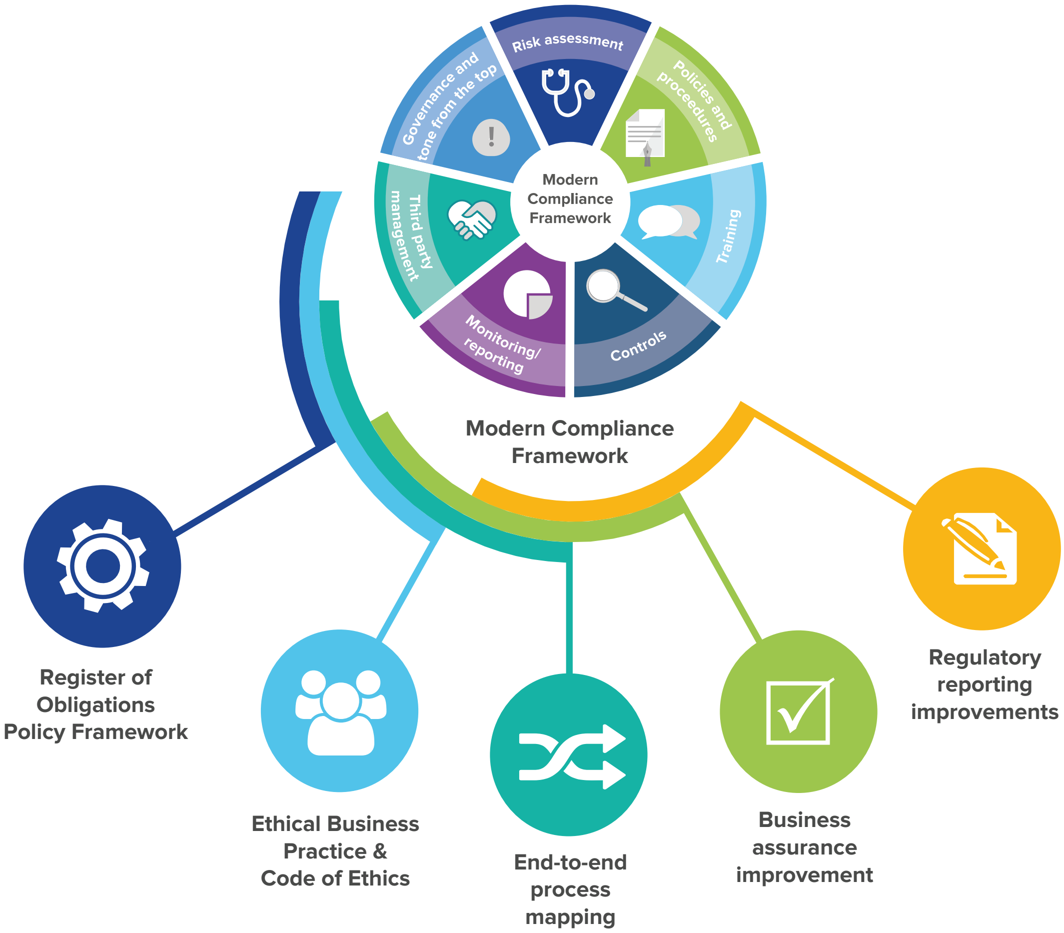
Statutory and regulatory obligations

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. As a regulated service provider, our primary obligations and duties are set out in the Water Industry Act 1991, the Drinking Water Regulations and our Instrument of Appointment (the Licence). These set the standards under which we must provide our services.

Southern Water is committed to driving structural and cultural change to support the development of a transparent and ethical compliance framework. We operate our Modern Compliance Framework (MCF) which was introduced four years ago and continues to be embedded across the company. The framework brings together key elements of our approach to risk and compliance (see Figure 1) including in relation to our regulatory obligations, our policy framework, ethical business practice and work to improve the quality and transparency of our regulatory reporting. This work is supported by strong governance in key areas of our operation (most notably in our monitoring and reporting programmes) backed up with strong training programmes to ensure good practice is embedded in all areas of the company.

We have clear roles and responsibilities with a dedicated Risk and Compliance function which provides a separation of duties in monitoring key performance of drinking water quality and wastewater performance. This function also provides internal assurance of our frontline teams.

Figure 1 – Performance Improvement under our Modern Compliance Framework



In the past the company has not met its own high expectations, and our performance has not been as good as our peers in the industry or as good as our customers might expect. We continue to work with our regulators, Ofwat, the Drinking Water Inspectorate (DWI) and the Environment Agency to implement improvements and to fully embed these changes.

Ofwat continue to scrutinise our response to the investigations into the management and operation of our wastewater treatment works. This is enacted through our Section 19 Undertakings, and is subject to six-monthly independent external assurance of the on-going programme of work to bring the company back into compliance. The Undertakings also include work to embed further changes to ensure we meet the expectations of our customers and wider stakeholders, as well as our regulators. We set out the details below.

The Environment Agency (EA)

The Environment Agency is shortly due to release the Environmental Performance Assessment for 2020, in its annual report on the environmental performance of the nine English water and sewerage companies. Our performance for 2020 has been rated at two star (requires improvement). This represents an improvement from the company's one star (poor performing company) performance rating in 2019. The EA has recognised that the company's culture has changed for the better and continues to seek performance improvement in key areas as below.

The Environment Agency has recognised that we continue to make good progress in the area of self-reporting of pollution incidents and we are one of the leaders in the industry in this regard. This continued good performance is evidence of how embedded our pollution reporting improvements have become. The EA also recognised improvements in our approach to catchment management and drainage and wastewater management planning. Our Environment+ programme continues to act as a focus for our improvement activities. This year we have also launched 'strategic programmes' (see page 6) which together with Environment+ drive internal transformation across all environmental wastewater and water operations.

In 2019 the Environment Agency expressed concerns about our performance in a number of areas, including an unacceptable number of pollution incidents. Performance during 2020 has shown an improvement of 10% reduction from 2019 as our Pollution Incident Reduction Plan improved performance in the later part of 2020.

The first quarter of 2020 in particular saw some very wet weather which followed a very wet 2019 winter. February was our worst month for pollutions and correlated with the wettest February on record. This is obviously not acceptable and our assets should be more resilient to these types of events and this is something we need to improve on.

Despite the challenging start to the year there are improvements – the number of wastewater treatment works incidents reduced by approximately 40%. Our performance in the last three months of 2020 was 46% better than the same period in 2019. The number of serious pollutions reduced from seven in 2019 to four in 2020.

We have continued to work to understand the conditions that create these risks ahead of time, finding and fixing problems more quickly, and targeting investment at those sites most likely to fail.

Our performance on wastewater treatment works compliance deteriorated in the early period of 2020. Overall there were 10 failed works in 2020. Compliance Process Assessment and Control processes for taking plant in and out of service, and the delivery of storm and winter plans to manage impact of weather have been introduced. In addition we have launched a new 'Go-to-Green' management process which has now been mobilised. The process will help to reduce the number of sites at risk by supporting strategic improvements for maintenance and proactive control.

A number of our projects in our National Environment Programme did not achieve completion by their regulatory dates due to a combination of planning, design or construction challenges. We recognise this is an area to improve and remains a key focus for the company. COVID-19 has had an impact on our delivery across our programmes and increased the risk of delivery to all schemes but in the majority of cases these challenges were accommodated.

We have seen a significant change in levels of water consumption, usage and customer behaviour as a result of the COVID-19 pandemic. The change in working patterns has resulted in a change from non-household to household usage, driven by fewer people in the workplace, school closures, leisure sector closures, and industrial closures (manufacturing, catering and travel). Furthermore, there has also been a substantial increase in everyone washing their hands much more regularly, and a rise in household jobs (decorating, pressure washing, cleaning and gardening) which has resulted in customers increasing their water usage at home. This increase is statistically significant in Kent and Hampshire and also linked to the commuter areas where the population has been working from home. These changes in household consumption have been accommodated within the headroom of our Security of Supply Index (SOSI) and our SOSI is assessed at 100%.

We have continued to see improvements in abstraction license compliance over the past year, despite the restrictions imposed by COVID-19 and those improvements have been recognised by the Environment Agency.

Like other wastewater operators, in the normal course of operations we occasionally face Environment Agency investigations. The company has been subject to a detailed investigation regarding permit breaches at some of our wastewater treatment works in two locations during the period 2010–15. In February 2020 the Environment Agency presented 51 charges before the court and we entered guilty pleas to these charges. We will continue to be open and transparent and are committed to working with the agency to ensure a swift conclusion to resolve the case.

We are also committed to assisting the Environment Agency with its separate investigation into sampling compliance and reporting issues between 2010 and 2017 (inclusive). As the investigation is ongoing, we are not able to say any more about it at this time.

In addition to the work we are implementing as part of Environment+, we continue to of deliver a range of initiatives to improve our wastewater treatment compliance and wider compliance performance and culture. Some of these initiatives are within the scope of on-going legal commitments we have made to Ofwat but the programme extends into other operational areas where we can see further improvement on performance is also required. Progress and the effectiveness of this programme of activity is being monitored by the Audit Committee and is independently assured and reported to Ofwat.

Ofwat

As reported previously, Ofwat undertook an investigation into our wastewater reporting that resulted in enforcement action being taken against us. This led to a decision to impose a financial penalty of £3 million. In addition, we agreed to make significant customer bill rebates, totalling £122.9 million (in 2017–18 prices), between 2020 and 2025. On 8 October 2019 we signed formal Undertakings pursuant to Section 19 of the Water Industry Act 1991 relating to the numerous changes we have put in place, and are putting in place, to ensure that the issues identified in the investigation have been stopped and cannot be repeated.

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

A. Customer redress measures;

B. Technical review of Wastewater Treatment Works;

C. Organisational compliance process measures;

D. Organisational cultural change measures;

E. Ensuring Transparency;

F. Condition P Certificate Assurance Undertaking and

G. Reporting on Compliance with the Undertakings.

We continue to make progress on all the Undertakings, with some of them now substantially complete. Our focus now moves to embedding the improvements and monitoring the effectiveness of that embedment. We have reduced our wastewater charges to existing customers from April 2020 and have made payments to eligible former customers as part of our Customer redress measures in Undertaking A. These have been delivered and were subject to external assurance as part of our progress updates to Ofwat.

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

- Values: Refreshing the Southern Water vision, mission and purpose;
- Employee Engagement;
- Management Training;
- Ethical Business Practice;
- Speak Up whistleblower policy; and
- Employee Incentives.

We also have a Culture Collaboration Group that meets monthly to provide programme oversight and to share ideas and best practice on positively influencing culture change. This includes reviewing outputs from our employee engagement survey to inform future delivery of culture change initiatives. The employee survey results from 2021 indicate a meaningful improvement in employee engagement, demonstrating increased understanding of the Company values and improved confidence that colleagues and the Company act in an ethical manner. In addition, one of our non-executive directors, Kevin McCullough, has a specific role to support employee engagement. We publish a quarterly Measures of Culture Dashboard and company balanced scorecard for all colleagues to be able to see and understand our progress and performance.

Our culture change progress is reported regularly to the executive leadership team and our Board.

We delivered plans for improved transparency on environmental performance information in our dedicated website (**southernwater.co.uk/our-performance/environmental-performance**). The information available includes pollution incidents, wastewater flow and spill reporting, wastewater treatment works final effluent compliance, regional bathing water compliance results, carbon emissions and river levels.

Compliance with the Section 19 Undertakings and progress of these actions was reported to Ofwat in our February 2021 Compliance Monitoring Report. Overall, we have made progress in fulfilling the actions required to ensure compliance with the Undertakings; actions are progressing, or a progression plan is in place, against all elements of the Undertakings. Our second-line theme-level assessment of progress and embedment of the undertakings is aligned to the views of our third-party assurer KPMG LLP. For those undertakings out of scope for KPMG LLP assurance we have updated our internal assessment of compliance and confirm this remains in line with the previous assessment made by PwC in the Deep Dive in August 2020.

Additional information on the investigation can be accessed in the Ofwat investigation report, which can be viewed at the following link **ofwat.gov.uk/wp-content/uploads/2019/06/Notice-of-Ofwats-proposal-to-impose-a-penalty-on-Southern-Water-Services-Limited-1.pdf**.

In addition, the Section 19 Undertakings require us to provide additional assurance on Board compliance with Condition P (previously Condition I as a result of changes to our Instrument of Appointment) of our Ofwat licence (please refer to page 16 for more detail).

The Drinking Water Inspectorate

We continue to progress in the transformation of our drinking water quality performance, with year-on-year improvement in our Compliance Risk Index (CRI), although further improvement is still required in this metric. Disappointingly, our Event Risk Index (ERI) metric deteriorated significantly due to a water quality event, where the wrong equipment was used, and this constituted 92% of our annual performance for this metric. We expect this to make us an outlier in the sector. In response we have carried out further audits on both internal controls and supply chain partner controls along with further training to avoid a reoccurrence. We are also sharing our findings with other companies to assist their learning.

We continue to work closely with the DWI and report frequently on our performance and our transformation action plans.

During 2020–21 we completed the last Section 18 Final Enforcement Order (FEO) regarding a final asset improvement scheme at Shoreham water supply works, which was then formally revoked by the DWI. This brings to a conclusion our work to close the four FEOs that were put in place from 2016 onwards.

We are implementing a broad programme of activity helping to improve our information management systems and process, including a risk-based review of monitoring, procedures, and manual intervention involved in all critical information systems. This package of work continues through to 2025 and includes a programme of asset and IT improvements designed in cooperation with the DWI. This work is within the scope of our Section 19 Information Management Undertaking with the DWI which formalises this element of our programme.

Separately we have continued to work with the DWI to improve our documentation and mitigation of water quality risk. We have completed a programme to identify water quality risks at all our water production sites and have undertaken to complete the required improvements over the next six years. These 'HazRev' reviews were identified in the DWI Chief Inspector's report as 'showing real outcome improvements'. We gave an undertaking to the DWI to complete a similar process at our network residual disinfection booster stations during 2020–21 and we are now moving on to do HazRevs of our treated water storage assets.

COVID-19 and its challenges meant that we needed to adapt and take our water quality monitoring samples from other locations to avoid entering customer households during the pandemic wherever possible. Despite the additional challenges of COVID-19 we maintained very high water quality monitoring performance with only two failed tests out of 228,000 in the 2020 programme.

On 31 March 2021 the DWI sent a letter confirming its decision to proceed to prosecution in relation to an event in May 2018 when high chlorate levels were detected at High Park reservoir. It is understood that the charges will be for breaches of Regulation 31 Water Supply (Water Quality) Regulations 2016 in relation to the storage and use of Hypochlorite at the High Park booster station.

The DWI closed their investigation into a further operational event from 2014–15 and issued the company with a formal warning.

Reporting our performance

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

Following historic failings in the quality of our reporting to our regulators, we continue to embed our programme of improvements to ensure our regulators and other stakeholders can trust the data that we report. These improvements have been led by our Risk and Compliance directorate which is ensuring compliance reporting to our regulators is subject to sustained internal review and assurance. Further information on this programme can be found in our Data Assurance Summary 2020–21, 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. For the business plan period 2020–21, this information was provided to the Board by way of a detailed performance dashboard, including a selection of 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 statutory obligations. This included a review of our compliance with our Instrument of Appointment which was presented to our Audit Committee in March 2021.

In November 2020, Ofwat published new guidance following a consultation on the regulatory reporting requirements for 2020–21 reporting year. As part of the guidance companies are expected to continue to strive for best practice in their assurance arrangements. Ofwat appear to be moving away from a prescriptive approach to assurance and instead companies are being asked to provide a board assurance statement, stating that the data and information provided is accurate and complete and setting out any exceptions to this.

Ofwat seeks to minimise the extra burden on companies of increased reporting and allow companies the flexibility to adopt approaches which suit their own particular circumstances. Previously, under Ofwat's Company Monitoring Framework (CMF) all companies were asked to meet minimum standards of assurance. Ofwat have indicated we may choose to continue with some of these mechanisms, however, there is no expectation for us to do so. At present there are no plans for us to change our approach to assurance; we are responding to the new guidance and will add the new governance requirements to our existing approach.

Each year we also seek to engage with our customers, employees and stakeholders to help us identify any risks, strengths and weaknesses associated with our reporting. We published the findings of this exercise in November 2020, with an invitation to stakeholders to comment on the findings. The publication set out how we would respond to stakeholders' feedback and detailed how our corporate assurance practices would meet our reporting compliance obligations. Our Final Assurance Plan was published on 30 March 2021. It set out how we planned to assure the financial and non-financial information that we publish in our Annual Performance Report.

In line with the Final Assurance Plan, KPMG LLP, as our independent non-financial assurer, completed the assurance of selected Performance Commitments, Outcome Delivery Incentives (ODIs) and selected Cost Assessment data. KPMG LLP provided Southern Water with an unqualified ISAE (UK) 3000 opinion for the last year over the selected Performance Commitments reported in Section 3 of the Annual Performance Report and over selected cost assessment data reported in the Annual Performance Report data tables. In line with Ofwat's RAG 3.12, the remaining data tables 4J to 9A including the selected cost assessment data which form part of the Annual Performance Report are published separately as an appendix at **southernwater.co.uk/our-reports**.

A programme of process and control improvements has been worked through over the last three years and continues into the current year. These have been focused on key data returns to Ofwat, DWI and the EA and include improvements in our reporting control environment.

In the Technical Audit report in June 2021, KPMG LLP reported that improvements to processes and controls in previous years had been maintained. Areas of further improvement have been identified, including to the control environment and the automation of a number of manual processes used in the reporting. For more detail see our Data Assurance Summary 2020–21.

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 sections 4 to 9.

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 non-financial 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 Ofwat Compliance Framework (OCF) 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 new OCF framework is an update of the previous Regulatory Compliance Framework. The former is in place for business plan period (2020–25) the latter was in place during the previous business plan period (2015–20). The OCF framework is subject to external assurance by KPMG LLP as part of our annual data submission to Ofwat.

We have seen improvements in quality of our reporting to the DWI, the EA and Ofwat. These improvements are part of an on-going programme of improvements that will continue well into the current business plan period and beyond.

All members of the ELT are required, every six months, to provide a declaration that they and their teams are fully compliant with our procedures and controls for areas of the business for which they are accountable. An action plan is required to address any areas of non-compliance. We have made improvements to this 'Statement of Compliance' process during the year. The updated process includes additional internal assurance and coordination of resulting action plans, and provides a compliance maturity assessment of each directorate.

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

We have delivered a review of our Customer Charter and the policy, procedures and monitoring in relation to customer appointments, which has focused on identifying past, current and future compliance with the Guaranteed Service Standards (GSS) regulations and further improving the customer experience. This review has now concluded and confirmed that some appointments had not been made in full accordance with the GSS regulations during the period 2015–20.

Over the past year we have begun to make payments to all affected customers and following analysis of non-compliant appointments over the preceding five years, we identified that £2.1 million in payments were due, of which £0.55 million could not be identified for a specific customer. A 'Goodwill Pot' was therefore established to distribute this additional sum by the end of 2021–22 to a combination of our most vulnerable customers and to a selection of large and small community groups across the region. This programme went live in April 2021 with all funds to be distributed before the end of March 2022. Our work in this area has had scrutiny from our Audit Committee since the issue was identified and we have had a number of sessions with Ofwat and CCW to update them on the delivery of the improvements and the customer payments.

Managing risks

The Board confirms that the company has appropriate systems and processes in place to identify, manage and mitigate its material risks.

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

Southern Water's approach to risk management is designed to provide a clear and consistent framework for managing and reporting risks associated with our operations, to executive management and to the Southern Water Board. The framework seeks to promote better decision making, avoid incidents and encourage the best outcome for the company and our customers by allowing us to:

- Understand the risk environment, identify the specific risks and assess the potential exposure for Southern Water.
- Determine how best to manage identified risks to balance overall potential exposure.
- Take action to manage the risks we do not want to be exposed to, ensuring our resources are effectively and efficiently prioritised and used.
- Define our appetite for the range of risks and monitor and report risks against our desired risk appetite.
- Report up the management chain and to the board on a periodic basis on how significant risks are being managed, monitored, assured and the improvements that are being made.

We face a diverse range of risks and uncertainties. Those risks that have the potential to have a material impact on our company are our Principal Risks. Southern Water manages, monitors and reports on the Principal Risks that can impact our ability to deliver our objectives. Details of our Principal Risks and more information regarding our risk management process are provided under the Risks section on page 118 of the Annual Report and Financial Statements.

All areas of the company review significant risks and business processes to help inform and enable risk-based decision making. As part of Southern Water's annual planning process, the executive team and Board review the business's principal risks. These may be updated during the year in response to changes in internal and external circumstances.

We have reviewed our Risk Appetite in relation to our Principal Risks, and we have streamlined and simplified the process. This has included a review of our risk categories and our risk assessment criteria and is linked to wider improvements to our risk management framework. The Southern Water Board defines our Risk Appetite, enabling the company, in both quantitative and qualitative terms, to judge the level of risk it is prepared to take in achieving its overall objectives.

The Risk Appetite for each of our Principal Risks is reviewed regularly by the Board. The comparison of Principal Risk exposure with Risk Appetite allows for an informed analysis and discussion of our risk position and has provided the Board with a risk insight to inform key decisions.

To successfully embed risk management across Southern Water, the risk management process is supported by a governance structure that defines roles and responsibilities at each level of the company. The Board has overall responsibility for risk management and discharges this role through the Board Risk Committee. The committee meets three times a year which allows a detailed focus on risk factors.

The Risk Committee advises the Board on the company's overall risk appetite, tolerance and strategy, taking into account the current and prospective regulatory, legal, political, macroeconomic and financial environment. The Board retain ownership and approval of the company's overall risk appetite, tolerance and strategy. The Southern Water Board still has ultimate accountability for risk management in Southern Water. The Risk Committee oversee and advise the Board on the current risk exposure of the company and future risk strategy.

In addition, the Risk Committee review the company's capability to identify and manage new risk types and review reports on any material breaches of risk limits and the adequacy of proposed action.

The Executive Leadership Team (ELT) is responsible for ensuring the corporate risk management system is effective and embedded in the business and operates in accordance with the Southern Water's risk management approach.

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

The Board continue to recognise the importance of effective risk and resilience management; it champions its use within decision making forums and is committed to embedding risk management at every level of the organisation. As part of our transformation, we have recognised the need to improve our approach to risk and resilience management. Additional resource and expertise has been brought into the company to support the further development of risk management. A key aspect of this development is the implementation of a new business partnering model developed to ensure teams across the company are supported, and facilitating risk-informed decision making throughout their day-to-day business activities.

Transforming our approach to risk management has included a range of improvements including:

Framework – By collaborating across the company we have better understood the needs of key stakeholders and identified any gaps and inconsistencies in the existing framework. We have also redefined the Enterprise Risk Management and Resilience framework, aligning it to industry best practice in the form of ISO 31000 – Risk Management.

Risk Criteria – Through engagement with the Board and other key stakeholders, the criteria for assessing material impact have been re-focused to be more reflective of our business operations.

Risk Taxonomy – We have refreshed our taxonomy and aligned the structure to our Principal Risks. The new taxonomy allows for clear, enhanced identification and allocation of risk from both a top-down and bottom-up perspective.

Risk Appetite – The Board have reviewed their view of risk appetite, and this is underpinned by the updated risk taxonomy. This includes a new simplified three-band approach to risk appetite. The refreshed framework now supports the company in understanding where we should be reducing the impact of downside risk, versus those risks where we should or could be seeking risk if there is a possibility of upside opportunities.

Data Cleanse – During the year we have also carried out a risk management data cleanse to improve the quality and relevance of the information in our system. This has led to the creation of revised risk profiles for our teams across the business.

In 2019–20 we submitted our plan to Ofwat to improve our resilience. The plan involved a comprehensive review of the key areas in our organisation responsible for our resilience, and subsequent recommendations for improvement. The plan was initiated in September 2019, and will continue into 2021 and beyond, with improvement plans in the key resilience areas of enterprise risk management, incident management and asset investment strategy. Key to this approach is embedding an approach to enterprise risk management that allows us to deliver a more resilient service for our customers and stakeholders. We continue to update our risk and resilience plans, gaining insight on emerging methodologies and recommendations, and will align to Ofwat guidance on resilience that is due toward the end of 2021 on the back of recommendations of the National Infrastructure Commission's May 2020 report 'Anticipate, React, Recover: Resilient infrastructure systems'.

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 the Secretary of State to be a water and wastewater undertaker – the activities covered by the appointment are the 'Appointed Business'. Southern Water Services Limited has other functions and activities which are not covered by the appointment as a water and wastewater undertaker. These activities are termed the 'Non-Appointed Business'.

Assets, rights and resources (Condition P14)

Under paragraph 14 of Condition P 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 resources (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 2021.

Ring-fencing Certificate and statement (Condition P30)

In order to provide the Ring-fencing Certificate required by Licence Condition P30 and meet the Ofwat Section 19 undertakings the Southern Water Board needs to be able to clearly evidence the level of diligent enquiry that the Board has undertaken, to ensure that it is able to demonstrate that the company will have sufficient:

- Financial resources and facilities;
- Management resources; and
- Systems of planning and internal control,

The directors declare that, in their opinion:

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

ii) The company will have available to it:

a) financial resources and facilities
b) management resources; and
c) methods of planning and internal control

which are sufficient to enable it to carry out those functions.

The Southern Water Board signs off Condition P assurance statements to support this process. These (and the evidence underpinning the statements) enable the Board to clearly demonstrate it has discharged its responsibilities and has made diligent enquiry into the principal risks facing both the wider business and the wastewater business (to support the Ofwat Section 19 undertakings).

A specific paper on the Condition P statement is presented for sign off by the Southern Water Board. This is subject to external assurance from our auditor, Deloitte as part of our Section 19 commitments, their report is provided separately to Ofwat. This sign off process happens in parallel with the Board sign off of an assurance statement on the accuracy and completeness of the data and information (financial and non-financial) submitted to Ofwat as part of our Annual Report and Annual Performance Report submission (see below).

In providing the Condition P assurance, the directors have taken into account a number of factors, summarised here and set out in detail in appendix 4:

– the company's financial performance during 2020–21, the liquidity position based on projected operating and capital expenditure and working capital requirements, headroom against financial covenants, credit ratings and financial risks

– the assessments behind the going concern and long term viability statements in the 2020–21 Annual Report and associated assurance

– assurance outputs from our external auditor and our non-financial assurers

– the company's plans for the period from 2020–25, including the Execution Plan for 2021–22

– regular financial updates that are made to our Board (and its Finance Working Group)

– that the organisation has the management capability in place to deliver its plans

– that the Executive Team are rebuilding capability across the company

– a number of improvements already made to our compliance and reporting processes

- the company's formal risk management process which reviews, monitors and reports on the company's risks and mitigating controls and considers potential impact in terms of service, compliance, value, people, society and partners
- the implementation of a three line of defence framework for reporting governance and assurance activity
- the need to continue making improvements to the monitoring and effectiveness of our water and wastewater compliance controls, reporting and data integrity

The Board can also confirm that there are no contracts entered into, by the wholesale part of the company, with any associate company.

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

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

b) preparing as set of regulatory accounting statements, in respect of the twelve month period ending on 31 March in each year, which are in accordance with the Regulatory Accounting Guidelines published by Ofwat

c) Complying with all other requirements that are set out in the Regulatory Accounting Guidelines published by Ofwat.

The directors approved the regulatory accounting statements (on pages 19 to 76) on 6 July 2021.

Board statement on accuracy and completeness of data and information

The Board confirms that the data and information provided to Ofwat during the reporting year, or published by the company in its role as a water and sewerage undertaker, was accurate and complete and is reflected in our Board Assurance Statement (see appendix 3).

The assurance statement includes a description of the activities which the Board has carried out to allow it to make the statement. The Board 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.

The Board has been fully aware of previous issues with the non-financial control environment of the company and has over the last four years worked with the executive management team to rebuild capability in this area. This work is on-going and is on track but will require further work in coming years.

The Board has actively engaged and challenged the assurance processes that have been adopted by the company. This covers assurance on both the financial and non-financial reporting. The Board has, over recent years, taken action to ensure that exceptions and weaknesses identified in the non-financial assurance have been addressed. The Board are satisfied that the assurance approaches have appropriately identified and addressed any risks to the provision of accurate and complete data and information. This has been discharged through the Southern Water Services Board and its relevant committees (most notably the Audit Committee).

The Board Assurance Statement does not identify any specific exceptions.

Section 35A of the Water Industry Act 1991

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

Long-term viability statement

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

The Board has elected to conduct this review to 31 March 2030 and full details of the assessment and the viability statement are set out within the Strategic Report section on page 140 of the Annual Report and Financial Statements.

Statement of disclosure of information to auditor

Each of the persons who is a director at the date of approval of this report confirms that:

1) so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware
2) he/she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

Board statement

Save for those matters mentioned on pages 10 and 11 (where the company has identified shortcomings or potential shortcomings in its performance in water and wastewater compliance, 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 Officer

Keith Lough
Chairman

6 July 2021

Regulatory financial reporting

1A – Income statement for the 12 months ended 31 March 2021

	Note	Statutory £m	Adjustments: Differences between statutory and RAG definitions £m	Adjustments: Non-appointed £m	Total adjustments £m	Total appointed activities £m
Revenue		819.810	(68.713)	9.896	(78.609)	**741.201**
Operating costs		(682.707)	14.019	(7.528)	21.547	**(661.160)**
Other operating income		0.826	35.620	–	35.620	**36.446**
Operating profit		**137.929**	**(19.074)**	**2.368**	**(21.442)**	**116.487**
Other income		1.616	29.571	–	29.571	**31.187**
Interest income	3	110.112	–	–	–	**110.112**
Interest expense	3	(160.356)	(32.874)	–	(32.874)	**(193.230)**
Other interest expense	3	(1.300)	–	–	–	**(1.300)**
Profit/(loss) before tax and fair value movements		**88.001**	**(22.377)**	**2.368**	**(24.745)**	**63.256**
Fair value losses on derivative financial instruments		(444.782)	–	–	–	**(444.782)**
(Loss)/profit before tax		**(356.781)**	**(22.377)**	**2.368**	**(24.745)**	**(381.526)**
UK Corporation tax	4	(0.931)	–	–	–	**(0.931)**
Deferred tax		65.748	–	–	–	**65.748**
(Loss)/profit for the year		**(291.964)**	**(22.377)**	**2.368**	**(24.745)**	**(316.709)**
Dividends		(3.968)	–	(2.368)	2.368	**(1.600)**
Tax analysis						
Current year		0.931	–	–	–	**0.931**
Adjustments in respect of prior years		–	–	–	–	**–**
UK Corporation Tax		**0.931**	**–**	**–**	**–**	**0.931**

Analysis of non-appointed revenue	
Imported sludge	–
Tankered waste	6.089
Other non-appointed revenue	3.807
Revenue	**9.896**

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 2021

		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	(291.964)	(22.377)	2.368	(24.745)	(316.709)
Actuarial losses on post-employment plans	(70.000)	–	–	–	(70.000)
Other comprehensive income	13.300	–	–	–	13.300
Total comprehensive income/(loss) for the year	(348.664)	(22.377)	2.368	(24.745)	(373.409)

1C – Statement of financial position for the 12 months ended 31 March 2021

		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	6,445.004	(239.177)	0.414	(239.591)	6,205.413
Intangible assets	189.729	(1.610)	–	(1.610)	188.119
Investments – loans to group companies	130.042	–	–	–	130.042
Investments – other	29.200	–	–	–	29.200
Financial instruments	68.245	–	–	–	68.245
Total non-current assets	6,862.220	(240.787)	0.414	(241.201)	6,621.019
Current assets					
Inventories	6.314	–	–	–	6.314
Trade and other receivables	214.192	–	0.743	(0.743)	213.449
Cash and cash equivalents	339.492	–	–	–	339.492
Total current assets	559.998	–	0.743	(0.743)	559.255
Current liabilities					
Trade and other payables	(175.041)	2.096	(1.157)	3.253	(171.788)
Capex creditor	(100.466)	–	–	–	(100.466)
Borrowings	(36.783)	–	–	–	(36.783)
Current tax liabilities	(14.000)	–	–	–	(14.000)
Provisions	(28.146)	–	–	–	(28.146)
Total current liabilities	(354.436)	2.096	(1.157)	3.253	(351.183)
Net current liabilities	205.562	2.096	(0.414)	2.510	208.072
Non-current liabilities					
Trade and other payables	(137.310)	–	–	–	(137.310)
Borrowings	(3,951.031)	–	–	–	(3,951.031)
Financial instruments	(1,500.638)	–	–	–	(1,500.638)
Retirement benefit obligations	(116.497)	–	–	–	(116.497)
Provisions	(79.923)	–	–	–	(79.923)
Deferred income – grants and contributions	(22.030)	(2.096)	–	(2.096)	(24.126)
Preference share capital	(69.829)	–	–	–	(69.829)
Deferred tax	(289.677)	–	–	–	(289.677)
Total non-current liabilities	(6,166.935)	(2.096)	–	(2.096)	(6,169.031)
Net assets	900.847	(240.787)	–	(240.787)	660.060
Equity					
Called up share capital	0.056	–	–	–	0.056
Retained earnings and other reserves	900.791	(240.787)	–	(240.787)	660.004
Total equity	900.847	(240.787)	–	(240.787)	660.060

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 2021

		Adjustments			
	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	Total adjustments £m	Total appointed activities £m
Operating profit	137.929	(19.074)	2.368	(21.442)	116.487
Other income	1.616	29.571	–	29.571	31.187
Depreciation	287.861	(10.497)	0.004	(10.501)	277.360
Amortisation – grants and contributions	2.374	(3.832)	–	(3.832)	(1.458)
Changes in working capital	31.920	–	(0.004)	0.004	31.924
Pension contributions	(17.303)	–	–	–	(17.303)
Movement in provisions	(55.358)	–	–	–	(55.358)
Profit on sale of fixed assets	(0.826)	–	–	–	(0.826)
Cash generated from operations	388.213	(3.832)	2.368	(6.200)	382.013
Net interest paid	(46.020)	–	–	–	(46.020)
Tax paid	(0.931)	–	–	–	(0.931)
Net cash generated from operating activities	341.262	(3.832)	2.368	(6.200)	335.062
Investing activities					
Capital expenditure	(381.690)	–	–	–	(381.690)
Grants and contributions	–	3.832	–	3.832	3.832
Disposal of fixed assets	0.458	–	–	–	0.458
Other	39.396	–	–	–	39.396
Net cash used in investing activities	(341.836)	3.832	–	3.832	(338.004)
Net cash generated before financing activities	(0.574)	–	2.368	(2.368)	(2.942)
Cash flows from financing activities					
Equity dividends paid	(3.968)	–	(2.368)	2.368	(1.600)
Net loans paid	214.754	–	–	–	214.754
Net cash used in financing activities	210.786	–	(2.368)	2.368	213.154
Increase in net cash	210.212	–	–	–	210.212

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

1E – Net debt analysis at 31 March 2021

	Interest rate risk profile		
	Fixed rate £m	Index linked RPI £m	Total £m
Borrowings (excluding preference shares)	1,435.193	2,504.887	3,940.080
Preference share capital			69.829
Total borrowings			4,009.909
Cash			(339.492)
Short term deposits			–
Net debt			3,670.417
Gearing			71.82%
Adjusted gearing			69.90%
Full year equivalent nominal interest cost	(18.694)	101.629	82.935
Full year equivalent cash interest payment	(18.694)	71.249	52.555
Indicative interest rates			
Indicative weighted average nominal interest rate	(1.303%)	4.057%	2.105%
Indicative weighted average cash interest rate	(1.303%)	2.844%	1.334%
Weighted average years to maturity	13,876	9.386	12.547

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, along with a reconciliation to the principal sum outstanding reported in table 4B, which is published separately alongside this report.

Reconciliation of borrowings between table 1C and tables 1E and 4B

	£m
1C – Current liabilities borrowings	36.783
1C – Non-current liabilities borrowings	3,951.031
Total Borrowings (table 1C)	3,987.814
Debt issue costs	9.956
Bond premium deferred	(7.542)
Deferred gilt lock proceeds	(4.520)
Deferred proceeds	(76.280)
Accrued swap accretion	30.652
Borrowings (table 1E)	3,940.080
Preference shares	69.829
Difference between amortised cost and nominal value	33.122
Accrued swap accretion	(30.652)
Principal sum outstanding (table 4B)	4,012.379

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 2021 and for the price review to date (2017–18 financial year average CPIH)

	12 months ended 31 March 2021					
	%			£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						
Return on regulatory equity	3.85%	2.67%	3.85%	74.903	51.991	51.991
Regulatory equity	1945.534	1945.534	1350.416			
Financing						
Gearing	–	1.18%	0.62%	–	22.912	8.325
Cost of debt	–	(3.45%)	(4.67%)	–	(67.172)	(63.126)
Hedging instruments	–	4.49%	6.47%	–	87.318	87.318
Return on regulatory equity including Financing adjustments	**3.85%**	**4.89%**	**6.26%**	**74.903**	**95.049**	**84.508**
Operational performance						
Totex out/(under) performance	–	(2.00%)	(2.88%)	–	(39.914)	(39.914)
ODI out/(under) performance	–	(2.12%)	(3.06%)	–	(41.306)	(41.306)
Retail out/(under) performance	–	(1.50%)	(2.16%)	–	(29.168)	(29.168)
Operational performance total	**–**	**(5.62%)**	**(8.10%)**	**–**	**(109.388)**	**(109.388)**
RoRE	**3.85%**	**(0.74%)**	**(1.84%)**	**74.903**	**(14.339)**	**(24.880)**
Actual performance adjustment 2015–20	(1.91%)	(1.91%)	(2.75%)	(37.158)	(37.158)	(37.158)
Total earnings	**1.94%**	**(2.65%)**	**(4.59%)**	**37.745**	**(51.497)**	**(62.038)**
RCV growth from inflation	1.01%	1.01%	1.01%	19.650	19.650	13.639
Total shareholder return	**2.95%**	**(1.64%)**	**(3.58%)**	**57.395**	**(31.847)**	**(48.399)**
Dividends						
Gross dividend	4.00%	0.19%	0.28%	77.821	3.790	3.790
Interest received on intercompany loans	–	(0.19%)	(0.28%)	–	(3.790)	(3.790)
Retained value	**(1.05%)**	**(1.64%)**	**(3.58%)**	**(20.426)**	**(31.847)**	**(48.399)**

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

1F – Financial Flows for the 12 months ended 31 March 2021 and for the price review to date (2017–18 financial year average CPIH)

	Average 2020–21					
	%			£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						
Return on regulatory equity	3.85%	2.67%	3.85%	74.903	51.991	51.991
Regulatory equity	1945.534	1945.534	1350.416			
Financing						
Gearing	–	1.18%	0.62%	–	22.912	8.325
Cost of debt	–	(3.45%)	(4.67%)	–	(67.172)	(63.126)
Hedging instruments	–	4.49%	6.47%	–	87.318	87.318
Return on regulatory equity including Financing adjustments	**3.85%**	**4.89%**	**6.26%**	**74.903**	**95.049**	**84.508**
Operational performance						
Totex out/(under) performance	–	(2.00%)	(2.88%)	–	(38.914)	(38.914)
ODI out/(under) performance	–	(2.12%)	(3.06%)	–	(41.306)	(41.306)
Retail out/(under) performance	–	(1.50%)	(2.16%)	–	(29.168)	(29.168)
Operational performance total	**–**	**(5.62%)**	**(8.10%)**	**–**	**(109.388)**	**(109.388)**
RoRE	**3.85%**	**(0.74%)**	**(1.84%)**	**74.903**	**(14.339)**	**(24.880)**
Actual performance adjustment 2015–20	(1.91%)	(1.91%)	(2.75%)	(37.158)	(37.158)	(37.158)
Total earnings	**1.94%**	**(2.65%)**	**(4.59%)**	**37.745**	**(51.497)**	**(62.038)**
RCV growth from inflation	1.01%	1.01%	1.01%	19.650	19.650	13.639
Total shareholder return	**2.95%**	**(1.64%)**	**(3.58%)**	**57.395**	**(31.847)**	**(48.399)**
Dividends						
Gross dividend	4.00%	0.19%	0.28%	77.821	3.790	3.790
Interest received on intercompany loans	–	(0.19%)	(0.28%)	–	(3.790)	(3.790)
Retained value	**(1.05%)**	**(1.64%)**	**(3.58%)**	**(20.426)**	**(31.847)**	**(48.399)**

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 aims to improve transparency and explain the elements that have the most significance 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 2020–25 but not realised by shareholders until the next price review period 2025–30, 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 above table provides information in a three-column format:

- ‘notional returns and notional regulatory equity’ (column 1) – equivalent to our allowance in the Final Determination for 2020–25
- ‘actual returns and notional regulatory equity’ (column 2) – provides a representation of the variance in financial performance between the return allowed in the PR19 Final Determination and actual results.
- ‘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).

Base return and adjustments for performance in the prior AMP:

The base return on regulatory equity of 3.85% is adjusted for our performance in the 2015–20 regulatory period (AMP6). The net decrease (1.91%) to shareholder returns is almost entirely driven by the regulatory settlement following the Ofwat investigation into our wastewater treatment compliance, discussed on pages 10 and 11. During AMP6 this adjustment was disclosed at the head of the table, as an adjustment to the base return. For AMP7 it has moved further down the table, to ensure that it is excluded from the Return on Regulatory Equity (RoRE) figure which is also reported in Table 4H.

This adjusted base return of 1.94%, plus inflation of 1.01% on the regulated equity, results in a total shareholder return of 2.95%. This is based on Ofwat’s price review approach to determining returns, reflecting an efficient company with the regulatory notional gearing of 60.00%. The equivalent actual total shareholder return, reflecting our average gearing in 2020–21 of 72.05% and actual performance, was -3.58%.

Our actual return of -3.58% differed from the notional return of 2.95% due to financing out-performance of 2.41%, operational under-performance of 8.10%, and an additional 0.84% negative impact due to the concentration on actual equity of the adjustment relating to our performance in AMP6.

Financing performance:

Our average actual gearing has increased since last year, mainly due to a reduction of the opening RCV through the regulatory ‘midnight adjustment’ at the beginning of the new AMP. Our average actual gearing of 72.05% is higher than the regulatory assumption of 60.00%, 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 60.00% and our actual gearing of 72.05%, 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 0.62%.

Our ‘Comparison between tax charge and allowance in price limits’ (see page 36) provides a detailed narrative on our corporation tax charge and approach to using group relief. In summary, our PR19 determination includes no funding from customers for corporation tax and, having excluded the cashflows relating to the inter-company loan to Southern Water Services Group (SWSG), we incurred no tax charge in the current year. The net impact on shareholder returns of corporation tax and group relief is 0.0%.

Our cost of debt (excluding the impact of swap instruments), measured by reference to an implied real rate of interest, was higher than the amount allowed in our PR19 determination (updated for the cost of debt reconciliation mechanism) decreasing returns by 4.68%. Reflecting the updated guidance notes for AMP7, this is now calculated on a pre-tax basis, consistent with other entries in this table.

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 positive impact for the year of 6.47%, reflecting benefits to our interest cashflows from the capital restructuring carried out in 2018. We also now report the impact of these hedging instruments on a pre-tax basis, aligning with the treatment for cost of debt.

Operational performance:

For AMP7 we will retain approximately 64% of wholesale totex overspends, but only 36% of wholesale totex cost savings, with the remainder being returned to customers. Some types of wholesale totex are not subject to customer sharing, with any out-performance or under-performance remaining entirely with the company. To account for any timing differences in our totex delivery, such as slippage or acceleration in our capital programme, we adjust for this in Table 4C. In 2020–21, having excluded expenditure relating to the Innovation Fund, we experienced a retained overspend of £38.9 million, equivalent to a decrease of 2.88% in returns.

The company share of retail cost under-performance represents the amount by which we are overspending against the PR19 price determination. There is no sharing with customers of the retail expenditure variance, with the result that the £29.2 million overspend for 2020–21 reduces returns by 2.16%.

The impact of our performance on Outcome Delivery Incentives (ODIs) is £41.3 million for 2020–21, decreasing returns by 3.06%. Penalties or rewards are included even if they are not payable or receivable until later in the current AMP or the next AMP. Tables 3A and 3B provide further details. In line with Ofwat guidance, for 2020–21 we report a nil entry for C-MeX and D-MeX.

Other

The inflationary RCV return of 1.01% is long-term in nature and cannot be immediately realised.

With the exception of the dividend paid as part of the SWSG intercompany loan (see notes below) no dividends were paid in 2020–21.

Notes:

To ensure consistency with treatment in the PR19 determination, the 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.

We believe that our RCV for 2020–21 published by Ofwat is understated by approximately £9.3 million, due to the approach taken to convert from year-average prices to March 2021 to prices for the proportion of our RCV which remains linked to RPI. For our reporting we have used the value published by Ofwat, which translates to a lower regulatory equity value, amplifying the impact of out-performance and under-performance in the Financial Flows table. We are engaging with Ofwat to determine the correct treatment.

Column 1 (‘notional returns and notional regulatory equity’) shows a gross dividend of 4.0%, reflecting guidance for completion of this table. The actual gross dividend implicit in our PR19 Final Determination was 1.42%.

Notes to the regulatory financial statements For the year ended 31 March 2021

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 1.09 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 recognition

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

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

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

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

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

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

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

Charging policy

Water and sewerage charges fall into the following three categories:

1) Charges which are payable in full

2) Charges which are payable in part

3) Not chargeable (void properties)

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

Charges payable in full

Charges are payable in full in the following circumstances:

i) Occupied and furnished

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

ii) Unoccupied and furnished

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

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

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

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

iii) Unoccupied and unfurnished

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

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

Charges payable in part

The following charges only are payable in certain circumstances:

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

Not chargeable

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

Definition and treatment of properties

Occupied properties

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

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 3.12 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 2021 for consumption in prior years was £245.4 million. The value of these billings was lower than the metered income accrual made at 31 March 2020. The estimation difference was £2.2 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) Social tariffs

We provide a number of schemes and tariffs to improve affordability and accessibility for vulnerable customers. These include:

- **Essentials** – for customers whose household income is less than £21,000, or for those in receipt of pension credit.
- **WaterSure** – for those who are in receipt of means tested benefits and use a large amount of water either as a result of large families, or because of a particular medical condition.
- **Water Direct** – where bills may be paid from a customer's existing benefit schemes directly to us.
- **NewStart** – for those who owe us money but have not been able to make a payment for a while.

In response to the COVID-19 pandemic, we took a number of immediate steps to help our customers. We introduced a three-month payment break for many of those impacted by the pandemic and took steps to streamline the application process for our social and capped tariffs. This included moving to an automatic renewal process (to relieve the administration burden on those in need).

Further details can be found in our Annual Report and on our website at: **southernwater.co.uk/account/help-paying-your-bill**.

f) 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. The value of debt written off over the past year has remained low due to the continuation of projects aimed at reducing bad debt before the point of write-off.

The value of trade and other receivables of the appointed business decreased to £213.4 million (2020: £272.5 million). This decrease largely results from a reduction in the balance on the inter-company debtor with Southern Water Services (Finance) Limited of £39.4 million. This inter-company arrangement is used to pay the interest on our loans, the balance was higher in the prior year as a result of a restructuring of interest payments due on our loans. In addition, as a result of the decrease to our tariffs this year, the value of unbilled revenue reduced by £9.3 million. The increase in our billed trade debtor was more than offset by the continued increase to our bad debt charge, linked to the pandemic, resulting in net debtors falling by £19.0 million. These reductions were offset by the accrual for interest receivable on an inter-company loan of £4.6 million together with a higher level of prepayments £2.4 million largely for IT related services.

g) Price control units

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 2.08 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.

h) Provisions

Environment Agency – wastewater sites

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

The Board, supported by external legal advice, has concluded that it is not yet possible to make a reliable overall estimate for the obligation that will arise from this prosecution, notwithstanding the company's guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, the Board does recognise that there will be a minimum liability associated with the charges before the court and having reviewed the information, has maintained the recognised a provision of £1.0 million, recognised in the financial statements for 2019–20, reflecting a minimum amount as indicated in the sentencing guidelines and an allowance for legal costs.

There is a wide range of possible outcomes which reflects the uncertain and disputed levels of culpability and environmental harm (both being amongst a number of key criteria that the court uses to help determine the level of the fine), the lack of a similar precedent, and the extent of the applicability of the Sentencing Council's Guidelines to the company which vary very widely. Further, as the company is a Very Large Organisation, there is a requirement for the court to examine the financial circumstances of the organisation in the round. The court has a very broad discretion to assess the level of the fine and the provision is not intended to indicate or predict any particular level. When considering the above it is noted that there are disputed levels of culpability and environmental harm. The sentencing guidelines are very wide. The next court hearing may take place in July 2021. The Board will continue to review the level of provision made as more information becomes available.

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

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

2 Differences between statutory and regulatory reporting

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

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

Income statement – differences between statutory and RAG definitions

	Revenue £m	Operating costs £m	Other operating income £m	Other income £m	Interest expense £m
i CHP income	(3.5)	3.5	–	–	–
ii) Grants and contributions	(29.5)	–	–	29.5	–
iii) Contribution amortisation	(0.1)	–	–	0.1	–
iv) Regulatory settlement amortisation	(35.6)	–	35.6	–	–
v) Borrowing costs	–	10.5	–	–	(32.9)
Total	(68.7)	14.0	35.6	29.6	(32.9)

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 £3.5 million of revenue has been re-classified as a negative operating cost.

ii) As required by RAG 1.09 section 4.11, 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 £29.5 million has been transferred from revenue to other income in the income statement. See table 2E for further information.

iii) Certain contributions received are held on the Balance Sheet before amortisation or release to the income statement. Those released to the income statement through revenue totalling £0.1 million have been reclassified as other income along with the grants and contributions mentioned above.

iv) In 2018–19 we made a provision for rebates to be made to customers during the period from 2020–25 as a result of the investigation undertaken by Ofwat into wastewater reporting as set out on page 9. For regulatory purposes, the amortisation of this provision is reclassified from revenue to other income.

v) 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 £10.5 million, reflecting the removal of depreciation on interest capitalised and the interest charge has been increased by £32.9 million reversing the element of interest capitalised in the year.

Statement of financial position – differences between statutory and RAG definitions

	Fixed Assets £m	Intangible Assets £m	Current trade and other payables £m	Deferred income – grants and contributions £m
i) Borrowing costs	(239.2)	(1.6)	–	–
ii) Grants and contributions	–	–	2.1	(2.1)
Total	(239.2)	(1.6)	2.1	(2.1)

i) As borrowing costs cannot be capitalised under regulatory reporting, fixed and intangible assets have been reduced by £239.2 million and £1.6 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 £2.1 million classified within current trade and other payables in the statutory accounts have been transferred to deferred income for regulatory reporting.

Statement of cash flows – differences between statutory and RAG definitions

	Operating profit £m	Other income £m	Depreciation £m	Amortisation – grants and contributions £m	Grants and contributions £m
i) Grants and contributions – income statement	(29.6)	29.6	–	–	–
ii) Depreciation	10.5	–	(10.5)	–	–
iii) Grants and contributions – cash	–	–	–	(3.8)	3.8
Total	(19.1)	29.6	(10.5)	(3.8)	3.8

i) The re-classification of grants and contributions received in the income statement of £29.6 million from operating profit to other income.

ii) There is a £10.5 million adjustment made to both operating profit and depreciation relating to the removal of capitalised borrowing costs.

iii) In the statutory accounts for 2020–21, cash contributions received and held on the Balance Sheet have been presented as operating cashflows. These have been included within the statutory amortisation of grants and contributions row of table 1D. For regulatory purposes £3.8 million, reflecting the cash received for specific capital assets, has been reclassified to grants and contributions within investing activities.

3 Interest

	£m
Interest income	
Interest receivable on swap instruments	98.7
Interest revenue from Southern Water Services Group Limited	9.5
Deposit income on short-term bank deposits	1.9
	110.1

Interest income	
Interest payable on bank loans	(1.3)
Interest payable on other loans	(2.1)
Interest paid to Southern Water Services (Finance) Ltd	(168.0)
Indexation	(20.5)
Amortisation of issue costs	(1.5)
Amortisation of gilt lock proceeds	0.1
Amortisation of deferred credits	4.7
Amortisation of bond premium	0.7
Finance lease interest	(0.5)
Dividends on preference shares	(4.9)
	(193.3)

Other interest expense	
Pension financing charge	(1.3)
	(1.3)

4 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.

	Appointed £m	Non-appointed £m
Profit before tax and fair value movement	63.3	2.4
Tax at the UK corporation tax rate of 19%	12.0	0.5
Permanent differences	2.9	–
Fixed asset timing differences	(5.8)	(0.5)
Other short-term timing differences	(4.5)	–
Pension cost relief in excess of pension charge	(3.7)	–
Group relief received for nil payment	–	–
Adjustment in respect of prior years – current tax	–	–
Tax charge for year	0.9	–

Details of factors affecting future tax charges:

In the March 2021 Budget it was announced that legislation will be introduced in Finance Bill 2021 to increase the main rate of UK corporation tax from 19% to 25%, effective 1 April 2023. As substantive enactment is after the balance sheet date, deferred tax balances as at 31 March 2021 continue to be measured at a rate of 19%. If the amended tax rate had been used, the deferred tax liability would have been £94.6m higher.

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.

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 final determination

	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	(4.5)	(4.5)
iii) Earnings before interest and tax	(19.5)	(19.5)
iv) Regulatory settlement	6.1	6.1
v) Net finance costs, including taxable fair value movements	8.2	6.6
vi) Depreciation and capital allowances claimed	12.6	13.3
vii) Pensions	(1.8)	(1.8)
vii) Group relief claimed	(0.9)	–
viii) Change in tax rate	0.1	0.1
Other	(0.3)	(0.3)
Current tax before payments for group relief and prior year adjustments	–	–
ix) Payments for group relief	0.9	–
Appointed current tax charge	0.9	–

i) In the price review process for the current regulatory period, 2020–25, there was no corporation tax forecast to be paid in the wholesale business and therefore there is no allowance for corporation tax in customer bills.

ii) For 2020–21 the price determination included tax losses of £4.5 million and no allowance was provided for these in price limits.

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

In 2018–19 we made a provision for the regulatory settlement on revenues, and did not reflect a reduction to our tax charge due to the reduced revenues in that year. During AMP7 this provision is released to the income statement, increasing revenues. We do not reverse this for tax purposes, instead recognising an increased tax charge due to the regulatory settlement.

iv) Net finance costs are lower, mainly due to lower inflation on index-linked debt instruments, 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 117 of the Annual Report and Financial Statements for further explanation). This is partially offset by higher interest costs and taxable fair value losses relating to debt indexation.

The cash flows relating to the inter-company loan to Southern Water Services Group (SWSG) are designed to be neutral to Southern Water and its customers as we receive interest and pay an equal amount of dividend and group tax relief back to SWSG. For 2020–21, however, we only claimed approximately half of these losses, and used additional capital allowances to offset the full amount of interest income. 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.

vi) We are making pension contributions in excess of those in the price determination. These additional contributions reduce our tax charge.

vii) Historically we have used losses from other companies within the Greensands group in order to reduce the current tax charge for Southern Water. In 2020–21 we have not done this, and have limited use of group relief to the losses at SWSG, as described above. Payment of £0.9 million was made for these losses, reflecting the full corporation tax rate for losses claimed,

Capital allowances not claimed, in favour of group losses, are available to Southern Water as a deduction against future taxable profits.

viii) The Final Determination assumed that corporation tax would be payable at a rate of 17%. The actual tax rate of 19% increases our current tax charge.

ix) 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 in the group were not claimed.

Taxation policy and strategy

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

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

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

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

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

Further information is available in our Annual Report and Financial Statements on page 109.

5 Innovation Fund

For the period from 2020–25 Ofwat has introduced a series of innovation competitions. We are collecting monies from customers through our revenue across this regulatory period to fund these innovation competition activities. Ofwat did not hold any innovation competitions during 2020–21 and, in order to recognise the liability we have for the contributions to the innovation competition, we have made an accrual of £2.7 million in the accounts to March 2021. On the basis that we are required to contribute this into the innovation competition over time £2.7 million is currently held within our overall cash balance for this purpose.

Price control and other segmental reporting

2A – Segmental income statement for the 12 months ended 31 March 2021

	Retail		Wholesale				
	Retail household £m	Retail non-household £m	Water resources £m	Water network + £m	Wastewater network + £m	Bioresources £m	Total £m
Revenue – price control	49.610	1.172	27.447	165.263	441.751	49.547	734.790
Revenue – non price control	–	–	4.843	0.089	1.453	0.026	6.411
Operating expenditure – excluding PU recharge impact	(68.184)	(0.948)					(69.132)
PU opex recharge	(5.578)	–					(5.578)
Operating expenditure – including PU recharge impact	**(73.762)**	**(0.948)**	**(13.091)**	**(93.742)**	**(186.552)**	**(21.283)**	**(389.378)**
Depreciation – tangible fixed assets	(3.889)	–	(4.572)	(56.869)	(179.167)	(20.078)	(264.575)
Amortisation – intangible fixed assets	(1.390)	–	(0.142)	(0.735)	(10.506)	(0.012)	(12.785)
PU recharge impact	–	–	(0.229)	(6.470)	13.606	(1.329)	5.578
Depreciation and amortisation – including PU recharge impact	**(5.279)**	**–**	**(4.943)**	**(64.074)**	**(176.067)**	**(21.419)**	**(271.782)**
Other operating income	–	–	1.563	11.193	21.264	2.426	36.446
Operating profit	**(29.431)**	**0.224**	**15.819**	**18.729**	**101.849**	**9.297**	**116.487**
Surface water drainage rebates							
Surface water drainage rebates							0.119

PU = Principal Use

2B – Totex analysis for the 12 months ended 31 March 2021 – Wholesale

	Water resources £m	Water network + £m	Wastewater network + £m	Bioresources £m	Total £m
Base operating expenditure					
Power	4.033	14.040	38.553	(2.438)	54.188
Income treated as negative expenditure	–	(0.023)	(0.004)	(3.496)	(3.523)
Abstraction charges/discharge consents	3.891	0.096	4.030	–	8.017
Bulk supply/bulk discharge	–	0.338	–	–	0.338
Renewals expensed in year (Infrastructure)	–	20.684	27.836		48.520
Renewals expensed in year (Non-Infrastructure)	–	–	–	–	–
Other operating expenditure	3.711	44.481	101.578	25.480	175.250
Local authority and Cumulo rates	0.802	9.064	13.246	1.737	24.849
Total base operating expenditure	**12.437**	**88.680**	**185.239**	**21.283**	**307.639**
Other operating expenditure					
Enhancement operating expenditure	0.008	1.713	–	–	1.721
Growth operating expenditure	–	0.998	1.313	–	2.311
Total operating expenditure excluding third party services	**12.445**	**91.391**	**186.552**	**21.283**	**311.671**
Third party services	0.646	2.351	–	–	2.997
Total operating expenditure	**13.091**	**93.742**	**186.552**	**21.283**	**314.668**
Grants and contributions					
Grants and contributions – operating expenditure	–	–	–	–	–
Capital expenditure					
Base capital expenditure	2.535	85.128	131.661	12.572	231.896
Enhancement capital expenditure	26.811	12.264	62.188	2.773	104.036
Growth capital expenditure	–	10.425	17.644	–	28.069
Total gross capital expenditure excluding third party services	**29.346**	**107.817**	**211.493**	**15.345**	**364.001**
Third party services	1.341	3.254	1.582	–	6.177
Total gross capital expenditure	**30.687**	**111.071**	**213.075**	**15.345**	**370.178**
Grants and contributions					
Grants and contributions – capital expenditure	1.522	5.438	9.250	–	16.210
Net totex	**42.256**	**199.375**	**390.377**	**36.628**	**668.636**
Cash expenditure					
Pension deficit recovery payments	0.186	4.892	10.248	0.830	16.156
Totex including cash items	**42.442**	**204.267**	**400.625**	**37.458**	**684.792**

2C – Cost analysis for the 12 months ended 31 March 2021 – Retail

	Household £m	Non-household £m	Total £m
Operating expenditure			
Customer services	20.967	–	20.967
Debt management	5.083	–	5.083
Doubtful debts	33.823	0.948	34.771
Meter reading	3.484	–	3.484
Other operating expenditure	4.809	–	4.809
Local authority and Cumulo rates	0.018	–	0.018
Total operating expenditure excluding third party services	**68.184**	**0.948**	**69.132**
Depreciation			
Depreciation on tangible fixed assets existing at 31 March 2015	1.135	–	1.135
Depreciation on tangible fixed assets acquired after 1 April 2015	2.754	–	2.754
Amortisation on intangible fixed assets existing at 31 March 2015	1.274	–	1.274
Amortisation on intangible fixed assets acquired after 1 April 2015	0.116	–	0.116
Recharges			
Recharge from wholesale for legacy assets principally used by wholesale (assets existing at 31 March 2015)	0.738	–	0.738
Income from wholesale for legacy assets principally used by retail (assets existing at 31 March 2015)	–	–	–
Recharge from wholesale assets acquired after 1 April 2015 principally used by wholesale	4.840	–	4.840
Income from wholesale assets acquired after 1 April 2015 principally used by retail	–	–	–
Net recharges costs	**5.578**	–	**5.578**
Total retail costs excluding third party and pension deficit repair costs	**79.041**	**0.948**	**79.989**
Third party services operating expenditure	–	–	–
Pension deficit repair costs	1.217	0.130	1.347
Total retail costs including third party and pension deficit repair costs	**80.258**	**1.078**	**81.336**
Debt written off			
Debt written off	1.486	–	1.486
Capital expenditure			
Capital expenditure	8.962	–	8.962
Other operating expenditure includes the net retail expenditure for the following household retail activities which are part funded by wholesale			
Demand-side water efficiency – gross expenditure	0.032		
Demand-side water efficiency – expenditure funded by wholesale	–		
Demand-side water efficiency – net retail expenditure	**0.032**		
Customer-side leak repairs – gross expenditure	–		
Customer-side leak repairs – expenditure funded by wholesale	–		
Customer-side leak repairs – net retail expenditure	–		

Movement in costs from 2019–20

Household retail operating expenditure has decreased by £11.6 million to £68.2 million (2020: £79.8 million). This is principally due to a reduction in debt management costs of £9.1 million to £5.1 million (2020: £14.2 million). This reduction is partly due to suspension of debt collection activity during the period of the first national COVID-19 lockdown, and partly due to the introduction of new debt collection processes.

The bad debt charge increased by £5.4 million to £34.8 million (2020 £29.4 million) as a result of assessment of the collectability of our outstanding debt in light of the anticipated impact of the pandemic on the economy and reflecting the fact that the likely recovery of debt that has reached the end of the recovery process has worsened.

Customer services costs have reduced by £4.6 million as 2020 included a one-off restructuring activity to transition customer services to an outsourced supplier.

Other operating expenditure has reduced by £2.1 million as a result of lower overhead allocation to the business unit following this outsourcing event. Meter reading costs have reduced by £0.2 million.

Comparison to the final determination

Household

Total household retail costs excluding recharges of £75.5 million are £24.7 million higher than allowed in the Final Determination (£50.8 million). The increase is due to the following factors:

The bad debt charge is £21.3m million higher than assumed in the business plan. This is due to a worsening in our assessment of the recoverability of debt that has reached the end of the recovery process largely as a result of to the impact of the COVID-19 pandemic. Debt management costs are £1.5 million lower than the business plan as a result of suspension of collection activities during the first National lockdown in quarter 1.

Customer services costs are £6.0 million higher than the business plan due to transformational activities taking longer than planned, but this is offset by £4.3 million lower allocated overheads due to the outsourcing of customer services. Meter reading costs are £1.2 million over the business plan due to additional costs incurred as a result of increasing volumes of failing automatic reads and due to transitional costs to a new meter reading contractor from 1 April 2021.

The charge for depreciation and amortisation of tangible and intangible assets for the household retail business is £1.9 million higher than the allowance in the Final Determination. This is because the charge for depreciation and amortisation on assets acquired after March 2015 is £2.0 million higher than the allowance in the Final Determination of £0.9 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 incurred during the year relate to increasing the bad debt provision for non-household debt outstanding from 31 March 2017.

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

	Wholesale				Retail		
	Water resources £m	Water network + £m	Wastewater network + £m	Bioresources £m	Household £m	Non-household £m	Total £m
Cost							
At 1 April 2020	201.523	1,893.818	6,288.851	592.985	32.836	–	9,010.013
Disposals	(1.388)	(6.880)	(9.876)	(0.296)	–	–	(18.440)
Additions	23.148	111.004	191.764	15.293	2.187	–	343.396
Assets adopted at nil cost	–	–	18.202	–	–	–	18.202
At 31 March 2021	**223.283**	**1,997.942**	**6,488.941**	**607.982**	**35.023**	**–**	**9,353.171**
Depreciation							
At 1 April 2019	(66.737)	(584.263)	(1,958.116)	(270.828)	(21.679)	–	(2,901.623)
Disposals	1.388	6.880	9.876	0.296	–	–	18.440
Charge for year	(4.572)	(56.869)	(179.167)	(20.078)	(3.889)	–	(264.575)
At 31 March 2021	**(69.921)**	**(634.252)**	**(2,127.407)**	**(290.610)**	**(25.568)**	**–**	**(3,147.758)**
Net book amount at 31 March 2021	**153.362**	**1,363.690**	**4,361.534**	**317.372**	**9.455**	**–**	**6,205.413**
Net book amount at 1 April 2020	134.786	1,309.555	4,330.735	322.157	11.157	–	6,108.390
Depreciation charge for year							
Principal services	(4.305)	(56.275)	(178.789)	(20.077)	(3.889)	–	(263.335)
Third party services	(0.267)	(0.594)	(0.378)	(0.001)	–	–	(1.240)
Total	**(4.572)**	**(56.869)**	**(179.167)**	**(20.078)**	**(3.889)**	**–**	**(264.575)**

The net book value of tangible assets includes £726.6 million in respect of assets in the course of construction.

In order to present the intangible asset information alongside the fixed asset information Table 2O is presented on the next page.

2O – Historic cost analysis of intangible assets – Wholesale and retail

	Wholesale				Retail		
	Water resources £m	Water network + £m	Wastewater network + £m	Bioresources £m	Household £m	Non-household £m	Total £m
Cost							
At 1 April 2020	12.798	4.991	93.513	0.224	22.219	–	133.745
Additions	7.539	0.067	21.311	0.052	6.775	–	35.744
Adjustments	124.606	–	–	–	–	–	124.606
At 31 March 2021	**144.943**	**5.058**	**114.824**	**0.276**	**28.994**	**–**	**294.095**
Depreciation							
At 1 April 2020	(8.303)	(1.646)	(70.642)	(0.081)	(12.519)	–	(93.191)
Charge for year	(0.142)	(0.735)	(10.506)	(0.012)	(1.390)	–	(12.785)
At 31 March 2021	**(8.445)**	**(2.381)**	**(81.148)**	**(0.093)**	**(13.909)**	**–**	**(105.976)**
Net book amount at 31 March 2021	**136.498**	**2.677**	**33.676**	**0.183**	**15.085**	**–**	**188.119**
Net book amount at 1 April 2020	4.495	3.345	22.871	0.143	9.700	–	40.554
Depreciation charge for year							
Principal services	(0.139)	(0.727)	(10.506)	(0.012)	(1.390)	–	(12.774)
Third party services	(0.003)	(0.008)	–	–	–	–	(0.011)
Total	**(0.142)**	**(0.735)**	**(10.506)**	**(0.012)**	**(1.390)**	**–**	**(12.785)**

The net book value of intangible assets includes £153.7 million in respect of assets in the course of construction.

During the year we have signed an agreement with Portsmouth Water for the construction of a new reservoir at Havant Thicket. The agreement requires us to make capacity charge payments to Portsmouth Water over an 80-year period to fund the construction of the reservoir as well as entitling us to a bulk supply from them. We have recorded an increase in our intangible assets during the year of £124.6 million for this agreement, offset by a long-term liability for the capacity charge payments and this has been presented in the adjustment line within table 2O above. This asset is currently held within assets in the course of construction

2E – Analysis of 'grants and contributions' for the 12 months ended 31 March 2021 – water resources, water network+ and wastewater network+

	Fully recognised in income statement £m	Capitalised and amortised (in the income statement) £m	Total £m
Grants and contributions – water resources			
Diversions – s185	–	–	–
Other contributions (price control)	–	1.522	1.522
Price control grants and contributions	–	1.522	1.522
Diversions – NRSWA	–	–	–
Diversions – other non-price control	–	–	–
Other contributions (non-price control)	–	–	–
Total	–	1.522	1.522
Value of adopted assets	–	–	–
Grants and contributions – water network+			
Connection charges	4.008	–	4.008
Infrastructure charge receipts	0.377	–	0.377
Requisitioned mains	(0.120)	1.094	0.974
Diversions – s185	0.879	–	0.879
Other contributions (price control)	–	0.945	0.945
Price control grants and contributions before deduction of income offset	5.144	2.039	7.183
Income offset	2.444	–	2.444
Price control grants and contributions after deduction of income offset	2.700	2.039	4.739
Diversions – NRSWA	0.699	–	0.699
Diversions – other non-price control	–	–	–
Other contributions (non-price control)	–	–	–
Total	3.399	2.039	5.438
Value of adopted assets	–	–	–
Grants and contributions – wastewater network+			
Receipts for on-site work	(0.246)	0.001	(0.245)
Infrastructure charge receipts	9.035	–	9.035
Diversions – s185	0.214	–	0.214
Other contributions (price control)	0.496	–	0.496
Price control grants and contributions before deduction of income offset	9.499	0.001	9.500
Income offset	1.631	–	1.631
Price control grants and contributions after deduction of income offset	7.868	0.001	7.869
Diversions – NRSWA	–	–	–
Diversions – other non-price control	–	–	–
Other contributions (non-price control)	–	1.381	1.381
Total	7.868	1.382	9.250
Value of adopted assets	18.202	–	18.202

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 £3.4 million and £7.9 million disclosed above for water and wastewater respectively together with £18.2 million of adopted assets.

2E – Analysis of 'grants and contributions' for the 12 months ended 31 March 2021 – water resources, water network+ and wastewater network+ – continued

	Water resources £m	Water network+ £m	Wastewater network+ £m	Total £m
Movements in capitalised grants and contributions				
Brought forward	2.762	7.581	10.414	**20.757**
Capitalised in year	1.522	2.039	1.382	**4.943**
Amortisation (in income statement)	(0.150)	(0.838)	(0.586)	**(1.574)**
Carried forward	**4.134**	**8.782**	**11.210**	**24.126**

2F – Residential retail

	Revenue £m	Number of customers 000's	Average residential revenues £
Residential revenue			
Wholesale charges	573.653		
Retail revenue	49.610		
Total residential revenue	**623.263**		
Retail revenue			
Revenue Recovered ('RR')	49.610		
Revenue sacrifice	–		
Actual revenue (net)	**49.610**		
Customer information			
Actual customers ('AC')		1,946.866	
Reforecast customers		1,965.818	
Adjustment			
Allowed revenue ('R')	49.427		
Net adjustment	(0.184)		
Other residential information			
Average residential retail revenue per customer			25.48

As we have exited the retail market and in accordance with the guidance in RAG 4.09, we are not required to report tables 2G and 2H.

2I – Revenue analysis for the 12 months ended 31 March 2021

	Household £m	Non-household £m	Total £m	Water resources £m	Water network+ £m	Total £m
Wholesale charge – water						
Unmeasured	16.787	0.987	17.774	2.539	15.235	17.774
Measured	137.157	37.179	174.336	24.908	149.428	174.336
Third party revenue	–	0.600	0.600	–	0.600	0.600
Total wholesale water revenue	**153.944**	**38.766**	**192.710**	**27.447**	**165.263**	**192.710**

	Household £m	Non-household £m	Total £m	Wastewater network+ £m	Bioresources £m	Total £m
Wholesale charge – wastewater						
Unmeasured – foul charges	77.895	2.632	80.527	71.452	9.075	80.527
Unmeasured – surface water charges	5.485	0.116	5.601	5.601	–	5.601
Unmeasured – highway drainage charges	3.131	0.061	3.192	3.192	–	3.192
Measured – foul charges	293.110	66.010	359.120	318.648	40.472	359.120
Measured – surface water charges	24.452	2.105	26.557	26.557	–	26.557
Measured – highway drainage charges	15.636	0.665	16.301	16.301	–	16.301
Total wholesale wastewater revenue	**419.709**	**71.589**	**491.298**	**441.751**	**49.547**	**491.298**
Wholesale total	**573.653**	**110.355**	**684.008**	**469.198**	**214.810**	**684.008**
Retail revenue						
Unmeasured	7.478	–	7.478			
Measured	42.132	–	42.132			
Other third party revenue	–	1.172	1.172			
Retail total	**49.610**	**1.172**	**50.782**			
Third party revenue – non-price control						
Bulk supplies – water			3.850			
Bulk supplies – wastewater			0.768			
Other third party revenue			1.783			
Principal services – non-price control			0.010			
Other appointed revenue						
Total appointed revenue			**741.201**			

2J – Infrastructure network reinforcement costs for the 12 months ended 31 March 2021

	Network reinforcement capex £m	On site / site specific capex (memo only) £m
Wholesale water network+ (treated water distribution)		
Distribution and trunk mains	–	6.091
Pumping and storage facilities	0.335	–
Total	**0.335**	6.091
Wholesale wastewater network+ (sewage collection)		
Foul and combined systems	10.502	4.836
Pumping and storage facilities	0.386	0.581
Total	**10.888**	5.417

2K – New connections – infrastructure charges reconciliation for the 12 months ended 31 March 2021

	Water £m	Wastewater £m	Total £m
Impact of infrastructure charge discounts			
Infrastructure charges	0.377	9.035	9.412
Discounts applied to infrastructure charges	0.049	–	0.049
Gross infrastructure charges	**0.426**	**9.035**	**9.461**
Comparison of revenue and costs			
Variance brought forward	4.216	(3.068)	1.148
Revenue	0.426	9.035	9.461
Costs	(0.335)	(10.888)	(11.223)
Variance carried forward	**4.307**	**(4.921)**	**(0.614)**

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.

2L – Analysis of land sales for the 12 months ended 31 March 2021

	Water resources £m	Water Network+ £m	Wastewater Network+ £m	Total £m
Proceeds from disposals of protected land	–	–	0.305	0.305

2M – Revenue reconciliation for the 12 months ended 31 March 2021 – wholesale

	Water resources £m	Water network+ £m	Wastewater network+ £m	Bioresources £m	Total £m
Revenue recognised					
Wholesale revenue governed by price control	27.447	165.263	441.751	49.547	684.008
Grants and contributions (price control)	1.522	4.739	7.869	–	14.130
Total revenue governed by wholesale price control	**28.969**	**170.002**	**449.620**	**49.547**	**698.138**
Calculation of the revenue cap					
Allowed wholesale revenue before adjustments (or modified by CMA)	28.324	169.784	444.800	49.528	692.436
Allowed grants and contributions before adjustments (or modified by CMA)	0.598	16.701	20.363	–	37.662
Revenue adjustment	–	–	–	(1.713)	(1.713)
Revenue cap	**28.923**	**186.485**	**465.162**	**47.815**	**728.385**
Calculation of the revenue imbalance					
Revenue cap	28.923	186.485	465.162	47.815	728.385
Revenue recovered	28.969	170.092	449.620	49.547	698.138
Revenue imbalance	**(0.047)**	**16.483**	**15.543**	**1.577**	**33.556**

Overall wholesale price control revenue was £33.5 million (4.5%) lower than allowed in the final determination.

Wholesale revenues governed by the price control (water, wastewater and trade effluent charges) were £8 million below allowed revenues. The COVID-19 national lockdown resulted in a large increase in household demand, with many customers spending more time at home. Consequently, our household revenues for 2020–21 were £22 million above allowed revenues. The higher household revenue was offset by non-household revenues which were £30 million lower than the allowance, principally because of the COVID-19 related restrictions on businesses.

Our actual wastewater revenues include the rebates being made to customers as part of the Ofwat settlement and include an amount of £1.0 million in respect of former customers.

In total grants and contributions were £23 million below the allowed level. Contributions received for water resources were £1 million higher than our allowance offset by water and wastewater network+ which were both £12 million lower than the allowance. This is primarily due to the impact of the national lockdown on the construction industry which reduced developer related activities in relation to requisitions, diversions and new connections. In addition, we have experienced increasing numbers of New Appointment Variations (NAV) and water self-lay activity, resulting in much lower requisition volumes.

The allowed wholesale revenue for bioresources is as set out in Ofwat's final determination. The associated Revenue adjustment is because the actual volume of sludge was lower than forecast in our business plan and reflected in the final determination. The calculation of the revenue adjustment and revenue imbalance are consistent with Ofwat's bioresources revenue reconciliation model.

2N – Residential retail – social tariffs

	Revenue £m	Number of customers 000s	Average amount of customers £
Number of residential customers on social tariffs			
Residential water only social tariffs		1.416	
Residential wastewater only social tariffs		49.471	
Residential dual service social tariffs		38.281	
Number of residential customers not on social tariffs			
Residential water only no social tariffs		88.729	
Residential wastewater only no social tariffs		861.669	
Residential dual service no social tariffs		907.300	
Social tariff discount			
Average discount per water only social tariffs customer			–
Average discount per wastewater only social tariffs customer			–
Average discount per dual service social tariffs customer			–
Social tariff cross-subsidy – residential customers			
Total customer funded cross-subsidies for water only social tariffs customers	0.059		
Total customer funded cross-subsidies for wastewater only social tariffs customers	2.779		
Total customer funded cross-subsidies for dual service social tariffs customers	3.268		
Average customer funded cross-subsidy per water only social tariffs customer			0.655
Average customer funded cross-subsidy per wastewater only social tariffs customers			3.050
Average customer funded cross-subsidy per dual service social tariffs customer			3.456
Social tariff cross-subsidy – company			
Total revenue forgone by company to fund cross-subsidies for water only social tariffs customers	–		
Total revenue forgone by company to fund cross-subsidies for wastewater only social tariffs customers	–		
Total revenue forgone by company to fund cross-subsidies for dual service social tariffs customers	–		
Average revenue forgone by company to fund cross-subsidy per water only social tariffs customer			–
Average revenue forgone by company to fund cross-subsidy per wastewater only social tariffs customer			–
Average revenue forgone by company to fund cross-subsidy per dual service social tariffs customer			–
Social tariff support – willingness to pay			
Level of support for social tariff customers reflected in business plan			6
Maximum contribution to social tariffs supported by customer engagement			6

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 the sections of Southern Water Services Limited's ("the Company") Annual Performance Report for the year ended 31 March 2021 ("the Regulatory Accounting Statements") which comprise:

- the regulatory financial reporting tables comprising the income statement (table 1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D), the net debt analysis (table 1E), lines 1F.1 to 1F.3, 1F.5 to 1F.6, 1F.8, 1F.12 to 1F.14, 1F.18 and 1F.23 to 1F.24 of the statement of financial flows (table 1F) and the related notes; and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of grants and contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G), the non-household wastewater revenues by customer type (table 2H), the revenue analysis and wholesale control reconciliation (table 2I), the infrastructure network reinforcement costs (table 2J), the infrastructure charges reconciliation (table 2K), the analysis of land sales (table 2L), the revenue reconciliation for wholesale (table 2M), residential retail social tariffs (table 2N) and historical cost analysis of intangible assets (table 2O) and the related notes.

We have not audited lines 1F.4, 1F.7, 1F.9 to 1F.11, 1F.15 to 1F.17, 1F.19 to 1F.22 and 1F.25 of the statement of financial flows (table 1F), the Outcome performance table (tables 3A to 3I) and the additional regulatory information in tables 4A to 4R, 5A to 5B, 6A to 6D, 7A to 7E, 8A to 8D and 9A.

In our opinion, Southern Water Services Limited's Regulatory Accounting Statements have been prepared, in all material aspects, in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.09, RAG 2.08, RAG 3.12, RAG 4.09 and RAG 5.07) and the accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.12, appendix 2), set out on page 28.

Basis for opinion

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

Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the Regulatory Accounting Statements within the Annual Performance Report section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit, including the Financial Reporting Council's (FRC's) Ethical Standard, 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 1h in the Regulatory Accounting Report concerning the uncertain outcome of certain regulatory investigations regarding the performance of certain wastewater plants. Southern Water faces a prosecution and other investigations from the Environment Agency ('EA'). The ultimate obligation arising from this matter cannot presently be determined because of the very wide range of possible outcomes in the sentencing guidelines, the uncertain and disputed levels of culpability and environmental harm, the lack of precedent, and the fact that for sentencing purposes Southern Water would be considered a Very Large Organisation meaning that the court has broad discretion in determining the penalty that might be applied. The Board, supported by legal advice, was not able to make a reliable overall estimate of the financial obligation that will arise from this EA prosecution, notwithstanding the guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, recognising that there will be a minimum liability associated with the permit breaches the Board has therefore recognised a provision of £1 million for the 51 cases brought to date, reflecting a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs.

Our opinion is not modified in respect of this matter.

Emphasis of matter – special purpose basis of preparation

We draw attention to the fact that the Regulatory Accounting Statements have been prepared in accordance with a special purpose framework, Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.12, appendix 2) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly, we make no such assessment. In addition, we are not required to assess whether the methods of cost allocation set out in the accounting methodology statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA.

The Regulatory Accounting Statements are separate from the statutory financial statements of the Company and have not been prepared under the basis of international accounting standards in conformity with the requirements of the Companies Act 2006 ("UK IASs"). Financial information other than that prepared on the basis of UK IASs 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 19 to 49 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from IASs. A summary of the effect of these departures in the Company's statutory financial statements is included in the tables within section 1.

Our opinion is not modified in respect of this matter.

Conclusions relating to going concern

In auditing the Regulatory Accounting Statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the Regulatory Accounting Statements is appropriate.

Our evaluation of the directors' assessment of the Company's ability to continue to adopt the going concern basis of accounting included:

- Obtained an understanding of relevant controls related to the management assessment of the going concern;
- Obtained third party confirmation for the group's borrowing facilities available, including drawn and undrawn amounts;
- Assessed the reasonableness of the cash flows projections and the appropriateness of the sensitivities performed by management;
- Performed integrity checks of management's going concern model, including checking for mathematical and clerical accuracy;
- Recalculated debt covenants and assessed compliance over the forecasted period, including consideration of the waiver from its Lenders in February 2021 which allows full use of available liquidity, plus the raising of new finance, even in a Trigger Event scenario of a credit rating downgrade or a breach of a trigger debt compliance ratio;
- Assessed consistency of the forecasted cash flows with the forecasts prepared for the goodwill and investments impairment models;
- Evaluated management's stress tests and performed independent sensitivity scenarios tests; and
- Assessed the appropriateness of the disclosures over going concern included within the financial statements in view of the latest guidance from the FRC.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for a period of at least twelve months from when the Regulatory Accounting Statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

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 we do not express any form of assurance conclusion thereon.

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

We have nothing to report based on these responsibilities.

Responsibilities of the Directors

As explained more fully in the Statement of Directors' Responsibilities set out on pages 12 to 13, the directors are responsible for the preparation of the Annual Performance Report in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.12, appendix 2).

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

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

Auditors’ responsibilities for the Audit of the Regulatory Accounting Statements

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

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

We considered the nature of the company’s industry and its control environment, and reviewed the company’s documentation of their policies and procedures relating to fraud and compliance with laws and regulations. We also enquired of management about their own identification and assessment of the risks of irregularities.

We obtained an understanding of the legal and regulatory framework(s) that the company operates in, and identified the key laws and regulations that:

- Had a direct effect on the determination of material amounts and disclosures in the Regulatory Accounting Statements. These included Regulatory Accounting Guidelines as issued by the WSRA, UK Companies Act, pensions legislation and tax legislation; and
- Do not have a direct effect on the Regulatory Accounting Statements but compliance with which may be fundamental to the company’s ability to operate or to avoid a material penalty. These included the company’s operating licence, regulatory solvency requirements and environmental regulations.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override. In addressing the risk of fraud through management override of controls, we tested the appropriateness of journal entries and other adjustments; assessed whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluated the business rationale of any significant transactions that are unusual or outside the normal course of business.

In addition to the above, our procedures to respond to the risks identified included the following:

- Reviewing financial statement disclosures by testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- Performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- Enquiring of management, internal audit and external legal counsel concerning actual and potential litigation and claims, and instances of non-compliance with laws and regulations; and
- Reading minutes of meetings of those charged with governance, reviewing internal audit reports and correspondence with HMRC and WSRA.

A further description of our responsibilities for the audit of the Regulatory Accounting Statements is located on the Financial Reporting Council’s website at **frc.org.uk/auditorsresponsibilities.** This description forms part of our auditor’s 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 2021 on which we reported on 30 June 2021, 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

8 July 2021

Performance Summary

Assurance

KPMG LLP were engaged to provide independent limited assurance over the selected annual performance data highlighted in this section marked with the symbol △ for the calendar year ended 31 December 2020 and the information marked with the symbol * for the year ended 31 March 2021 using the assurance standard ISAE (UK) 3000. KPMG LLP has provided assurance only over the amounts for the current reporting year and not the previous reporting year. KPMG LLP has issued an unqualified opinion over the selected data. KPMG LLP's full assurance statement is available on page 66.

3A – Outcome performance – Water common performance commitments

			Performance level – actual				
Common performance commitments – Water (Financial)	Status	Unit	Previous reporting year	Current reporting year	PCL met?	Outperformance or underperformance payment	Forecast of total 2020–25 outperformance or underperformance payment
Water quality compliance (CRI)△	−	number	7.66	4.53	No	(1.589)	(2.832)
Water supply interruptions*	✗	hh:mm:ss	00:10:41	00:12:43	No	(1.517)	(4.575)
Leakage*	−	%	–	1.4	No	(0.398)	(2.239)
Per capita consumption*	✗	%	–	-3.0	No	(0.908)	(5.660)
Mains repairs*	✗	number	111.5	150.0	No	(1.756)	(1.498)
Unplanned outage*	✓	%	18.59	9.21	Yes	–	(0.681)
Bespoke performance commitments – Water and Retail (Financial)							
Drinking water appearance△	−	nr	0.93	0.89	No	(0.277)	0.909
Drinking water taste and odour△	−	nr	0.27	0.26	No	(0.092)	(0.416)
Abstraction Incentive Mechanism*	✓	nr	-15	-15	Yes	–	2.044
Access to daily water consumption data	−	nr	–	0	No	–	0.001
Void properties*	−	%	3.49	3.47	No	(0.600)	(2.520)
Replace lead customer pipes	−	nr	–	0	No	–	0.159
Properties at risk of receiving low pressure*	✗	nr	203	310	No	(0.118)	(0.467)
Long term supply demand schemes	✓	months	–	0	Yes	–	0.000
Impounding reservoirs	✓	%	–	0	Yes	–	(0.324)
Financial water performance commitments achieved	%	–			27		
Overall performance commitments achieved (excluding C-MeX and D-MeX)	%	–			33		

Notes:
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.

3B – Outcome performance – Wastewater common performance commitments

Common performance commitments – Wastewater (Financial)	Status	Unit	Performance level – actual: Previous reporting year	Performance level – actual: Current reporting year	PCL met?	Outperformance or underperformance payment	Forecast of total 2020–25 outperformance or underperformance payment
Internal sewer flooding*		Number of internal sewer flooding incidents per 10,000 sewer connection	2.27	1.96	No	(1.556)	3.334
Pollution incidents△		Pollution incidents per 10,000 km of sewer length	116.41	101.52	No	(7.718)	(17.990)
Sewer collapses*		Number of sewer collapses per 1,000 km of all sewers	7.80	7.91	No	(4.036)	(10.026)
Treatment works compliance△		%	99.37	97.06	No	(19.400)	(28.400)
Bespoke performance commitments – Wastewater (Financial)							
Effluent re-use		nr	–	273	Yes	0.001	0.001
Renewable generation*		%	16.10	16.42	No	(1.326)	(3.819)
Satisfactory bioresources recycling△		%	100.00	100.00	Yes	–	–
River water quality*		nr	–	–	–	–	–
Maintain bathing waters at 'Excellent'△		nr	–	–	–	–	–
Improve the number of bathing waters to at least 'Good' (Cost Adjustment Claim)△		nr	–	–	–	–	(3.704)
Improve the bathing waters at 'Excellent' quality (Cost Adjustment Claim)△		nr	–	–	–	–	(1.700)
Surface water management		m^3	–	–	No	(0.030)	(0.239)
External sewer flooding*		nr	5,968	4,409	Yes	0.014	5.589
Thanet sewers		months	–	–	Yes	–	–
Financial wastewater performance commitments achieved	%	–			40		

Key

Ofwat target met or exceeded

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

Ofwat target missed and performance worse than prior year outcome

– Not applicable

3C – Customer measure of experience (C-MeX) table

Item	Unit	Value
Annual customer satisfaction score for the customer service survey	Number	67.50
Annual customer satisfaction score for the customer experience survey	Number	81.79
Annual C-MeX score*	Number	74.64
Annual net promoter score	Number	14.50
Total household complaints	Number	88,210
Total connected household properties	Number	2,023,725
Total household complaints per 10,000 connections	Number	435.88
Confirmation of communication channels offered	True or False	True

3D – Developer services measure of experience (D-MeX) table

Item	Unit	Value
Qualitative component annual results	Number	62.41
Quantitative component annual results	Number	85.13
D-MeX score*	Number	73.77
Developer services revenue (water)	£m	8.754
Developer services revenue (wastewater)	£m	9.500

Calculating the D-MeX quantitative component

Water UK performance metric	Unit	First reporting period (1 April to 30 September)	Second reporting period (1 October to 31 March)	Quantitative score (annual)
W1.1 Pre-development enquiry – reports issued within target	%	96.43%	100.00%	
W3.1 s45 quotations – within target	%	88.15%	99.54%	
W4.1 s45 service pipe connections – within target	%	100.00%	100.00%	
W6.1 Mains design	%	0.00%	68.00%	
W7.1 Mains design >500 plots – quotations within target	%	–	100.00%	
W8.1 Mains construction within target	%	98.18%	100.00%	
W17.1 Mains diversions (without constraints) – quotations within target	%	–	80.00%	
W17.2 Mains diversions (with constraints) – quotations within target	%	100.00%	–	
W18.1 Mains diversions – construction/commissioning within target	%	100.00%	–	
W20.1 Self lay Point of Connection report < 500 plots etc – reports issued within target	%	50.00%	66.67%	
W21.1 Self lay Point of Connection reports >500 plots etc – reports issued within target	%	–	100.00%	
W23.1 Self lay design and terms request	%	54.55%	72.73%	
W24.1 Self lay design and terms request >500 plots etc – quotations within target	%	–	–	
W26.1 Self lay water for pressure/bacteriological testing – provided within target	%	100.00%	100.00%	
W27.1 Self lay permanent water supply – provided within target	%	100.00%	100.00%	
W30.1 Self lay plot references and costing details – issued within target	%	–	–	

Calculating the D-MeX quantitative component (continued)

Water UK performance metric	Unit	First reporting period (1 April to 30 September)	Second reporting period (1 October to 31 March)	Quantitative score (annual)
S1.1 Pre-development enquiry – reports issued within target	%	96.63%	98.18%	
S3.1 Sewer requisition design – offers issued within target	%	70.59%	100.00%	
S4.1 Sewer requisition – constructed and commissioned within agreed extension	%	–	100.00%	
S7.1 Adoption legal agreement – draft agreements issued within target	%	100.00%	100.00%	
SN2.2 % Bulk discharge offer letters issued to the applicant within target period	%	–	97.92%	
SN4.1 % of main laying schemes constructed and commissioned within the target period	%	–	100.00%	
WN1.1 % of confirmations issued to the applicant within target period	%	–	–	
WN2.2 % Bulk supply offer letters issued to the applicant within target period	%	–	82.86%	
WN4.1 % of main laying schemes constructed and commissioned within the target period	%	–	–	
WN4.2 % of testing supplies provided within target period	%	–	–	
WN4.3 % of permanent supplies made available within the target period	%	–	–	
SAM – 3/1 Update draft agreement	%	–	–	
SAM 4/1 Inspections and construction period	%	–	100.00%	
D-MeX quantitative score (for the relevant reporting period)	%	76.97%	93.29%	
D-MeX quantitative score (annual)	Number			0.85

3E – Outcome performance – Non financial performance commitments

			Performance level – actual		
Common	Status	Unit	Previous reporting year	Current reporting year	PCL met?
Risk of severe restrictions in a drought*	✓	%	0.0	0.0	Yes
Priority services for customers in vulnerable circumstances – PSR reach*	–	%	1.1	1.9	No
Priority services for customers in vulnerable circumstances – Attempted contacts*	✓	%	0.0	51.8	Yes
Priority services for customers in vulnerable circumstances – Actual contacts*	✓	%	0.0	19.8	Yes
Risk of sewer flooding in a storm	✓	%	12.31	11.77	Yes

Bespoke performance commitments					
Target 100*	–	%	–	35	No
Water saved from water efficiency visits	–	nr	–	105	No
Effectiveness of financial assistance	✗	%	72	65	No
Customer satisfaction with vulnerability support*	✗	%	–	70	No
Community engagement	–	rank	–	0	No
Schools visited and engagement with children	✓	%	–	–	–
Water supply resilience*	✓	nr	–	139,121	Yes
Combined Sewer Overflows (CSO) monitoring	–	%	–	84.77	No
Natural capital	✓	nr	–	0	Yes
Gap sites*	✗	nr	–	12	No
Distribution input*	✗	nr	544	563	No
Value for money	–	%	71	71	No
WINEP delivery*	–	text	–	Not met	No
Financial water performance commitments achieved	%	0			35

3F – Underlying calculations for common performance commitments – water and retail

Performance commitments set in standardised units – Water	Status	Unit	Standardising data indicator	Standardising data numerical value	Performance level – Actual (current reporting year)	Performance level – Calculated (i.e. standardised)
Mains repairs – Reactive	✗	Mains repairs per 1000 km	Mains length in km	13,972.50	1,310	93.76
Mains repairs – Proactive	✗	Mains repairs per 1000 km	Mains length in km	13,972.50	786	56.25
Mains repairs	✗	Mains repairs per 1000 km	Mains length in km	13,972.50	2,096	150.01
Per capita consumption (PCC)	✗	lpd	Total household population (000s) and household consumption (Ml/d)	2,545.27	350	137.51

Performance commitments measured against a calculated baseline	Status	Unit	Performance level – actual (2017–18)	Performance level – actual (2018–19)	Performance level – actual (2019–20)	Baseline	Performance level – actual (2020–21)	Performance level 3 year average	Calculated performance level to compare against PCLs
Leakage	–	Ml/d	102.6	102.9	94.1	99.9	98.4	98.5	1.4
Per capita consumption (PCC)	✗	lpd	126.0	129.6	128.1	127.9	137.5	131.7	-3.0

Water supply interruptions	Status	Unit	Standardising data indicator	Standardising data numerical value	Total minutes lost	Number of properties supply interrupted	Calculated performance level
Water supply interruptions	✗	Average number of minutes lost per property per year	Number of properties	1,134.8	14,432,151	26,037	00:12:43

Unplanned or planned outage	Status	Current company level peak week production capacity (PWPC) Ml/d	Reduction in company level PWPC Ml/d	Outage proportion of PWPC %
Unplanned outage	✓	885.4	81.54	9.21%

Priority services for customers in vulnerable circumstances	Status	Total residential properties	Total number of households on the PSR (as at 31 March)	PSR reach	Total number of households on the PSR over a 2 year period	Number of attempted contacts over a 2 year period	Attempted contacts %	Number of actual contacts over a 2 year period	Actual contacts %
Priority services for customers in vulnerable circumstances	–	1,957	36,441	1.9%	20,420	10,580	51.8%	4,037	19.8%

3G – Underlying calculations for common performance commitments – wastewater

Performance commitments set in standardised units	Status	Units	Standardising data indicator	Standardising data numerical value	Performance level – actual current reporting year	Calculated performance level
Internal sewer flooding – customer proactively reported		Number of internal sewer flooding incidents per 10,000 sewer connection	Number of sewer connections	2,009.68	393	1.96
Internal sewer flooding – company reactively identified (i.e. neighbouring properties)		Number of internal sewer flooding incidents per 10,000 sewer connection	Number of sewer connections	2,009.68	0	0.00
Internal sewer flooding		Number of internal sewer flooding incidents per 10,000 sewer connection	Number of sewer connections	2,009.68	393	1.96
Pollution incidents		Pollution incidents per 10,000 km of sewer length	Sewer length in km	39,600.00	402	101.52
Sewer collapses		Number of sewer collapses per 1,000 km of all sewers	Sewer length in km	39,835.00	315	7.91

3H – Summary information on outcome delivery incentive payments

	Initial calculation of performance payments (excluding C-MeX and D-MeX) £m (2017–18 prices)
Initial calculation of in period revenue adjustment by price control	
Water resources	(0.908)
Water network+	(5.786)
Wastewater network+	(32.725)
Bioresources (sludge)	(1.286)
Residential retail	(0.600)
Business retail	–
Dummy control	–
Initial calculation of end of period revenue adjustment by price control	
Water resources	–
Water network+	–
Wastewater network+	–
Bioresources (sludge)	–
Residential retail	–
Business retail	–
Dummy control	–
Initial calculation of end of period RCV adjustment by price control	
Water resources	–
Water network+	–
Wastewater network+	–
Bioresources (sludge)	–
Residential retail	–
Business retail	–
Dummy control	–

3I – Supplementary outcomes information

Unplanned or planned outage	Status	Current company level peak week production capacity (PWPC) Ml/d	Reduction in company level PWPC Ml/d	Outage proportion of PWPC %
Unplanned outage		885.40	1.83	0.21%

Risk of severe restrictions in drought	Status	Deployable output	Outage allowance	Dry year demand	Target headroom	Total population supplied	Customers at risk
Risk of severe restrictions in drought		782.62	97.18	562.66	37.80	2,597,123.55	0.0

Risk of sewer flooding in a storm	Status	Total pe served	Total pe in excluded catchments	Percentage of total pe in excluded catchments
Risk of sewer flooding in a storm		4,863,436.04	0.00	0.00

Risk of sewer flooding in a storm	Status	Total pe Option 1a	Percentage of total pe Option 1a	Total pe Option 1b	Percentage of total pe Option 1b	Vulnerability risk grade Low	Medium	High
						Percentage of total population served		
Risk of sewer flooding in a storm		254,200.23	5.23%	4,609,235.82	94.77%	88.23%	4.03%	7.73%

Sewer collapses	Status	Number of patch repairs or relining undertaken on sewer and not included in reported sewer collapses
Sewer collapses		664.00

2020–21 performance against performance commitments

2020–21 represents the first year of AMP7 with a new set of performance commitments and targets set as part of the PR19 process.

Performance in this first year has been mixed, partly reflecting the step change in performance required from all companies by Ofwat. We met or exceeded 14 of our performance commitments, but were below (worse than) the PR19 target for the remaining 28 commitments. For seven performance commitments performance deteriorated compared with 2019–20.

As a result we have incurred total ODI penalties of £40.7m million for wholesale services. We earned small rewards totalling £0.015 million for two performance commitments, external sewer flooding and effluent re-use. For Ofwat's C-MeX and D-MeX measures of customer experience, which are based on comparative performance, we forecast penalties of £4.7 million and £1.0 million respectively. The impact of these penalties and rewards will be reflected in customers' bills from 2022–23.

We comment here on the wholesale performance commitments associated with the largest underperformance payments[4]. A full description of performance against all of our performance commitments is provided in our Annual Report and Financial Statements.

Mains repairs (underperformance payment: £1.8 million)

We have incurred a significant underperformance payment for mains repairs, following extreme temperatures in January which resulted in a 65% month-on-month increase in the number of repairs and levels only exceeded by the 'beast from the east' event in late 2018–19.

Compliance Risk Index (underperformance payment: £1.6 million)

Whilst our CRI score has improved, and is therefore amber, we are aware that we remain an outlier in the industry and have a recovery plan in place which will see us below the underperformance payment deadband by 2023–24.

Interruptions to supply (underperformance payment: £1.5 million)

The extreme weather of January 2021 also impacted interruptions to supply, with our year end outcome exceeding 12 minutes and incurring an underperformance payment. Whilst we anticipate we will incur further underperformance payments for interruptions during this five-year regulatory period, a recovery plan is in place to improve performance to no more than seven minutes and 18 seconds by the end of the AMP.

Leakage (underperformance payment: £0.4 million)

Leakage for 2020–21 is 98.4 Ml/d which is below the year-end forecast of 99.6 Ml/d contained in our 2019 Water Resources Management Plan. However, our three-year average total leakage, which is the basis of our performance commitment was above target, resulting in an underperformance payment. During last year we maintained the planned level of leakage activity, but the need to maintain social distancing meant that we were unable to increase the level of resources in the field to respond to higher leakage resulting from higher network pressure (associated with COVID-19 related changes in demand patterns).

Per capita consumption (underperformance payment: n/a)

The COVID-19 pandemic resulted in significant changes to patterns of water consumption with much more consumption in the home and reduced business usage. The notional underperformance payment associated with this performance commitment has been included in the table above, but Ofwat has determined that the per capita consumption performance commitment for all companies should be assessed as an end-of-period ODI. There will therefore be no in-period effect from our performance in this area.

Wastewater treatment works compliance (underperformance payment: £19.4 million)

During the 2020 calendar year, ten of our wastewater treatment works were classified as failed works by the Environment Agency, a deterioration from the previous year. A new 'Go to Green' process was introduced last year to review all compliance breaches and near misses to understand the root causes and drive improvement actions across the region. Root causes included UV daily dose failures, repeat failure modes, asset inadequacy and human error. Whilst this is a disappointing outcome, mitigations are now in place with a comprehensive range of work streams within our internal Environment+ programme to improve performance. In addition, a new organisational design for the wastewater directorate was rolled out in April 2021 to enable closer working relationships between maintenance, process support and field teams.

[4]Comment is provided for all performance commitments with an underperformance penalty of greater than £1 million for 2020–21. In addition, we provide a brief commentary on leakage performance, due to the level of stakeholder interest in this area.

Pollution incidents (penalty: £7.7 million)

Whilst we delivered a reduction in pollution incidents and continue to work to improve this, we fell far short of our target and will receive the maximum underperformance payment. We have now published a detailed Pollution Incident Reduction Plan, which we have shared with the Environment Agency (**southernwater.co.uk/media/3839/pirpfinal-20200904.pdf**). The plan is based on extensive data analysis and industry best practice, with its primary focus being on wastewater pumping stations and wastewater treatment works, where we have seen the largest increase in pollutions since 2018.

Sewer collapses (underperformance payment: £4.0 million)

As with pollution incidents, while we missed our target for sewer collapses, we successfully reduced the number of incidents compared with 2019–20. We forecast that we will continue to reduce the number of collapses each year; performance will, however, remain above target to the end of the AMP.

Internal sewer flooding (underperformance payment: £1.6 million)

We beat our target for external sewer flooding, but we fell short of our target for internal sewer flooding. However, we did successfully reduce the number of incidents below the level of the previous year and we have clear plans in place which we forecast will result in us being better than our target level from 2023.

Renewable generation (underperformance payment: £1.3 million)

The percentage of our energy generated in 2020–21 was the same as the previous year, but below our target of 21.2%. This principally resulted from a number of CHP engine maintenance issues and breakdowns which impacted the output of our CHP engines. Projects are in place to replace our oldest CHP units during the AMP. In addition, a new solar array at our Peel Common treatment works will come on line summer 2021 and projects are underway to identify additional sites for further solar installations.

Impact of COVID-19 on performance against performance commitments

Over the last twelve months we have been focused on ensuring that our customers continue to receive high quality services despite the restrictions associated with the COVID-19 pandemic. A detailed description of how we have maintained services to customers is provided in our Annual Report and Accounts. However, the restrictions have had some impact on performance against our performance commitments.

As noted above, the most significant impact is in relation to household per capita consumption, which has been affected by the changes in customer habits, including greater hand washing and working from home.

A number of our other performance commitments were impacted as a result of us having to cease a number of activities last year, including visits to schools and our home water efficiency visits. These activities were resumed as soon as it was safe to do so, but there has been an impact on performance in the first year.

We have been unable to report performance against our performance commitment to maintain the number of bathing waters at Excellent water quality status. This is because the Environment Agency, which is responsible for sampling bathing waters, was unable to carry out the normal pre-season testing which is required to produce reliable bathing water statistics. As a result, no bathing waters results were available for the 2020 bathing water season. We report performance in this case as not applicable.

There was no material impact on our WINEP programme as a result of COVID-19.

Forecasts of future years' performance

As required by Ofwat, we have provided a forecast of total 2020–25 outperformance or underperformance payments for all performance commitments. These represent a current best estimate based on our latest internal delivery plan. This delivery plan will be updated throughout the AMP to reflect ongoing performance and thus forecasts of outperformance or underperformance payments. We will continue to strive to meet the targets set in the final determination and thus reduce the level of underperformance payments incurred.

Reporting to customers

Ofwat requires us to describe how the information reported in the Section 3 of this Annual Performance Report relates to the information on outcome performance it has published and reported to its customer challenge group or similar body and customers more generally.
We can confirm that the performance commitment information reported here is fully consistent with the information we have reported to our customers in our Annual Report and Financial Statements.
We do not currently have a customer challenge group as we are in the process of reviewing the most appropriate challenge bodies in the lead up to the next price review in 2024.

Independent Limited Assurance Report of KPMG LLP to Southern Water Services Limited

KPMG LLP ('KPMG' or 'we') were engaged by Southern Water Services Limited ('Southern Water') to provide limited assurance over the Selected Information described below for the year ended 31 March 2021 and for the calendar year ended 31 December 2020.

Our conclusion

Based on the work we have performed and the evidence we have obtained, nothing has come to our attention that causes us to believe that the Selected Information has not been properly prepared, in all material respects, in accordance with the Reporting Criteria.

This conclusion is to be read in the context of the remainder of this report, in particular the inherent limitations explained below and this report's intended use.

Selected Information

The scope of our work includes only the information included within the Southern Water Annual Performance Report ('the Report') and the Appendix to the Report named 'Appendix – APR data tables 2020–21' for the year ended 31 March 2021 marked with the symbol * and the information for the calendar year ended 31 December 2020 marked with the symbol △ ('the Selected Information').

We have not performed any work, and do not express any conclusion, over any other information that may be included in the Report, the Appendix to the Report or displayed elsewhere on Southern Water's website for the current year or for previous periods unless otherwise indicated.

Reporting Criteria

The Reporting Criteria we used to form our judgements are the Southern Water Reporting Criteria 2020–21 summarised in **southernwater.co.uk/our-performance/reports/annual-reporting** ('the Reporting Criteria').

The Selected Information needs to be read together with the Reporting Criteria.

Inherent limitations

The nature of non-financial information; the absence of a significant body of established practice on which to draw; and the methods and precision used to determine non-financial information, allow for different, but acceptable evaluation and measurement techniques and can result in materially different measurements, affecting comparability between entities and over time.

Directors' responsibilities

The Directors of Southern Water are responsible for:

- designing, implementing and maintaining internal controls relevant to the preparation and presentation of the Selected Information that is free from material misstatement, whether due to fraud or error;
- selecting and/or developing objective Reporting Criteria;
- measuring and reporting the Selected Information in accordance with the Reporting Criteria; and
- the contents and statements contained within the Report, the Appendix to the Report and the Reporting Criteria.

Our responsibilities

Our responsibility is to plan and perform our work to obtain limited assurance about whether the Selected Information has been prepared in accordance with the Reporting Criteria and to report to Southern Water in the form of an independent limited assurance conclusion based on the work performed and the evidence obtained.

Assurance standards applied

We performed our work in accordance with International Standard on Assurance Engagements (UK) 3000 – 'Assurance Engagements other than Audits or Reviews of Historical Financial Information' ('ISAE (UK) 3000') issued by the UK Financial Reporting Council.

The work performed in a limited assurance engagement varies in nature and timing from, and is 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.

Independence, professional standards and quality control

We comply with the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants and we apply International Standard on Quality Control (UK) 1, 'Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements'. Accordingly, we maintain a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements and professional standards (including independence, and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour) as well as applicable legal and regulatory requirements.

Summary of work performed

Considering the level of assurance and our assessment of the risk of material misstatement of the Selected Information, whether due to fraud or error, our work included, but was not restricted to:

- Assessing the appropriateness of the Reporting Criteria for the Selected Information;
- Conducting interviews with Southern Water management to obtain an understanding of the key processes, systems and controls in place over the preparation of the Selected Information;
- Selected limited substantive testing, including agreeing a selection of the Selected Information to corresponding supporting information;
- Performing analytical review procedures over the aggregated Selected Information, including a comparison to the prior period's amounts having due regard to changes in business volume; and
- Reading the Report and narrative accompanying the Selected Information in the Report with regard to the Reporting Criteria, and for consistency with our findings.

This report's intended use

This assurance report is made solely to Southern Water in accordance with the terms of the engagement contract between us. Those terms permit disclosure to other parties, solely for the purpose of Southern Water showing that it has obtained an independent assurance report in connection with the Selected Information.

We have not considered the interest of any other party in the Selected Information. To the fullest extent permitted by law, we accept no responsibility and deny any liability to any party other than Southern Water for our work, for this assurance report or for the conclusions we have reached.

KPMG LLP

KPMG LLP

Chartered Accountants

London,

6 July 2021

The maintenance and integrity of Southern Water's website is the responsibility of the Directors of Southern Water; the work carried out by us does not involve consideration of these matters and, accordingly, we accept no responsibility for any changes that may have occurred to the reported Selected Information, Reporting Criteria or Reports presented on Southern Water's website since the date of our report.

Additional regulatory information

4A – Water bulk supply information for the 12 months ended 31 March 2021

	Volume Ml	Operating costs £m	Revenue £m
Bulk supply exports			
Affinity	14.632	–	0.016
Wessex	85.613	–	0.106
South East Water	10,752.830	3.449	3.464
Total bulk supply exports	**10,853.075**	**3.449**	**3.586**

	Volume Ml	Operating costs £m
Bulk supply imports		
Affinity Water	4.568	0.006
Sutton and East Surrey Water	0.365	–
Portsmouth Water	1,794.000	0.338
Total bulk supply imports	**1,798.933**	**0.344**

Bulk exports to New Appointment Variation (NAV) customers are not included in the table.

We do not show cost information for the bulk exports to Affinity Water and Wessex Water. These supplies are made via our distribution network and the costs are thus not separately identifiable. Operating costs are included for the exports to South East Water. These agreements are based on a sharing of specific costs, thus the relevant costs are agreed as part of the charging process.

4B – Analysis of debt

As permitted by RAG 3.12 section 2.7, table 4B is excluded from this APR document and is published alongside this document and can be found at **southernwater.co.uk/our-reports**.

4C – Impact of price control performance to date on RCV

	12 months ended 31 March 2021			
	Water resources £m	Water network+ £m	Wastewater network+ £m	Bioresources £m
Totex (net of business rates, abstraction licence fees and grants and contributions)				
Final determination allowed totex (net of business rates, abstraction licence fees and grants and contributions)	16.540	174.306	332.421	35.772
Actual totex (net of business rates, abstraction licence fees and grants and contributions)	28.312	174.312	373.310	34.891
Transition expenditure	1.721	0.980	–	–
Disallowable costs	–	–	3.663	–
Total actual totex (net of business rates, abstraction licence fees and grants and contributions)	**30.033**	**175.292**	**369.647**	**34.891**
Variance	13.493	0.986	37.226	(0.881)
Variance due to timing of expenditure	–	(18.595)	(7.244)	(0.523)
Variance due to efficiency	**13.493**	**19.581**	**44.470**	**(0.358)**
Customer cost sharing rate	36.448%	36.448%	36.076%	0.000%
Customer share of totex over/underspend	4.918	7.137	16.043	–
Company share of totex over/underspend	8.575	12.444	28.427	(0.358)
Totex – business rates and abstraction licence fees				
Final determination allowed totex – business rates and abstraction licence fees	5.645	10.817	12.334	1.284
Actual totex – business rates and abstraction licence fees	4.693	9.160	13.246	1.737
Variance – business rates and abstraction licence	**(0.952)**	**(1.657)**	**0.912**	**0.453**
Customer cost sharing rate – business rates and abstraction licence fees	75.00%	75.00%	75.00%	75.00%
Customer share of totex over/underspend – business rates and abstraction licence fees	(0.714)	(1.243)	0.684	0.340
Company share of totex over/underspend – business rates and abstraction licence fees	(0.238)	(0.414)	0.228	0.113
Totex not subject to cost sharing				
Final determination allowed totex – not subject to cost sharing	8.476	16.768	9.046	–
Actual totex – not subject to cost sharing	9.251	15.903	3.821	–
Variance – 100% company allocation	**0.775**	**(0.865)**	**(5.225)**	**–**
Total company share of totex over/underspend	**9.112**	**11.165**	**23.430**	**(0.245)**
RCV				
Total customer share of totex over/underspend	4.204	5.894	16.727	0.340
PAYG rate	56.125%	44.963%	49.011%	59.637%
RCV element of totex over/underspend	**1.844**	**3.244**	**8.529**	**0.137**
Adjustment for ODI outperformance payment or underperformance payment	–	–	–	–
RCV determined at FD at 31 March	95.724	1,084.637	3,723.851	206.718
Projected 'shadow' RCV	**97.568**	**1,087.881**	**3,732.380**	**206.855**

Wholesale totex analysis

Our total expenditure (totex) for 2020–21 was higher than the allowance in the PR19 final determination for both water and wastewater. We set out below the principal reasons for the variances within each wholesale price control and each cost category shown above. It is important to note that the final determination from Ofwat does not explicitly show the totex allowance at a granular level. The variances described therefore represent a best estimate of the reasons for the variances.

The principal totex variances to the final determination have been allocated between timing and efficiency within the table above. The following rules have been applied in making these allocations:

- All operating expenditure variances are allocated to efficiency on the basis that these are recurring costs that cannot typically be shifted between years.
- All variance related to renewals and capital maintenance expenditure has been allocated to timing. This is because over the five-year period we currently forecast that we will spend in line with the final determination allowance.
- Enhancement costs have been compared with a notional allocation of each category of expenditure to each year of the AMP using Ofwat's final determination profiling assumptions. All identified variances have been allocated to timing on the basis that we currently forecast that, in aggregate, we will spend in line with the final determination enhancement totex allowances.
- Any enhancement costs incurred in relation to schemes which were not funded within the final determination (for example carryover of AMP6 expenditure) has been allocated to the efficiency category.

Totex variance to Final Determination

Totex variance over/(under) £m	Water		Wastewater	
	Water resources	Water network+	Wastewater network+	Bioresources
Net totex	13.5	1.0	37.2	(0.9)
Business rates and abstraction licences	(1.0)	(1.6)	0.9	0.5
Not subject to cost sharing	0.8	(0.9)	(5.2)	–
Total totex variance	**13.3**	**(1.5)**	**32.9**	**(0.4)**

Water

Water resources totex is £13.3 million higher than the final determination allowance. This principally reflects expenditure associated with the completion of some Eels Regulations schemes from the previous regulatory period (AMP6). In addition, there is a small operating expenditure variance arising from a combination of forecast efficiencies not delivered including COVID-19 related cost pressures and an increase to the provision made for ecological work associated with the section 20 agreement in relation to the Rivers Test and Itchen and the Candover Stream. All of this variance has been allocated to the (in) efficiency category.

In total, water network+ totex is broadly in line with the final determination with a total variance of £1.5 million below the final determination.

However, within net totex there is a £19.6 million variance associated with in(efficiency) offset by timing variances of £18.6 million. The efficiency variance comprises a small element of the Eels Regulations schemes combined with higher operating expenditure arising from a combination of forecast efficiencies not delivered, COVID-19 related cost pressures and higher power prices and usage. The timing variance arises from lower actual expenditure for a number of schemes including those relating to supply demand enhancements, raw water deterioration and lead standards, offset by higher capital maintenance than allowed.

Business rates for water resources and water network+ are £2.6 million lower than the final determination allowance overall, reflecting the benefit of a cumulo rates rebate of £2.4 million received during the year.

Within the 'costs not subject to sharing' category water resources expenditure is £0.8 million higher than the final determination allowance while water network+ is £0.9 million below the allowance. The largest element of expenditure within this category is related to the strategic water resources development schemes which form our Water for Life Hampshire programme (£12.9 million in the year plus £2.2 million of the transition expenditure), which is broadly in line with the final determination allowance. In line with guidance from RAPID, costs disallowed at Gate 1 of the RAPID process on the basis that they were incorrectly allocated, have been re-allocated to base costs. Expenditure associated with the income offset (relating to developer-led schemes) is £3.0 million lower than allowed reflecting a lower level of development activity during the year. This is offset by third party contributions with are £1.6 million higher than the final determination assumption, mainly relating to bulk supplies and an accrual of £0.7 million for expenditure relating the Ofwat Innovation Fund.

Pension deficit repair costs, which are not subject to cost sharing, are excluded from both the final determination allowed totex and the actual totex.

Wastewater

Bioresources totex is £0.4 million lower than the final determination allowance. Expenditure on capital maintenance is lower than the estimated final determination allowances offsetting actual expenditure which is higher than allowed expenditure on sludge growth and quality schemes, resulting in timing differences of £0.5 million. Operating expenditure efficiencies achieved have been offset by higher power costs resulting in a net efficiency of £0.4 million.

Wastewater network+ totex is £32.9 million higher than the final determination, with the main element of totex, which is subject to cost sharing, having a variance of £37.2 million. This represents the net effect of £44.4 million of (in)efficiency, offset by £7.2 million of timing differences.

The (in)efficiency variance relates principally to higher operating expenditure than was allowed within the final determination. This results from forecast efficiencies not delivered, partly due to COVID-19 related cost pressures, higher power prices and usage and non-routine tankering and plant repairs.

Timing differences represent lower year one expenditure than allowed for a number of enhancement schemes, with the largest variances against the notional allocation of the final determination being in relation to Flows to Full Treatment schemes, the P-removal programme and WTW storage schemes. These are offset by higher capital maintenance expenditure £29.3 million from bringing forward maintenance activity.

Business rates for bioresources and wastewater network+ are £1.4 million higher than the final determination allowance but are in line with previous years' business rates expenditure.

Within the 'costs not subject to sharing' category actual expenditure is £5.2 million less than the final determination allowance. This is principally associated with the income offset (relating to developer-led schemes) which is £5.5 million lower than allowed reflecting a lower level of development activity during the year. Lower expenditure on third party services is offset by an accrual of £2.0 million for expenditure relating the Ofwat Innovation Fund.

Pension deficit repair costs, which are not subject to cost sharing, are excluded from both the final determination allowed totex and the actual totex.

Atypicals/Exceptionals

The atypical costs shown in tables 4D and 4E form part of the variances that are highlighted above.

Link to the final determination outcomes

With the exception of performance commitments that relate to specific capital delivery schemes it is generally not possible to directly associate expenditure with the delivery of the final determination outcomes. This is because the vast majority of outcomes are delivered through base operating and capital maintenance expenditure rather than specific funded schemes. We note that despite wastewater totex being significantly higher than the final determination allowance we have nonetheless incurred significant Outcome Delivery Incentive underperformance payments, in particular in relation to wastewater treatment works compliance and pollution incidents. These remain key areas of focus and investment for the business.

Disallowable costs

When comparing our actual totex to that allowed in the Final Determination we are required to make adjustments for certain disallowable costs, including fines and investigation costs. We have identified disallowable costs for 2020–21 of £3.7 million, all within the wastewater network+ price control. These comprise costs relating to the ongoing investigations into wastewater reporting and associated system changes.

Recharges between business units

Details of our process for allocating costs between business units can be found in our Methodology Statement.

4D – Totex analysis for the 12 months ended 31 March 2021 – water resources and water network+

		Network+				
	Water resources £m	Raw water transport £m	Raw water storage £m	Water treatment £m	Treated water distribution £m	Total £m
Operating expenditure						
Base operating expenditure	12.437	0.310	0.267	40.101	48.002	101.117
Enhancement operating expenditure	0.008	–	–	1.642	0.071	1.721
Developer services operating expenditure	–	–	–	–	0.998	0.998
Total operating expenditure excluding third party services	12.445	0.310	0.267	41.743	49.071	103.836
Third party services	0.646	–	–	1.270	1.081	2.997
Total operating expenditure	13.091	0.310	0.267	43.013	50.152	106.833
Grants and contributions						
Grants and contributions – operating expenditure	–	–	–	–	–	–
Capital expenditure						
Base capital expenditure	2.535	(0.006)	0.641	48.847	35.646	87.663
Enhancement capital expenditure	26.811	1.196	–	9.927	1.141	39.075
Developer services capital expenditure	–	–	–	–	10.425	10.425
Total gross capital expenditure (excluding third party)	29.346	1.190	0.641	58.774	47.212	137.163
Third party services	1.341	–	–	2.922	0.332	4.595
Total gross capital expenditure	30.687	1.190	0.641	61.696	47.544	141.758
Grants and contributions						
Grants and contributions – capital expenditure	1.522	–	–	1.146	4.292	6.960
Net totex	42.256	1.500	0.908	103.563	93.404	241.631
Cash expenditure						
Pension deficit recovery payments	0.186	–	0.022	2.339	2.531	5.078
Totex including cash items	42.442	1.500	0.930	105.902	95.935	246.709
Atypical expenditure						
Innovation (Base operating expenditure)	–	–	–	0.733	–	0.733
West Hants Provision (Base operating expenditure)	0.758	–	–	–	–	0.758
COVID-19 related (Base operating expenditure)	0.023	–	(0.034)	0.691	0.883	1.563
Cumulo rebate 2010–17 (Base operating expenditure)	(0.197)	(0.026)	–	(0.312)	(1.887)	(2.422)
Total atypical expenditure	0.584	(0.026)	(0.034)	1.112	(1.004)	0.632

4E – Totex analysis for the 12 months ended 31 March 2021 – wastewater network+ and bioresources

	Network+ Sewage collection			Network+ Sewage treatment		Bioresources			
	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									
Base operating expenditure	63.751	12.457	12.457	93.667	2.907	4.582	10.791	5.910	206.522
Enhancement operating expenditure	–	–	–	–	–	–	–	–	–
Developer services operating expenditure	0.915	0.199	0.199	–	–	–	–	–	1.313
Total operating expenditure excluding third party services	64.666	12.656	12.656	93.667	2.907	4.582	10.791	5.910	207.835
Third party services	–	–	–	–	–	–	–	–	–
Total operating expenditure	64.666	12.656	12.656	93.667	2.907	4.582	10.791	5.910	207.835
Grants and contributions									
Grants and contributions – operating expenditure	–	–	–	–	–	–	–	–	–
Capital expenditure									
Base capital expenditure	40.333	8.792	8.792	73.744	–	–	12.572	–	144.233
Enhancement capital expenditure	7.952	–	–	54.236	–	–	2.773	–	64.961
Developer services capital expenditure	11.825	2.577	2.577	0.665	–	–	–	–	17.644
Total gross capital expenditure (excluding third party)	60.110	11.369	11.369	128.645	–	–	15.345	–	226.838
Third party services	0.013	0.003	0.003	1.563	–	–	–	–	1.582
Total gross capital expenditure	60.123	11.372	11.372	130.208	–	–	15.345	–	228.420
Grants and contributions									
Grants and contributions – capital expenditure	5.479	1.195	1.195	1.381	–	–	–	–	9.250
Net totex	119.310	22.833	22.833	222.494	2.907	4.582	26.136	5.910	427.005
Cash expenditure									
Pension deficit recovery	3.336	0.556	0.556	5.220	0.580	–	0.830	–	11.078
Totex including cash items	122.646	23.389	23.389	227.714	3.487	4.582	26.966	5.910	438.083
Atypical expenditure									
Wastewater investigation costs (Base operating expenditure)	–	–	–	2.423	–	–	–	–	2.423
Innovation (Base operating expenditure)	–	–	–	1.989	–	–	–	–	1.989
COVID-19 related (Base operating expenditure)	0.176	0.038	0.038	0.948	–	(0.017)	0.058	(0.034)	1.207
Wastewater investigation (Base capital expenditure)	–	–	–	1.240	–	–	–	–	1.240
Total atypical expenditure	0.176	0.038	0.038	6.600	–	(0.017)	0.058	(0.034)	6.859

4F – Major project expenditure for wholesale water by purpose 12 months ended 31 March 2021

	Expenditure in report year					
		Water network+				
	Water resources £m	Raw water transport £m	Raw water storage £m	Water treatment £m	Treated water distribution £m	Total £m
Major project capital expenditure by purpose						
Otterbourne to Andover Pipeline	–	–	–	–	0.007	0.007
Crabwood to Micheldever Pipeline	–	–	–	–	0.007	0.007
Testwood to Otterbourne Pipeline	–	–	–	–	0.007	0.007
Western Grid SRO Common costs	4.942	–	–	–	–	4.942
Fawley Desalination	–	–	–	1.949	–	1.949
River Itchen effluent re-use	–	–	–	3.426	–	3.426
West Country Sources North	0.271	–	–	–	–	0.271
Havant Thicket – Pipeline	0.131	–	–	–	–	0.131
Total major project capital expenditure	5.344	–	–	5.375	0.021	10.740

The totals shown for the Strategic Resource Option Schemes (Fawley desalination and Itchen Water re-use) are the amounts incurred in the financial year 2020–21. They include costs that were subsequently excluded by Ofwat in its Gate 1 final decision of 28 January 2021, on the grounds that some of the costs were not appropriate for inclusion in the ring-fenced funding provided.

4G – Major project expenditure for wholesale wastewater by purpose for the 12 months ended 31 March 2021

We have no projects classed as major projects to report within wholesale wastewater.

4H – Financial metrics for the 12 months ended 31 March 2021

	Units	Metric	AMP to date
Financial Indicators			
Net debt	£m	3,670.417	
Regulatory equity	£m	1,440.513	
Regulatory gearing	%	71.82%	
Post tax return on regulatory equity	%	4.21%	
RORE (return on regulatory equity)	%	(0.74%)	(0.74%)
Dividend yield	%	0.11%	
Retail profit margin – Household	%	(59.32%)	
Retail profit margin – Non Household	%	19.11%	
Credit rating – Fitch	n/a	BBB+ (Negative)	
Credit rating – Moody's	n/a	Baa3 (Stable)	
Credit rating – Standard and Poor's	n/a	BBB+ (Negative)	
Return on RCV	%	2.90%	
Dividend cover	dec	197.94	
Funds from operations (FFO)	£m	303.138	
Interest cover (cash)	dec	2.61	
Adjusted interest cover (cash)	dec	1.06	
FFO/Debt	dec	0.08	
Effective tax rate	%	1.47%	
RCF	£m	301.538	
RCF/Net debt	dec	0.082	
Revenue and earnings			
Revenue (actual)	£m	734.790	
EBITDA (actual)	£m	345.412	
Borrowings			
Proportion of borrowings which are fixed rate	%	37.53%	
Proportion of borrowings which are floating rate	%	0.00%	
Proportion of borrowings which are index linked	%	62.47%	
Proportion of borrowings due within 1 year or less	%	0.07%	
Proportion of borrowings due in more than 1 year but no more than 2 years	%	0.85%	
Proportion of borrowings due in more than 2 years but no more than 5 years	%	7.61%	
Proportion of borrowings due in more than 5 years but no more than 20 years	%	78.94%	
Proportion of borrowings due in more than 20 years	%	12.53%	

4I – Financial derivatives for the 12 months ended 31 March 2021

	Nominal value by maturity (net) at 31 March 2021			Total value at 31 March 2021		Total accretion at 31 March 2021	Interest rate (weighted average for 12 months to 31 March 2021)	
	1 to 2 years	2 to 5 years	Over 5 years	Nominal value (net)	Mark to Market		Payable	Receivable
	£m	£m	£m	£m	£m	£m		
Interest rate swap (sterling)								
Fixed to index-linked	–	–	1,316.608	1,316.608	1,432.393	30.652	2.23%	9.79%
Total	–	–	**1,316.608**	**1,316.608**	**1,432.393**	**30.652**		

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 £1,432.4 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 crystallising is extremely remote given that it can only crystallise under certain conditions of a default of our financing covenants, in which case operations of the company are protected and will continue. Further details are available on page 253 of our Annual Report and Financial Statements.

Additional regulatory tables

As permitted by RAG 3.12 section 2.9, the remaining regulatory tables which form the Annual Performance Report are excluded from this document and are published as an appendix at **southernwater.co.uk/our-reports**.

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 2020–21 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 2020–21
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 266 of that report. The Annual Performance Report (APR), sections 1 and 2, excluding table 1F, were audited by Deloitte LLP. Their assurance statement is included on page 50. Deloitte LLP also performed assurance activities agreed with us on the financial information presented in table 1F and section 4 to 9 of the APR and the financial information published in the cost assessment tables alongside this report. No issues were identified.
Additional assurance undertaken	Deloitte LLP also undertook assurance procedures on the following statements made in the Annual Report and Annual Performance Report: • Viability statement • Certificate of adequacy (Licence Condition I17 Certificate)
Ofwat Performance Commitments and Outcome Delivery Incentives (ODIs)	Our technical assurers KPMG LLP have issued us with an unqualified limited assurance ISAE (UK) 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

Appendices

The information in the appendices has not been audited.

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

Services supplied to the associated companies by the appointee

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

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

Services supplied to associated companies by the appointee

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

Services received by the appointee from associated companies

There were no services supplied by associate companies to SWS.

Group relief received by the appointee

Service	Company	Turnover of associate	Terms of supply	Value £m
Corporation tax group relief	Southern Water Services Group	–	Cost	0.931

Allocation of costs between regulated and non-regulated businesses

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

Service provided by non-appointed business	Basis of recharge made by the appointed business	Value £m
Treatment of imported sludge	Not applicable	–
Treatment of tankered waste	The Mogden Formula was used to calculate the income for tankered waste and the costs were derived from this calculation	5.813
Other	Headcount (FTE) was used to calculate administrative overhead for property searches, accommodation rental and Homeserve costs	0.156

Details of intercompany loans

Loans granted to Southern Water Services Limited

Company	Loan type	Interest rate %	Repayment date	Balance at 31 March 2021 £m
Southern Water Services (Finance) Limited	Fixed rate	6.202	2029	348.815
	Index linked	3.716	2034	247.643
	Index linked	3.716	2034	57.732
	Fixed rate	6.650	2026	349.126
	Index linked	3.826	2023	247.643
	Fixed rate	5.010	2041	147.182
	Fixed rate	4.510	2052	197.274
	Fixed rate	5.135	2056	292.753
	Fixed rate	2.385	2028	370.175
	Fixed rate	3.010	2037	443.473
	Fixed rate	1.626	2027	294.343
	Fixed rate	2.790	2031	174.145
	Fixed rate	2.970	2036	74.592
	Index linked	4.086	2033	272.547
	Index linked	3.645	2032	252.221
	Fixed rate	0.000	On demand	30.250
Total				**3,799.914**

Loans granted by Southern Water Services Limited

Company	Loan type	Interest rate %	Repayment date	Balance at 31 March 2021 £m
Southern Water Services (Finance) Limited	Fixed rate	0.000	On demand	16.875
Southern Water Services Group Limited	Fixed rate	7.000	2052	130.042
Total				**146.917**

Dividends paid by Southern Water Services Limited to group companies

Company	2021 £m	2020 £m
Southern Water Holdings (ordinary dividend)	–	–
Southern Water Holdings (for SWSG loan agreement)	3.968	7.092

No ordinary dividend was declared for payment to Southern Water Holdings Limited (SWH) in 2021 (2020: £nil).

A dividend of £3.968 million (2020: £7.092 million) was paid to SWS Holdings Limited to allow SWSG to service part of 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

   a) the impact on the company's credit rating

   c) the liquidity position and ability to fulfil licence conditions

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

Comparison of dividend to the PR14 Final Determination

These tests are not applied to the interim dividends of £4.0 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).

The Board has resolved that the company will not pay dividends, other than those associated with the 'dividend loop' mentioned above, until it is clear that to do so would not be detrimental to the company's financial position.

The Board has not approved the payment of preference share dividends for 2020–21 (2020: £9.0 million dividends and £50.1 million redemption). Preference share dividends are disclosed as interest in the financial statements and an accrual for £4.9 million in relation to this liability is included within the financial statements.

Asset transfers

There were no asset transfers during the year.

Appendix 2. KPI definitions and status assessment rules

Performance Commitment Definitions RAG status

- ✔ Ofwat target met or exceeded
- ⊖ Ofwat target missed but performance improved in relation to prior year outcome
- ✖ Ofwat target missed and performance worse than prior year outcome
- – Not applicable

Performance Commitment Definitions

Deliver great service

Water quality compliance (Compliance Risk Index)	**Definition:** The definition for this performance commitment is set by the Drinking Water Inspectorate (DWI) in collaboration with the industry. This is published as DWI Compliance Risk Index (CRI), August 2018: **ofwat.gov.uk/publication/dwi-compliance-risk-index-cri-definition/**.
Drinking water appearance	**Definition:** The number of times the company is contacted by consumers due to the drinking water not being clear, reported per 1,000 population. Calculation is the number of contacts for appearance multiplied by 1,000 divided by the resident population as reported to the Drinking Water Inspectorate (DWI).
Drinking water taste and odour	**Definition:** The number of times the company is contacted due to the taste and odour of drinking water, reported per 1,000 population. Calculation is the number of contacts for all taste/odour contacts multiplied by 1,000 divided by the resident population as reported to the Drinking Water Inspectorate (DWI).
Replace lead customer pipes	**Definition:** The number of residential properties receiving grants from the company towards removing lead pipes in the home in the 2020–25 period. This is a co-delivery measure with the company's customers to reduce the amount of lead in customer pipes. The performance commitment will apply only in the company's Deal, Kent, water supply zone, where it is trialling this approach to eliminating lead pipes and fittings.
Water supply interruptions	**Definition:** Reducing interruptions to water supply is defined in the reporting guidance for PR19 – Supply Interruptions, published on 27 March 2018: **ofwat.gov.uk/publication/reporting-guidance-supply-interruptions/** It is calculated as the average number of minutes lost per customer for the whole customer base for interruptions that lasted three hours or more.
C-MeX	**Definition:** The customer measure of experience (C-MeX) is a measure of customer satisfaction. A company's C-MeX score is calculated as the weighted average of customer satisfaction (CSAT) scores from customer service (CS) and customer experience (CE) surveys. Standard and higher performance payments under C-MeX depend on a company's performance relative to those of other companies. Higher performance payments are available if the company passes each of the following three 'gates': • the company is one of the top three performers by C-MeX score; • the company is at or above a cross-sector threshold of customer satisfaction performance based on the all-sector upper quartile (ASUQ) of the UK Customer Satisfaction Index (UKCSI); and • the company has lower than the industry average number of household complaints (per 10,000 connections).

Deliver great service

Void properties	**Definition:** The number of household properties classified as void as a percentage of the total number of household properties served by the company. Void properties are defined as properties, within the company's supply area, which are connected for either a water service only, a wastewater service only or both services but do not receive a charge, as there are no occupants. Additionally a property connected for both services that is not occupied, only counts as one void property.
Gap sites	**Definition:** The number of household gap sites identified by the company and brought into charge annually. A gap site is identified as a property that is not recorded on the company's billing database. To add one more site requires the company to add one property to its billing database.
Internal sewer flooding	**Definition:** The internal sewer flooding measure is defined in the reporting guidance for PR19 – Sewer Flooding, published on 27 March 2018: **ofwat.gov.uk/publication/reporting-guidance-sewer-flooding/** The measure is calculated as the number of internal sewer flooding incidents normalised per 10,000 sewer connections including sewer flooding due to severe weather events. Companies might also want to present their performance commitments in absolute numbers to make it easier for customers and stakeholders to understand. The definitive service levels are those expressed as the values normalised per 10,000 sewer connections.
External sewer flooding	**Definition:** The performance commitment will be reported as the absolute number of the company's external sewer flooding incidents per year including incidents caused by severe weather. The external sewer flooding measure is defined in the reporting guidance for PR19 – Sewer Flooding, updated on 28 April 2018: **ofwat.gov.uk/publication/reporting-guidance-sewer-flooding/**
Customer Satisfaction with Vulnerability Support	**Definition:** Percentage of customers that have received non-financial support who believe Southern Water's support addresses their specific requirements and needs. Non-financial support is defined as any support that is provided by the company to a customer with specific requirements or needs which affects the customer for reasons that are not specific to their financial position. This support is provided through the PSR e.g. braille bills or talking bills. Performance will be measured through a survey of customers that have received PSR support. Customers will be asked whether the support provided addresses their specific requirements and needs in relation to their water and wastewater service. Customers will be provided information about the support the company provides as part of the questionnaire so they clearly understand the premise of the question. The questionnaire used will be consistent with that used in the company's baseline survey for 2017–18. Customers will be able to respond with a 'Yes' or 'No' answer and provide additional comments to give the company feedback on any improvements that could still be made to improve support. The performance will be measured as the total number of yes responses divided by the number of responses. The company will not include in the survey PSR customers who have not received a service from the company in the reporting period. The survey should be planned and carried out following social research best practice (example any applicable sections of a relevant code such as that published by the Market Research Society). The sample size should be selected to give a reasonable statistical significance for the purpose of the performance commitment.

Deliver great service

Effectiveness of financial assistance

Definition:
The percentage of customers that pay their bills in the immediate twelve months following the receipt of financial assistance.

The measure includes residential customers who have received support through the Essentials social tariff, WaterSure, Water Direct, NewStart Debt Matching scheme and any new financial assistance schemes the company implements. Any new financial schemes introduced by the company for inclusion in this performance commitment should be subject to assurance from the Customer Challenge Group.

Customers 'paying their bills' is defined as customers either having paid in ten distinct months (of twelve) or having paid 90% of the billed value.

Priority services for customers in vulnerable circumstances

Definition:
This common performance commitment is defined in the reporting guidance: 'Reporting guidance – Common performance commitment for the Priority Service Register'.

This performance commitment consists of the following criteria:

- The PSR reach: percentage of households that the company supplies with water and/or wastewater services that are registered on the company's PSR;
- Attempted contact: percentage of distinct households on the PSR that the company has attempted to contact over a two-year period;
- Actual contact: percentage of distinct households on the PSR that the company has actually contacted over a two-year period.

To achieve compliance with this performance commitment the reach, attempted contact and actual contact targets should be achieved.

Properties at risk of receiving low pressure

Definition:
The number of properties receiving or at risk of receiving pressure below the low pressure reference level. This measure is calculated as the total number of properties receiving pressure below standard, minus the number of those properties that are covered by the predetermined allowable exclusion categories as detailed in the reporting guidance.

Low pressure reference level is defined in the reporting guidance published 11 December, 2017 'Properties at risk of receiving low pressure':
ofwat.gov.uk/publication/properties-at-risk-of-receiving-low-pressure/

Value for money

Definition:
Percentage of customers that state they are satisfied with the value for money of water and sewerage services in their area.

This performance commitment will be measured through an annual survey of customers that is run by CCWater (Water Matters). The measure will take the results for Southern Water customers only.

The proportion of customers that state either 'very' or 'fairly' satisfied on a five-point scale, as measured by CCWater's annual tracking report 'Water Matters'.

It combines a mean average score of the ratings:

- Satisfaction with value for money for water services; and
- Satisfaction with value for money for sewerage services

CCWater will interview 200 of Southern Water's customers each year in this survey.

The measurement of the survey will be conducted in a consistent way over the 2020 to 2025 period.

If, during the period, CCWater cease measurement of the relevant data set, the company will replace the source data and measurement for this performance commitment with an appropriate equivalent confirmed and assured by an appropriately qualified independent third party.

Fit for the future

Long term supply demand schemes	**Definition:** The expected number of months delay to deliver long term supply-demand capacity benefit of 182.5 Ml/d which is expected to be delivered by 31 March 2027. The capacity benefit (Ml/d) target represents the total of the stated average capacities for the individual schemes, both treatment and transfer, identified by the company within the business plan and the revised draft WRMP. The following schemes are expected to be delivered: • Ford Wastewater Treatment Works (WwTW) indirect potable water reuse (20 Ml/d); • Utilise full existing transfer capacity (3 Ml/d); • East Woodhay Water Supply Works (WSW) (1 Ml/d); • Bournemouth Water supply from Knapp Mill (20 Ml/d); • Coastal desalination – Shoreham Harbour (10 Ml/d); • Sussex Coast – Lower Greensand (2 Mld); • Hardham winter transfer: Stage 2 (2 Ml/d); • Aylesford WwTW indirect potable water reuse – Eccles Lake (18 Ml/d); • Sandown WwTW indirect potable water reuse (8.5 Ml/d); and • Internal interconnections (98 Ml/d).
Sewer collapses	**Definition:** Sewer collapse: A sewer collapse is considered to be where a structural failure has occurred to the pipe that results in a service impact to a customer or the environment and where action is taken to replace or repair the pipe to reinstate normal service. The measure intentionally does not refer to the magnitude of the collapse. The measure includes rising mains. Collapses on the entire network are to be reported. Sewer length: Include the length of the entire network, including sewers that transferred to their responsibility under the Transfer of Public Sewers Regs 2011. The company should separately record the length of transferred sewers, the calculation of this measure should be based on the latest measurements of the length.
Surface water management	**Definition:** Reduction in volume (m^3) of surface water entering the surface or combined sewer network as a result of rough sustainable urban drainage approaches. Solutions include sustainable urban drainage approaches to slow down and reduce the volume of water entering the network. These include, but are not limited to: • Provision of a soakaway, either through providing a grant to the customer or through installation by Southern Water. • Provision of a sustainable drainage system which does not connect to a combined sewer network or which materially attenuates the flow of surface water to the combined network (e.g. a rain garden). The definitive service levels are those expressed as the values normalised per 10,000 sewer connections.
Community engagement	**Definition:** The percentile performance of Southern Water compared to other utility companies in the London Benchmarking Group (LBG) annual report. LBG have rebranded as B4SI. The company has engaged B4SI, a company that measures corporate community investment and philanthropy, to measure the company's performance in line with organisations both within and outside the sector. The measure will be based on the company's annual ranking of utilities companies in the B4SI annual report, which will be influenced by the company's ongoing commitment to increase hours volunteered, partnering with charities, raising money for charities, flagship programmes such as Learn to Swim, community and outreach events and administering community grants. Each year the company will convert the ranking into a percentile using the excel function 'PERCENTRANK.INC' multiplied by 100 and report this. The data will be organised so that the best company will receive the highest percentile.

Fit for the future

Schools visited and engagement with children

Definition:

The measure is the percentage of feedback the company receives, from schools that have been visited in the year, which the schools have rated as 'good' or 'excellent', based on a survey completed after the visit.

It is measured annually on a reporting year basis.

A 'visit' is defined as any activity involving a school, either at the school premises or other venue, which has as its aim the education of pupils in relation to the company's core activities, including the value of water, water efficiency, 'unflushables' and the water cycle.

'Schools' includes any establishment involved in the education of children under the age of 18.

The survey should be planned and carried out following social research best practice (e.g. any applicable sections of a relevant code such as that published by the Market Research Society).

The sample size should be selected to give a reasonable statistical significance for the purpose of the performance commitment.

Impounding reservoirs

Definition:

This performance commitment measures the progress that the company makes against its programme of work for enhancing the safety of four named reservoir assets, measured as the percentage completion of the schemes. The company must increase the drawdown rates for four of its largest impounding reservoirs to at least the basic levels as set out in the below table for the purposes of measuring delivery under this performance commitment.

The company must comply with the Reservoirs Act 1975.

Statutory reservoir name	Basic drawdown standard rate (metres per day at 50 percentile inflow)	Latest timing of statutory inspection	% completion allocation	Target completion date of the works
Bewl	1.00	2018	48.8	11 November 2022
Darwell	0.83	2024	14.8	11 November 2024
Powdermill	0.31	2019	19.9	11 November 2024
Weir Wood	0.53	2023	16.5	11 November 2024

Mains repairs

Definition:

Mains repairs is defined in the reporting guidance for PR19 – Mains Repairs per 1000km, published on 27 March 2018. **ofwat.gov.uk/publication/reporting-guidance-mains-repairs-per-1000km/**

It is reported as the number of mains repairs per thousand kilometres of the entire water main network (excluding communication and supply pipes).

Unplanned water outage

Definition:

Unplanned outage is defined in the reporting guidance for PR19 – Unplanned Outage, published on 4 April 2019. **ofwat.gov.uk/publication/reporting-guidance-unplanned-outage/**

This measure is reported as the temporary loss of peak week production capacity (PWPC) in the reporting year weighted by the duration of the loss (in days). Unplanned outage for each water production site is calculated separately and then summed over the reporting year to give a total actual unplanned outage for the water resource zone.

The company water resource zone weighted outage should then be summed (Ml/d) and normalised based on overall company peak week production capacity to be reported as a percentage.

Risk of sewer flooding in a storm

Definition:

Risk of sewer flooding in a storm is defined within the guidance titled, Reporting guidance – Risk of sewer flooding in a storm, published on 4 April 2019: **ofwat.gov.uk/publication/reporting-guidance-risk-of-sewer-flooding-in-a-storm/**

This measure will record the percentage of the region's population at risk from internal hydraulic flooding from a 1 in 50-year storm, based on modelled predictions.

D-MeX

Definition:

D-MeX is a measure of customer satisfaction. A company's overall D-MeX score is calculated from two components that contribute equally:

- qualitative D-MeX score, based on the ratings provided by developer services customers who transacted with the company throughout the reporting year to a customer satisfaction survey; and
- quantitative D-MeX score, based on the company's performance against a set of selected Water UK performance metrics throughout the reporting year.

The survey results which are used to calculate the qualitative component of the company's D-MeX score will be supplied by a survey agent appointed by Ofwat. This is supplied out of 100 to form the score for the qualitative component of D-MeX.

The set of Water UK performance metrics which are used to calculate the quantitative component of the company's D-MeX score, in place at the time of PR19 final determinations publication, are set out in annex 2 of 'PR19 final determinations: Customer measure of experience (C-MeX) and developer services measure of experience (D-MeX) policy appendix'. For each metric, a percentage is reported and a simple average of these metrics is taken. This is rescaled to be out of 100 to form the score for the quantitative component of D-MeX.

Water supply resilience

Definition:

Number of residential properties at risk of long term loss of supply (>48 hours) in the company's Thanet, Brighton and the Isle of Wight water supply zones.

A property is considered at risk of long term loss of supply (>48 hours) if it is likely to experience a long term supply interruption if one of the key hazards identified in the table below were to occur.

The key hazards and assets that are considered in the assessments are summarised in the table below.

Key hazards	Water supply works	Service reservoir	% completion allocation	Target completion date of the works
Flooding	✓	✓	✓	✗
Critical Asset Failure	✓	✓	✓	✓
Contamination	✗	✓	✗	✓
Raw Water Loss	✓	✗	✗	✗
Malicious Damage	✓	✓	✓	✗
Cyber Security Incident	✓	✓	✓	✗

Protect and improve the environment

Abstraction Incentive Mechanism	Definition: The abstraction incentive mechanism (AIM) reduces abstraction of water at environmentally sensitive sites when flow or levels are below an agreed point otherwise known as a trigger. The trigger point is usually based on a level or flow, beyond which the AIM is considered to be 'switched on'. This trigger will usually be related to the point at which damage is caused and is intended to prevent this from happening or ameliorate the negative impacts. The company has included one site for AIM for the period 2020–25, this is Otterbourne and Twyford. The trigger point for this site is the month of September as this is when impacts on the environment are most severe. The September abstraction limit for the 2020–25 period is 2280 Ml. The company's stated target is to outperform this by 15 Ml/d. The abstraction incentive mechanism is defined in the reporting guidance – Guidelines on the abstraction incentive mechanism, published in 2016: **ofwat.gov.uk/wp-content/uploads/2016/02/gud_pro20160226aim.pdf**
Pollution incidents	Definition: Pollution Incidents is defined in the following guidance for PR19 – Water & Sewerage Company Environmental Performance Assessment (EPA) Methodology (version 3). Published November 2017 by the Environment Agency. **ofwat.gov.uk/wp-content/uploads/2017/12/WatCoPerfEPAmethodology_v3-Nov-2017-Final.pdf**
Thanet sewers	Definition: The expected number of months delay to deliver an enhancement scheme related to the reduction of exfiltration from sewers located within tunnels in Thanet by 31 March 2025. The specification of the scheme is set out in the company's April 2019 business plan
Maintain bathing waters at 'excellent'	Definition: The number of bathing waters maintained at 'Excellent' each year, as designated by the Environment Agency, based on a four-year average. This measures the number of designated bathing waters within the Southern Water region which are assessed as having Excellent bathing water quality at the end of each bathing season. This is based on a four-year assessment. If a bathing water is closed for sampling the company will use the most recent classification as reported by the Environment Agency.

Continued on next page

Protect and improve the environment

Measure	Definition
Improve the number of bathing waters to at least 'good'	**Definition:** The cumulative number of named bathing waters that are improved and assessed as at least 'Good' water quality classification by the Environment Agency in the 2020-25 period. The following are the named bathing waters to be taken to 'Good' classification: • Broadstairs Viking Bay • Littlestone • Lancing, Beach Green • Hastings Pelham Beach • Felpham If during investigations an additional bathing water is identified it can be added to this list with the agreement of the Environment Agency. If a bathing water is de-designated during the period, it will not be counted and will reduce the potential for the company to perform. For the 2024–25 reporting year, if a season is classed as 'abnormal' as there are at least two samples two standard deviations away from typical wet weather affected samples, an underperformance payment will not apply for the 2024–25 year so far that it relates to an 'abnormal' assessment. The performance assessment would be deferred to the following year. The performance assessment for bathing waters assessed as abnormal will not be deferred again. It is expected that any underperformance or outperformance payments for bathing waters assessed as abnormal for the 2024–25 year will apply instead for the year 2025–26, this will be confirmed at the next price review. The overall amount of underperformance or outperformance payments should be the same as if an assessment takes place in 2025–26, had taken place in 2024–25.
Improve the number of bathing waters at 'excellent' quality	**Definition:** The cumulative number of named beaches that are improved and assessed as 'Excellent' bathing water classification by the Environment Agency in the 2024–25 period. At least two from the following four bathing waters will be improved: • Gurnard; • Seagrove; • Ramsgate Sands; and • Pevensey Bay If a bathing water is de-designated during the period, it will not be counted and will reduce the potential for the company to perform. For the 2024–25 reporting year, if a season is classed as 'abnormal' as there are at least two samples two standard deviations away from typical wet weather affected samples, underperformance payments will not apply for the 2024–25 year so far that it relates to an 'abnormal' assessment. The performance assessment would be deferred to the following year. The performance assessment for bathing waters assessed as abnormal will not be deferred again. It is expected that any underperformance or outperformance payments for bathing waters assessed as abnormal for the 2024–25 year will apply instead for the year 2025–26, this will be confirmed at the next price review. The overall amount of underperformance or outperformance payments should be the same as if an assessment that takes place in 2025–26, had taken place in 2024–25.
Effluent re-use	**Definition:** Volume of treated effluent in cubic metres (m^3) made available annually for direct re-use by customers. The measurement will be m^3 of treated effluent utilised by local authorities, businesses, farmers and communities on an annual basis. It measures effluent that the company no longer discharges direct to the environment but instead provide to a third party (at the appropriate quality required) for use. This could be, for example, to a council for watering flower beds or to a grower for crop irrigation.

Protect and improve the environment

Natural capital	**Definition:** The cumulative number of river catchments for which the company establishes and publishes baseline natural capital accounts. The company will establish baseline natural capital accounts for at least three of its ten catchments (the Test, Arun & Western Streams and Medway catchments) supported by natural and social capital metrics that will allow it to monitor and measure changes in natural capital stocks (extent and condition) and the value of water-related ecosystem services over time as a result of it investments/activities.
Distribution input	**Definition:** This measure is reported as an annual average in megalitres per day (Ml/d). Distribution input should be reported using the following criteria: • Distribution input to the system shall be metered with at least daily readings at all locations of water input to the distribution network at treatment works, boreholes and bulk supply locations; • Meters shall be an appropriate size for the flow to be measured and located at appropriate inputs to the network confirmed by record plans. Any treatment works' take-off downstream of a meter shall be excluded from the distribution input calculations; Data validity checks shall be carried out at least monthly; • Any missing data shall be infilled using both pre- and post-data for the location over at least one month, extrapolated from pump hours or use of upstream or downstream meters; and • The data transfer systems from meter output to the central database shall be checked and validated on a risk-based frequency every one to two years. This measure should be calculated consistently with other water balance components. If any missing data is infilled then the same data should be used in leakage and per capita consumption (PCC) reporting.
Treatment works compliance	**Definition:** Treatment works compliance is defined in the reporting guidance for PR19 – Water & Sewerage Company Environmental Performance Assessment (EPA) Methodology (version 3). Published November 2017 by the Environment Agency. **ofwat.gov.uk/wp-content/uploads/2017/12/WatCoPerfEPAmethodology_v3-Nov-2017-Final.pdf** The discharge permit compliance metric is reported as the number of failing sites (as a percentage of the total number of discharges) and not the number of failing discharges.
Renewable generation	**Definition:** Total renewable electricity generated as a percentage of the company's total electricity consumption. The measure includes all electricity consumed at the company's sites, including both operational sites and offices. All renewable energy generated on the company's sites will contribute towards this performance measure, irrespective of whether it has been generated using assets owned, operated and maintained by it, or on behalf of it by a third party, non-regulated, or subsidiary business unit. In this way performance against the target will be intrinsically linked to behaviours incentivised by the market for the purpose of value creation and not restricted by a traditional operating model. The total amount of renewable electricity generated at the company's sites is measured in kilowatt hours (kWh) at the generation source after deducting any power not used (parasitic loads) and including electricity both consumed on site and any surplus exported into the National Grid.

Protect and improve the environment

Satisfactory bioresources recycling	**Definition:** The overall percentage of company sludge satisfactorily used or disposed of in line with version 3 of the Environment Agency's Water and Sewerage Company Environmental Performance Assessment (EPA) methodology (published November 2017), which includes compliance with certain environmental laws and industry agreements in effect at the date of final determination, including: • the Sludge (Use in Agriculture) Regulations 1989; • Environmental Permitting (England and Wales) Regulations 2010; and • Water company voluntary compliance with the Safe Sludge Matrix. The full methodology, published in 2017, can be found here: **ofwat.gov.uk/wp-content/uploads/2017/12/WatCoPerfEPAmethodology_v3-Nov-2017-Final.pdf**
River water quality	**Definition:** The cumulative length of river improved as a consequence of regulatory and legislative drivers. The length of river defined as improved will be based on the delivery of specified schemes in the WINEP. The commitment level will be limited to those schemes with Green status as at 1 April 2019 and which are already confirmed. The length of river water quality improvements will be derived from specified schemes in the WINEP. It is assumed for the purposes of this performance commitment that delivery of the WINEP schemes will deliver the specified improvements to water quality.
Combined Sewer Overflows (CSO) Monitoring	**Definition:** Percentage of CSOs with effective monitoring. To count as effective monitoring under this measure, the following criteria will apply: • The monitor is an 'Event and Duration Monitor', which is a monitor that monitors that a CSO has spilt and the duration of the spill; • The monitor is in place and available providing at least 10 months valid data in any one year; • Data from the monitor has been validated, through either internal or external review; and • Data from the monitor has been made available on the company's website.
WINEP delivery	Has the company 'met' or 'not met' all of its requirements for WINEP, in the reporting year. This measure tracks the completion of required schemes in each year, as per the latest WINEP programme published by Defra. If any scheme is not delivered by the time specified in the WINEP tracker titled 'Completion Date (DD/MM/YY)', the company will report 'not met'. All WINEP schemes will be included including those reported under other performance commitments.

Use water wisely

Access to daily water consumption data	**Definition:** Number of residential properties provided with a device which can give access to daily water consumption. The measure includes all residential properties.
Water saved from water efficiency visits	**Definition:** Estimated reduction in consumption in cubic meters per days from 1 April 2020. The estimate is based on the number and type of water saving devices fitted and their estimated usage reduction. This will be calculated by the company's water efficiency visit supplier at the time of the visit. A water saving device is any physical device designed to save water (for example, a low flow shower head or tap aerator) or other intervention (for example, dripping tap repair). The estimated saving will be based on the estimated daily saving associated with each device installed and the customer's stated usage. The estimated daily saving associated with each device installed will be published on the company website. The annual savings will be calculated as the sum of the estimated daily savings at each property. The measure includes all residential properties.
Leakage	**Definition:** The percentage reduction of three year average leakage in megalitres per day (Ml/d) from the 2019–20 baseline. The total level of leakage is defined in the Final reporting guidance for PR19 – Leakage, published on 27 March 2018: **ofwat.gov.uk/publication/reporting-guidance-leakage/** Three-year average values are calculated from annual average values for the reporting year and two preceding years and expressed in megalitres per day (Ml/d).
Per capita consumption	**Definition:** Per capita consumption is defined in the Final reporting guidance for PR19 – Per Capita Consumption, published on 27 March 2018: **ofwat.gov.uk/publication/reporting-guidance-per-capita-consumption/** Three-year average values are calculated from annual average values for the reporting year and two preceding years and expressed in litres/person/day (l/p/d).
Target 100	**Definition:** Percentage of household population with estimated per capita consumption (PCC) of less than 100 litres/person/day. PCC is defined as the average amount of water used by each customer that lives in a household property

Appendix 3. Board statement on the accuracy and completeness of the data and information (financial and non-financial)

We, the Board of Southern Water (SWS), have considered carefully the requirements of the Board statement on the accuracy and completeness of the data and information (financial and non-financial). The Board is pleased to provide the following Board Statements.

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.

The Board has been fully aware of previous issues with the control environment of the company and has over the last four years worked with the executive management team to rebuild capability in this area. This work is on-going and is on track but will require further work in coming years.

Subject to this, the Board has actively engaged and challenged the assurance processes that have been adopted by the company. This covers assurance on both the financial and non-financial reporting. The Board has, over recent years, taken action to ensure that exceptions and weaknesses identified in the non-financial assurance have been addressed. The Board are satisfied that the assurance approaches have appropriately identified and addressed any risks to the provision of accurate and complete data and information. This has been discharged through the SWS Board and its relevant committees (most notably the Audit Committee).

Detail of this activity is included below:

Financial Reporting

- The Board reviewed the assurance outputs regarding the financial performance and prospects, reported in the 2020–21 Annual Performance Report, from Deloitte relating to the statutory and regulatory accounts (and the Long Term Viability Assessment). Deloitte presented their views to the Audit Committee on 16 June 2021.
- The Board has visibility of the high level financial governance and controls that are in place around our financial reporting, and this is captured as part of the annual external audit, internal audit reports looking at financial controls and updates on the implementation of new accounting standards. There is a Schedule of Matters Reserved to the Board.
- The Board reviews the monthly KPI reports and the financial report from the CFO, including performance against budgets.
- The Board, via its Committees, monitors the Southern Water internal control framework and if necessary, how weaknesses are being addressed. This applies to both Financial and Non-Financial controls.
- The Board has approved updates in the Annual Report, Interim Accounts, Annual Performance Report and Data Assurance Summary that detail improvements in governance and controls, and has included specific caveats where capability is still improving.

Non-Financial Reporting

- SWS is becoming a more resilient organisation and continues to deliver a wide-ranging transformation programme. The Company has been building on improvements to business monitoring and compliance processes, systems and training and reporting. These are part of a continuing programme that has been taking place since 2016, when concerns came to the attention of the SWS Board. The key focus of this programme is on the embedment of controls across the business and reflects the fact that the company is well into its long term programme of change.
- The Board continues to support the company to ensure it maintains the standards required by our regulators and ourselves – for example, data reporting and assurance – work is ongoing to materially improve processes and systems, underpinned by values-based ethical business practice, to ensure the mistakes of the past are not repeated.
- SWS has adopted the ‘three lines of defence’ framework for reporting governance and assurance activity. This has been in place for non-financial reporting since 2017 and has supported the continued maturity of the internal system of control and helps to assure performance information by applying multiple levels of control. The process continues to be embedded across the business, and the management focus is on the areas of highest risk. The framework is delivered and reviewed as part of the Final Assurance Plan and the Internal Audit Annual plan (both of which are signed off by the Audit Committee).
- In high risk non-financial reporting areas, the Company has applied separation of duties in the monitoring and control of compliance, in line with the ‘three lines of defence’ model. This has been in place since 2017 and is subject to regular review from internal assurance teams and external assurance.

- Internal controls are applied and improved processes are now in place to mitigate the risk of supplying incorrect or inaccurate information in all the Company's non-financial regulatory reporting. A programme of improvements continues to strengthen first and second-line assurance processes for all regulatory reporting. The improvements to reporting are being applied to new Ofwat reporting for this business plan period and build on the improvements in the last three years of reporting for the previous period. The next phase of control improvements will be supported by the implementation of new technology (including a new Governance Risk and Control system) that will help to systemise some of the manual improvements that have been implemented over the last four years.
- The Board and Audit Committee regularly receives and reviews information and reports on non-financial resources and performance that support the efficient delivery of services to our customers and other stakeholders.
- The Audit Committee reviews progress of non-financial reporting improvement plans, IAP Action plans, and the Ofwat Section 19 undertakings.
- The Board reviewed the assurance outputs regarding the non-financial performance, reported in the 2020–21 Annual Performance Report from KPMG LLP. KPMG LLP presented their views to the Board Audit Committee at the meeting on 16 June 2021.
- The Board, via its Audit Committee, has received an internal assurance report in March 2021, which reported Southern Water compliance with their Licence of Appointment.
- The Board, via its Committees, monitors the Southern Water internal control framework and if necessary, how weaknesses are being addressed. This applies to both Financial and Non-Financial controls.
- The Audit Committee has monitored the completion of a risk-based programme of internal assurance activities during the year, as part of a three-year rolling Internal Audit programme.

Data Assurance Summary

We have published a separate document that details the completed assurance work performed on our reported information for the 2020–21 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**.

Ian McAulay
Chief Executive Officer

Keith Lough
Chairman

6 July 2021

Appendix 4. Condition P – Ring-fencing Certificate – Board assurance statement

We, the Board of Southern Water (SWS), have considered carefully the requirements of the Condition P Certificates and have undertaken reasonable diligent enquiry and challenge to confirm the statements made below. The Board is pleased to provide the following Statements:

Financial resources and facilities:

- The Board has reviewed the going concern and long-term viability assessment (LTVA) (in June 2021). This included the company's liquidity position, headroom against the financial covenants, credit ratings and financial risk assessment against a number of downside scenarios.
- The company obtained a waiver from its Lenders in February 2021 which allows full use of available liquidity, plus the raising of new finance, even in a Trigger Event scenario of a credit rating downgrade or a breach of a trigger debt compliance ratio. The next planned financing activity will be in anticipation of a bond maturity on 31 March 2023.
- The Board reviewed the assurance outputs regarding the financial performance and prospects, reported in the 2020–21 Annual Performance Report, from Deloitte relating to the statutory and regulatory accounts and the LTVA. Deloitte presented their views to the Audit Committee on 16 June 2021.
- The Board has considered the operational plans that have been presented to them in the updated SWS Execution Plan (EP21) and have concluded that they are aligned to meeting the needs of our customers and stakeholders and are aligned with the final determination that has been agreed with Ofwat.
- The Board is confident that the EP21 delivers our statutory and regulatory obligations, and allows us to demonstrate compliance with Condition P of the Licence of Appointment.
- The Board approved the EP21 and the Budget for 2021–22 in March 2021.
- The Board (and its Finance Working Group) receives regular updates on the financial status of the company including regular cash flow forecast and monitoring. The Board also receives updates on the company's credit ratings and meetings with the credit rating agencies.
- The Board is aware of on-going litigation in relation to a prosecution from the Environment Agency, and has approved related financial disclosures within the financial accounts. The Board is also aware of other [potential] litigation, in relation to regulator investigations that are at earlier stages.

The Board therefore confirms that the company has sufficient financial resources and facilities.

Management resources:

- The Board is focused on ensuring the company has the right organisational capability including Management skills, experience and/ or any relevant qualifications to deliver the very challenging five year business plan.
- The Board has acknowledged that, in the past, the company failed to meet its own high expectations. The Board continues to strongly support the executive management, who have continued to work very hard to ensure previous improvements are embedded into the way the company carries out its business (an example of this has been the regular updates the Audit Committee receives on the embedment of the Three Line Defence model).
- The company has evolved its structure in the financial year, bringing in key resource at executive level to support the further development of the company.
- The Risk and Compliance director and directorate continue to act as the second line team and provide the check and challenge on the rest of the company. It delivers a risk-based programme (structured around our obligations) to ensure that the company is meeting its regulatory and statutory obligations.
- The executive management team continues to rebuild capability in the company. A range of training programmes in compliance, public health and protecting the environment were put in place and these programmes continue to develop and strengthen with key training material in these areas being delivered in 2020–21. These programmes are actively monitored to ensure they are embedded in teams across the business.
- The Board challenges the organisational capacity, capability and culture to deliver the significant changes required and monitors progress, both directly and through the Audit Committee.
- The Board received a 'Culture Dashboard' in September 2020 and March 2021, and will continue to receive these on a six monthly basis. The Dashboard provides key metrics on the development of company culture, and helps provides key information to help the Board to comment on culture change initiatives.
- The executive team have implemented the People plan and the necessary Execution Plan resourcing.
- The Board also carries out reviews of its own capability through Board effectiveness

reviews, which are supported by independent assessments of their capability.

- The Board also looks to ensure that its membership is diverse to ensure a diversity of perspectives. An active process of succession planning is in place to support this.

The Board therefore confirms that the company has sufficient management resources.

Systems of planning and internal control:

- SWS is becoming a more resilient organisation and continues to deliver a wide-ranging transformation programme. The company has continued to build improvements to business monitoring and compliance processes, systems and training and reporting. These are part of a continuing programme that have been taking place since 2016, when concerns came to the attention of the SWS Board. The key focus of these programmes is on the embedment of controls across the business and reflects the fact that the company is well into its long term programme of change.
- The Board continues to support the company to ensure it maintains the standards required by our regulators and ourselves – for example, asset compliance, or data reporting and assurance – work is ongoing to materially improve processes and systems, underpinned by values-based ethical business practice, to ensure the mistakes of the past are not repeated.
- The Board has previously had visibility of the asset management approach taken by the company. This includes the Asset Life Cycle process and the Risk and Value process. The Board has regular visibility of the capital programme of delivery, via the monthly KPI Board pack.
- SWS has adopted the 'three lines of defence' framework for reporting governance and assurance activity. In relation to non-financial reporting, this has been in place since 2017 and has supported the continued maturity of the internal system of control and helps to assure performance information by applying multiple levels of control. The process continues to be embedded across the business, and the management focus is on the areas of highest risk. The framework is delivered and reviewed as part of the Final Assurance Plan and the Internal Audit Annual plan (both of which are signed off by the Audit Committee).
- In high risk non-financial reporting areas, the company has applied separation of duties in the monitoring and control of compliance, in line with the 'three lines of defence' model. Again, this has been in place since 2017 and is subject to regular review from second-line assurance teams and external assurance as described in the published Final Assurance Plan, as well as in the Internal Audit Plan. Internal controls are applied and improved processes are now in place to mitigate the risk of supplying incorrect or inaccurate information in all the company's non-financial regulatory reporting.
- A programme of improvements continues to strengthen first and second-line assurance processes for all regulatory reporting. The improvements to reporting are being applied to new Ofwat reporting for this business plan period and build on the improvements in the last three years of reporting for the previous five year period. The next phase of control improvements will be supported by the implementation of new technology and process automation that will help to systemise some of the manual improvements that have been implemented over the last four years.
- The Board and Audit Committee regularly receives and reviews information and reports on non-financial performance that support the efficient delivery of services to our customers and other stakeholders .
- The Board have visibility of the high level financial governance and controls that are in place around our financial reporting, and this is captured as part of the annual external audit, internal audit reports looking at financial controls and updates on the implementation of new accounting standards. There is a Schedule of Matters Reserved to the Board.
- The Board reviews the monthly KPI reports and the financial report from the CFO, including performance against budgets.
- The Audit Committee reviews progress of non-financial reporting improvement plans, IAP Action plans, and the Ofwat Section 19 undertakings.
- The Board reviewed the assurance outputs regarding the non-financial performance, reported in the 2020–21 Annual Performance Report from KPMG LLP. KPMG LLP presented their views to the Audit Committee at the meeting on 16 June 2021.
- The Board, or its Committees as appropriate, has sought to ensure that Southern Water has an effective policy framework to protect the reputation of the business and that it operates in a compliant and ethical manner. Critical policies are reviewed by the Board. The Board is aware that improvements are being enacted to improve the quality of the policies, and to ensure that they are up to date. The Board also refers to the Schedule of

Matters Reserved to the Board, which outlines the Board sign off responsibilities.

- The Board, via its Audit Committee, has received an internal assurance report in March 2021 (produced by the Risk and Assurance Team), which reviewed Southern Water compliance with its Licence of Appointment.
- The Board, via its Committees, monitors the Southern Water internal control framework and if necessary, how weaknesses are being addressed.
- The Board have also supported the compliance training of front line operational teams. This has been reflected in high level of uptake from teams across the company.
- The Audit Committee has monitored the completion of a risk-based programme of internal assurance activities during the year, as part of a three year rolling Internal Audit programme.
- The Board has overall responsibility for risk management and is supported in this role by the Risk Committee.
- The Board continues to recognise the importance of effective risk and resilience management, champion its use within decision making forums and is deeply committed to support the embedment of risk management at every level of the organisation.
- The Board has recognised the need to improve SWS's approach to risk and resilience management. Additional resource and expertise has been brought into the company during the year to support the further development of risk management.
- A key aspect of this development is the implementation of a new business partnering model developed to ensure teams across the company are supported and facilitating risk-informed decision making throughout their day to-day business activities.
- Additional work has delivered improvements in the approach to Enterprise Risk Management, with Board approval of an updated Risk Appetite and associated Risk Taxonomy and Risk Criteria. This includes specific elements that relate to compliance, regulatory and statutory obligations.
- To successfully embed risk management across Southern Water, the risk management process is supported by a governance structure that defines roles and responsibilities at each level of the company.
- The Board, via the Risk Committee, reviews key areas of risk for the company in regular 'deep-dive reviews'.
- The Board has approved updates in the Annual Report, Interim Accounts, Annual Performance Report and Data Assurance Summary that detail improvements in governance and controls, and has included specific caveats where capability is still improving.
- The executive team have implemented strategies that have maintained service levels, despite the challenges of working with the context of COVID- 19. This has provided firm foundations for our preparations to move out of the Pandemic and return to a sustained new way of working.

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

Resources other than financial or management resources:

- The Board consider the culture of the company to be a key foundation for the company when it manages its business and delivers its obligations. To reflect this, the Board has appointed a non-executive director with responsibility for employee engagement. In addition, the Board receives regular updates from the executive on employee engagement.
- The Board has continued to support the embedment of the Southern Water values. The company values developed in 2019 continue to be embedded, and the Board continues to support and sign up to the Code of Ethics. These actions, along with the establishment of a Modern Compliance Framework, have already successfully started to change the culture in Southern Water.
- The Board re-approved the Code of Ethics in September 2020
- The company's 'Speak Up' procedures have been enhanced, and an annual review of 'Speak Up' was presented to the Audit Committee in March 2021.
- The Audit Committee receives regular detailed reports on Speak Up cases and discusses progress on resolution.
- The Board now receive a 'Measures of Culture Dashboard' on a six monthly basis (which provides key metrics on the development of company culture) and approves any changes to the metrics and targets presented within the dashboard.

- The Board also receive updates on the Culture Change Group, a coordinating executive group within the company that aligns culture change work across the company.

The Board therefore confirms that the company has sufficient programmes on culture and employee engagement to support non-financial resources and facilities.

Contracting:

- The Board has reviewed the terms of a number of the key contracts that the business has put in place and has previously reviewed the procurement strategy.
- The company does have active associated companies, but these are used for financing purposes and do not have any operational contracts or transactions with the operating company.

The Board therefore confirms that the company has adequate contractual relationships in place and is active in its review of key contracts. The Board also confirms that whilst it does have associated companies in place it can confirm that these do not have any operational contracts or transactions with the operating company.

Material issues or circumstances:

The Board has considered the following material issues or circumstances that meet our Condition P Certificates in relation to the operation of our wastewater business (as detailed in our Section 19 undertakings with Ofwat):

- The Board has reviewed the financial resources and facilities related to our wastewater business in the Execution Plan (EP21) and the Budget and confirms that they are sufficient resources in relation to our wastewater operations over the next twelve months.
- The Board has previously considered the organisational structures and governance within our wastewater business and confirms that we are able to deliver services to our customers and stakeholders and meet our statutory and regulatory requirements in this area – the Board originally approved changes to company's organisational structure that took place in 2017, and included work on the separation of duties in the Wastewater Directorate and the establishment of the Risk and Compliance Directorate and the development of a 'Three Lines of Defence' model of compliance. The Board are confident that these changes have been embedded in the company and are a key element of improvements and transformation of the company. These arrangements are subject to detailed external assurance as part of our Section 19 Undertakings to ensure they remain in place and are embedded in the way the company carries out its duties.
- The Board confirms that is aware of the material risks faced by the wastewater business and the company has undertaken appropriate investigations to ensure all significant risks are identified, together with the monitoring of key risk mitigation actions.
- The Board has considered the specific operational plans relating to our wastewater business, as part of our review of the updated Execution Plan (EP21) and the Budget and confirm they are aligned to meeting the needs of our customers and stakeholders and are aligned with the final determination and Undertakings that have been agreed with Ofwat.
- The Board, via its Audit Committee, has been provided regular updates on the progress of the Section 19 Undertakings and has provided robust check and challenge on the process over the year.

The Board therefore confirms that they have considered the material issues facing our wastewater business (as detailed in our Section 19 undertakings with Ofwat), and that the company has sufficient financial, non-financial resources and facilities.

The Condition P ring-fencing certificate and Board assurance statements which cover a period of at least 12 months from the date of signing the accounts were approved by the Board at its meeting on 24 June 2021.

Ian McAulay
Chief Executive Officer

Keith Lough
Chairman

6 July 2021

Appendix 5. 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. AMP7, the seventh plan since privatisation, covers April 2020 to March 2025.

Associated company

Condition A of the Licence defines an associated 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.

C-MeX

C-MeX is Ofwat's measure of customer experience. It comprises two surveys – a survey of customers who have recently contacted their company and a survey of random members of the public in relation to their water company. These are used to calculate a score which can be compared between water companies, with rewards and penalties for the best and worst performers.

Final Determination (FD)

The conclusion of discussions on the scale and content of the Asset Management Plan for the forthcoming five-year period. It includes a determination of the allowable revenues for the period and the performance targets that must be achieved.

K factor

The annual increase, set by Ofwat, in wholesale revenues that companies in the water industry can recover from customers. The amount by which a company can increase (or must decrease) its revenues is controlled by the price limit formula CPIH + or – 'K'. CPIH is expressed as the percentage increase in the Consumer Price Index (including owner occupiers' housing costs) 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 the revenues 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 Commitments with outperformance and/or underperformance payments agreed with customers and Ofwat through the periodic review process.

Performance Commitment (PC)

Performance Commitments are service targets set by Ofwat as part of the Final Determination.

Periodic review

A review conducted by Ofwat each five years for the purpose of determining price controls. Each water and wastewater undertaker submits a business plan covering the five-year period for which Ofwat will set the controls. (PR19 relates to 2020–25; PR24 will cover the period 2025–30).

Price control

A price control determines the limit on the level of charges or revenues that can be recovered from customers. As part of the price control Ofwat also determines performance targets and other related matters.

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).

Consumer Price Index (CPIH)

CPI is a measure of the change in consumer prices based on the prices of a typical basket of goods and services in the United Kingdom. The CPIH measure, includes owner occupier's housing costs. This is the principal measure of inflation used by Ofwat for regulatory purposes, including inflating allowed revenues or prices.

Totex

Total expenditure is the sum of operating expenditure and capital expenditure. It is used by Ofwat to determine the efficient level of costs as part of the periodic review process.

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