South Staffs Water

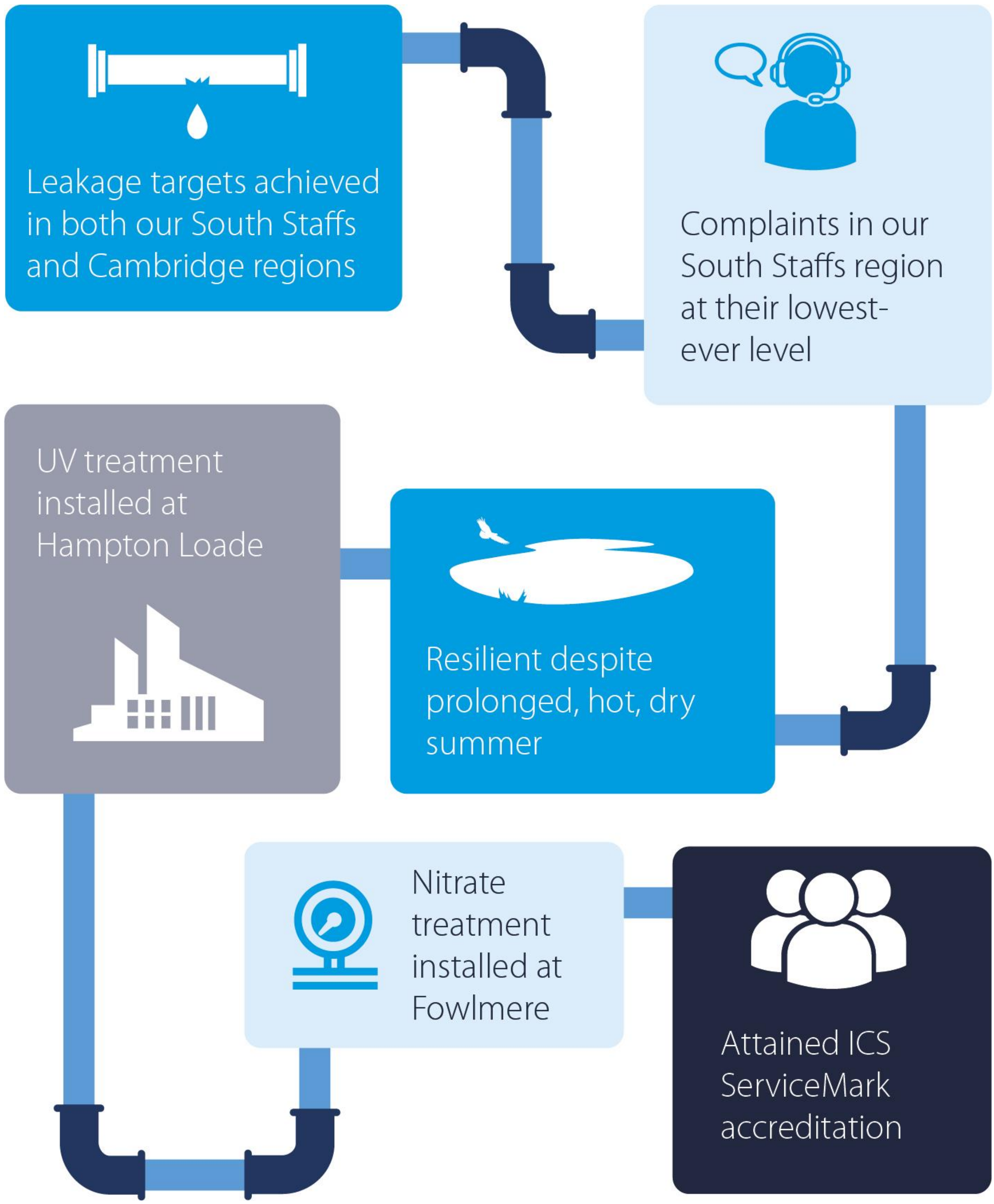
South Staffordshire Water PLC

Annual report and accounts and annual performance report

Year Ended 31 March 2019

making water count

The year at a glance

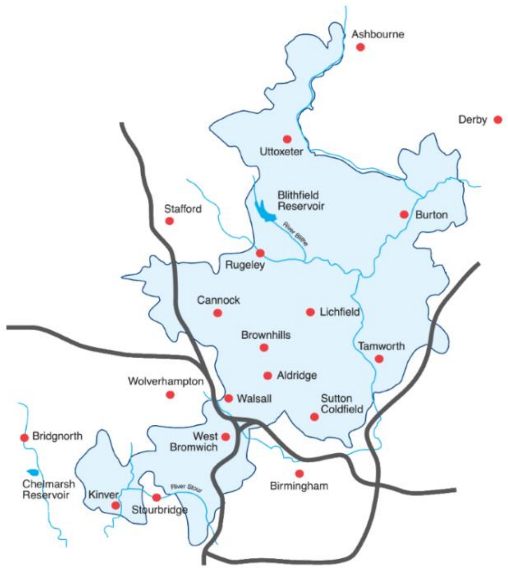


About South Staffs Water

South Staffordshire Water PLC ('South Staffs Water' or 'the company') is part of the South Staffordshire Plc group of companies, a privately-owned integrated services group concentrating on regulated water supply and complementary specialist service businesses. We operate across two regions under a single water supply licence, supplying clean water services to more than 1.7 million people and around 45,000 businesses in Staffordshire, parts of the West Midlands, and in and around Cambridge.

Our South Staffs region extends from Ashbourne in the north to Halesowen in the south, and from Burton-upon-Trent in the east to Kinver in the west. Our Cambridge region stretches from Ramsey in the north to beyond Melbourn in the south, and from Gamlingay in the west to the east of Cambridge city.

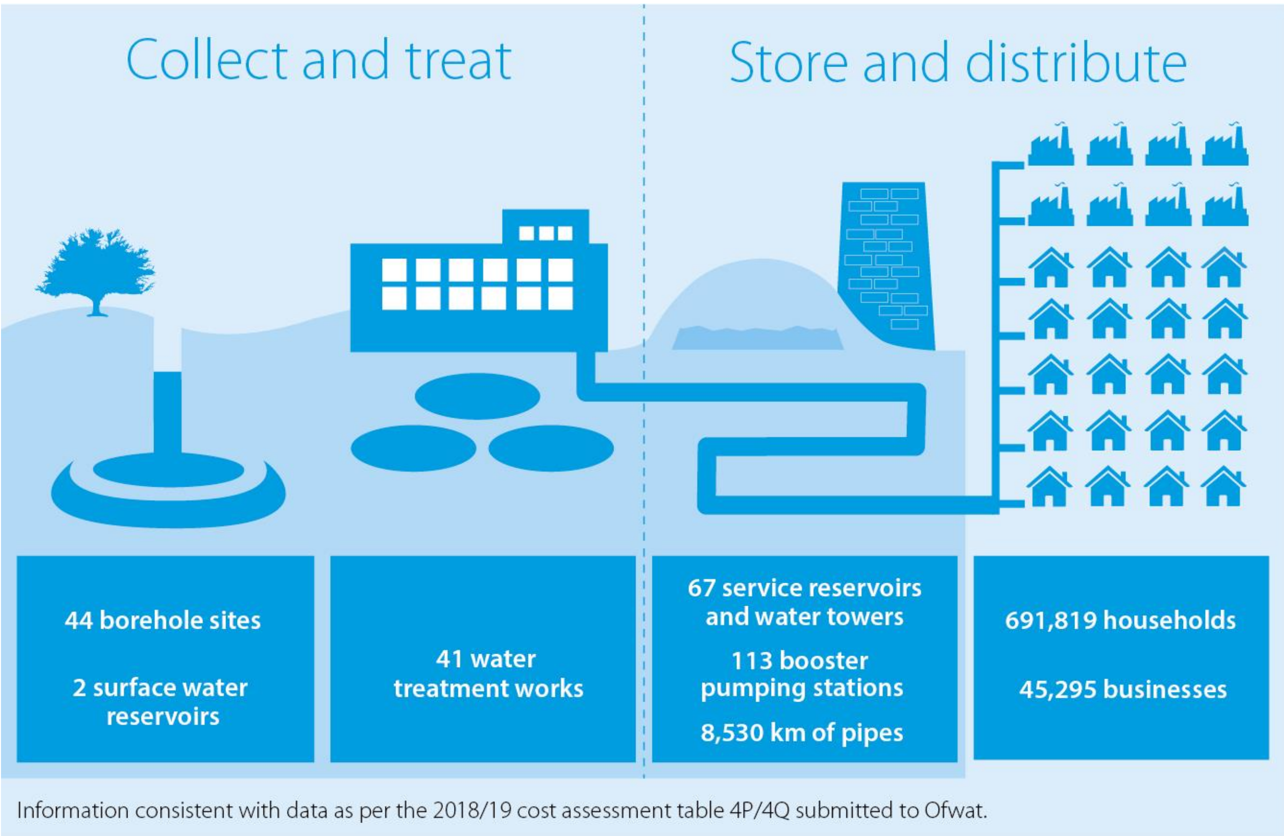
South Staffs region



Cambridge region

	South Staffs region	Cambridge region
Area served (km²)	1,497	1,175
Population served	1,361,623	351,189
Water supplied each day on average (Million litres Ml)	312.38	84.26
Household connections	557,524	134,295
Non-household connections	34,886	10,409

Our role



South Staffs Water is a water only company and does not provide sewerage services. We bill customers for these services on behalf of Severn Trent Water in our South Staffs region and Anglian Water in our Cambridge region.

Our business

Our vision

To make sure all our customers have access to clean, high-quality and affordable drinking water every day. And to make sure all our people are empowered to provide excellent service that our customers, communities and wider stakeholders can trust – now and in the future.

Our purpose

We have a long history of delivering clean water every day and in all weathers to our customers, providing an essential public service that touches everything they do. This guiding purpose enables the 1.7 million people and around 45,000 businesses across our South Staffs and Cambridge regions to go about their daily lives and helps to keep them healthy.

We actively work in partnership with local communities, helping them to thrive. And we focus our efforts on being a custodian of our assets and the local environment to make sure we can keep delivering the things that matter most to our customers now and for future generations.

We run an efficient business, which has always been in the private sector and which delivers sustainable, long-term returns for our investors. This is how we are **making water count**.

Our purpose is underpinned by our core beliefs, which are that:

- preparing for the future is essential;
- minimising waste in every area of our business operations is critical;
- using water wisely is important;
- we are always looking for new ways to do things better and quicker;
- listening to customers is crucial;
- our focus is on local issues; and
- working with partners creates better communities.

These core beliefs are reflected in our people's objectives and the work they do.

making water count

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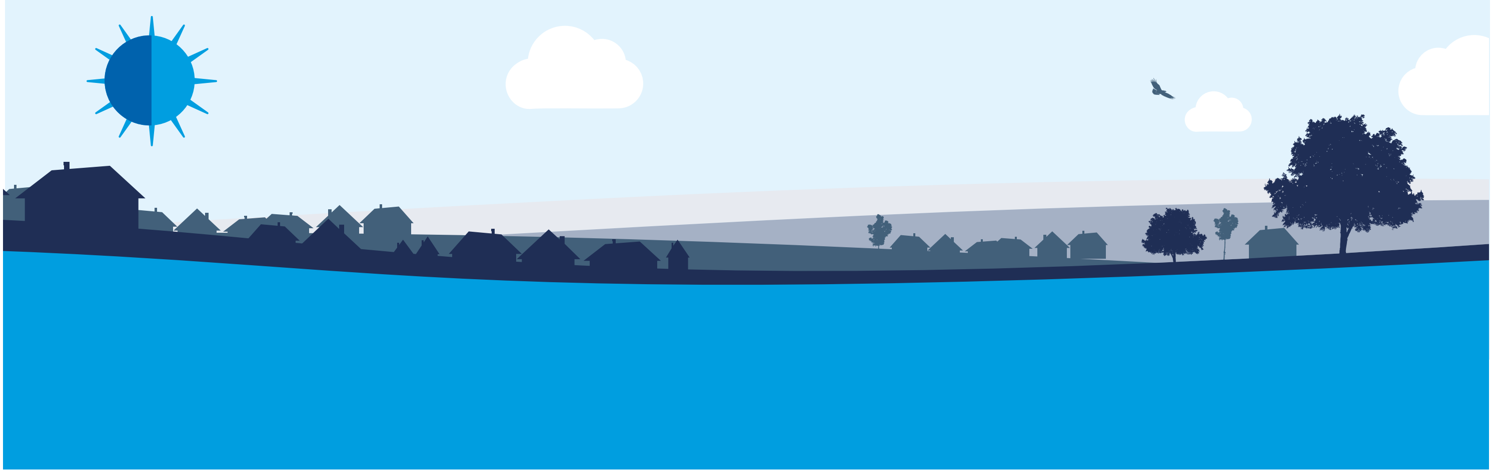


Chair's foreword

Welcome to South Staffs Water's annual report and accounts for 2018/19. It has been a particularly busy year for the company – one that has been dominated both by the debate around the long-term future of the water sector in England and Wales and the impact of the sustained period of hot, dry weather last summer on our resources and operations.

At the same time as we were experiencing this extreme weather event, the Board and I were actively involved in the process for preparing, approving and assuring our business plan for 2020 to 2025, which was submitted to Ofwat in September 2018. As a Board, we have been involved throughout the development of the plan, and are convinced by its ambition and the way it takes into account our customers' changing needs and expectations. We firmly believe it represents a fair balance between costs, strategic investment, efficiency and innovation.

It has also been a year of change for the company. In July 2018, Arjun Infrastructure Partners acquired a majority controlling interest in the South Staffordshire group of companies. At the same time, Mitsubishi UFJ Lease & Finance acquired a stake in the Group, with the sale completing in July 2018. I am delighted that our investors bring with them a wealth of experience of the UK water sector combined with wide-ranging global insights.

I was also pleased to welcome two new Independent Non-executive Directors to the Board during the year – Lord Smith of Finsbury and Catherine May. I am confident that their knowledge and experience will strengthen the Board as we look ahead to delivering our ambitious plan for our customers to ensure we continue to deliver the high-quality services they expect and pay for.

Finally, I would like to extend the Board's thanks to all our teams for their continued commitment to the company and the communities we serve every day. We have faced a number of challenges during the year – not least the extreme weather in the spring and summer. But the business has performed well, maintaining supplies to customers, improving leakage performance and completing key investments in both our South Staffs and Cambridge regions. I am pleased with how well everyone has continued to pull together to deliver the very best outcomes for our customers.

Sir James Perowne

Managing Director’s introduction

Thank you for taking the time to read this annual report and accounts for the year ended 31 March 2019. I hope it provides you with a useful snapshot of the work South Staffs Water has done over the past 12 months. I also hope it gives you an idea of how we have performed against our current performance targets.

It has been a very busy year for South Staffs Water. In September 2018, we submitted our business plan for 2020 to 2025 to Ofwat, the economic regulator of the water sector in England and Wales. Titled ‘Making water count’, this ambitious plan is the result of extensive engagement and includes our largest-ever investment programme to ensure we deliver the things our customers have said are important to them. Following Ofwat’s initial assessment, we revisited certain areas of our plan, which we resubmitted on 1 April 2019. Ofwat will make its final decision on our business plan in December and we will discuss the outcome of this in next year’s annual report.

Alongside this, we have continued with our business as usual activities. After narrowly missing our leakage target in 2017/18, we are pleased to report that we achieved our target in both our South Staffs and Cambridge regions in 2018/19. This is the result of the hard work of our people, increased investment in resources, more network monitoring and the use of new technology. We understand that our customers care deeply about the environment – and that tackling leakage is an important part of this. We are confident that we will continue to drive leakage levels down in the coming 12 months.

As part of this, during the year we started trialling our innovative HydroSEAL technology that enables leaks in water distribution pipes to be sealed from the inside without the need to dig up roads or use conventional lining techniques. We are excited about the potential for this and other innovations we are exploring, and will discuss these in more detail in next year’s annual report.

We are disappointed to report that we missed our targets both for water quality compliance and the acceptability of water to customers in 2018/19. This was partly because of failures we experienced at our Hampton Loade and Seedy Mill water treatment works. We have investigated the reasons for these failures and have taken action to get back on track. This includes making substantial investment to install UV treatment at both works, and planning for even more significant investment for the five years from 2020. Despite the failures we experienced during the year, our water presented no risks to public health and remains at a very high standard overall.

We believe that responding to our customers’ needs is at the heart of who we are as a provider of an essential public service. So, in March 2019 we were pleased to learn that our contact centre had been awarded the Institute of Customer Service’s ServiceMark accreditation. Achieving this recognised national customer service standard validates our dedication to always providing the highest levels of customer service.

In addition, during 2018/19 we saw a 19% reduction in the number of complaints from customers, and our average response time has reduced from eight days to around six days. By the end of the year, complaints in our South Staffs region had fallen to their lowest-ever level, improving by more than 30%. We will continue to build on this strong position in the year ahead.

We also understand the importance of being embedded within the communities we serve, delivering what our customers want and need. At a time when the legitimacy of the sector is being called into question, we pride ourselves on the connections we have with our local communities and the partnerships we have formed with different organisations – for example, through our community hub, which celebrated its first anniversary in April 2019. At the time of writing, nearly 4,000 customers have visited our hub, so we – and they – are really seeing the benefits of this approach.

But there are other ways in which we work with our different communities. This includes our successful SPRING catchment management programme with farmers in the River Blithe catchment in our South Staffs region, and our PEBBLE fund, where we provide support to local groups and community organisations for projects that are designed to improve, restore or create new habitats for plants and wildlife. And our education outreach programme continues to go from strength to strength. All these programmes are crucial in reinforcing our commitment to our customers and the communities we serve.

Over the past 12 months, we have also been looking at ways to improve the service we provide to our customers. We know that while some of our customers prefer to engage with us in person, others are keen to embrace a self-service, digital approach that fits around their lifestyles and individual circumstances. So, in June 2018 we launched what we believe to be the most comprehensive Alexa skill in the water sector. More recently, we also launched a mobile app, which enables customers to submit a meter reading, pay their bill and report leaks.

> “We understand the importance of being embedded in the communities we serve, and pride ourselves in the connections and partnerships we have formed with different organisations”

Looking ahead, we are facing a number of challenges over the next year or so – not least the turbulent political climate, the impact of Brexit, environmental pressures resulting from climate change and changes in customers’ expectations. We will continue to consider all our operations in the round – building more flexibility and resilience into our systems and processes across the business to ensure we can adapt and respond to these changing circumstances quickly and efficiently.

Finally, I would like to take this opportunity to thank all our teams for their commitment and hard work during 2018/19. There have been challenges, including extremes of weather, but we have performed well. None of what we have achieved would have been possible without everyone across the business playing their part every day in all weathers and sometimes difficult circumstances.

Phil Newland

Strategic report

Performance against our targets

Our five outcomes and 15 performance commitments reflect what our customers have told us is important to them. Some have financial incentives attached, which means over the five-year period, we may incur a penalty for under-performing against our targets or a reward for performing better than our targets. For the first four years of the 2015 to 2020 period, we have earned a total outperformance reward of £1.34 million. We have taken this into account in our business plan for the five years from 2020 to 2025.

Outcome	Measure name	What we are measuring	Progress of meeting our targets			
			2015/16	2016/17	2017/18	2018/19
1 Excellent water quality	Mean Zone Compliance	The number of times we fail to meet drinking water standards when supplying customers within our network	✗	✓	✗	✗
	Acceptability of water to customers	The number of contacts for every 1,000 customers that we receive about the taste, smell and appearance of tap water, or cases of illness to customers each year	✗	✗	✗	✗
2 Secure and reliable supplies	Interruptions to supply	The number of times a customer's property suffers a loss of water supply for more than three hours	✓	✓	✓	✓
	Asset health infrastructure	The long-term ability of our underground assets (e.g. pipes) to provide a reliable service	✓	✓	✓	✓
	Asset health non-infrastructure	The long-term ability of our above-ground assets (e.g. water treatment works) to provide a reliable service	✓	✓	✓	✓
3 An excellent customer experience to customers and community	Service Incentive Mechanism	The percentage of customers, who agree that we have handled their enquiry to a high standard	✗	✗	✗	✗
	Customer satisfaction	The percentage of customers, who agree that we offer a good overall service	✓	✓	✗	✓
	Community engagement	The amount of time our staff spend supporting worthwhile community projects	✗	✗	✓	✓
4 Operations that are environmentally sustainable	Leakage South Staffs region	The amount of water, measured in litres, lost through leaking pipes	✓	✓	✗	✓
	Leakage Cambridge region		✓	✗	✗	✓
	Water efficiency	The number of litres of water each person uses per day in our regions	✓	✓	✗	✗
	Biodiversity	The area of land, where we actively protect wildlife, trees and plants from damage	✓	✓	✓	✓
	Carbon emissions	The number of tonnes of carbon we save by changing the way our business operates	✗	✗	✗	✗
5 Fair customer bills and fair investor returns	Value for money and affordability satisfaction	The percentage of customers, who agree that our services offer value for money and that their water bills are affordable	✓	✓	✓	✓
	Support for customers in debt	The number of customers experiencing financial hardship we supported through lower bills	✓	✓	✓	✓
		Total targets passed	10	10	7	10
		Total targets missed	5	5	8	5

Excellent water quality

How we performed in 2018/19

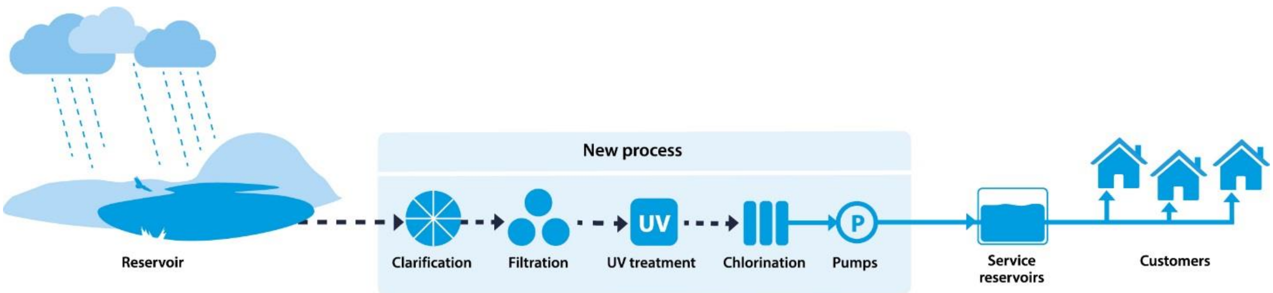
Water quality is one of the most important areas of our service. It is also a top priority for our customers. That is why we have two performance targets covering overall drinking water compliance and the acceptability of water to customers, measured by how often our customers contact us to report issues. We have stretching regulatory targets for both these measures.

We are disappointed to report that we have not met our target of 100% water quality compliance, as 15 out of 16,958 samples in our South Staffs region and 2 out of 5,000 samples in our Cambridge region did not meet the strict regulatory compliance standards in 2018. Despite this, our water quality remains at a very high standard overall at 99.92% compliance. During the year, we suffered failures at both our Hampton Loade and Seedy Mill water treatment works. While there was no risk to public health, we investigated these failures thoroughly and as well as completing the installation of ultraviolet (UV) treatment at Hampton Loade (see below), we also invested in powder-activated carbon. This is an effective process, which works by quickly absorbing impurities, such as pesticides and organic material, in drinking water. In addition, we engaged with the Drinking Water Inspectorate (DWI), which enforces water quality standards, regularly on these issues throughout the year.

We have also not met our stretching regulatory target for acceptability of water, which we measure by how often customers contact us to report issues with their water supply, such as the colour, taste and smell. Until 2018/19, we had made continuous improvement towards our target of 1.23 contacts per thousand of population, delivering a reduction of nearly 30% between 2015 and 2017. But the hot summer in 2018 resulted in a higher demand for water, which in turn caused higher flow rates in the pipes transporting the water. The higher flow rates caused sediment within the pipes to be disturbed, resulting in a slight increase in contacts from customers in the affected areas. We remain committed to improving this area of service and will be working to achieve our target during 2019/20, coupled with significant investment in the five years from 2020 to 2025. We will discuss the outcome of this in next year's annual report.

UV treatment installed at Hampton Loade

In October 2018, we completed the installation of an ultraviolet (UV) treatment stage at our Hampton Loade water treatment works alongside the conventional clarification, filtration and disinfection treatment processes. In recent years, we have seen some water quality-related failures from this treatment works, which falls short of the standards we and the DWI expect. The addition of a UV treatment stage to the process will significantly reduce the risk of water-borne bacteria and viruses leaving the works.



New water treatment plant at Fowlmere

On 16 May 2019, new Board member and Cambridge Water customer, the Rt Hon Lord Smith of Finsbury, officially opened the new water treatment plant at Fowlmere in our Cambridge region, the work for which was carried out during the 2018/19 financial year. He is pictured (centre) toasting the new plant – with water – with Adrian Page, Group Chief Executive of South Staffordshire Plc and fellow Board member, Catherine May.

The pumping station at Fowlmere has supplied water to Cambridge since 1959. It is a major hub in the region's water supply network, pumping around 3.5 million litres of water on average every day. We have added the new state-of-the-art treatment plant to remove nitrates from the water supply. And we have upgraded the existing treatment processes to ensure we can continue to provide some of the highest quality water in the country. Nitrates are naturally present in soil and can also be found in fertilisers. As they are soluble, they can be washed into rivers or streams, or seep through the ground into underground water sources. Fowlmere is now the fourth nitrate treatment plant in our Cambridge region.

Sampling water smartly

The water we supply to our customers must always meet the highest quality standards. One of the ways we check this is by taking regular samples. There are specific Water Quality Regulations that tell us how many samples we must take, from where and for which quality parameters. At the start of each year, our Water Quality team develops the sampling schedules for the following 12 months. One of the key challenges for the team is to make sure the right samples get taken from the right place at the right time. In early 2018 we were successful in gaining ISO17025 accreditation for our sampling activities. Our seven-strong team of trained and accredited samplers take around 48,000 samples from both our South Staffs and Cambridge regions over the course of the year.

During 2018/19, members of our Water Quality team worked in partnership with AIS Laboratory Information Management to develop a unique sampling scheduling system, which creates a yearly sampling plan for both regions that complies with our regulatory requirements. The new system can produce optimised sample collection rounds, print sample bottle labels and estimate workloads. It also has the benefit of transforming a lengthy manual process into a more streamlined one. The next phase will be to develop the system further to meet any changing requirements or future aspirations.

Secure and reliable supplies

How we performed in 2018/19

One of our highest priorities is to maintain a continuous supply of clean, wholesome drinking water to our customers' taps. This means minimising the risk of supply interruptions and maintaining a stable asset health overall.

But, as we reported in last year's annual report, the freeze/thaw event in March 2018, known colloquially as the 'Beast from the East', resulted in a large number of bursts on our network that we had to repair in very challenging weather conditions. The impact of this event carried over into the first part of the 2018/19 financial year and was followed by a prolonged period of hot, dry weather. Such extremes of weather can cause a higher number of burst mains as the ground contracts and expands more than normal. We repaired these burst mains as quickly as possible and our long-term asset health is still in a stable condition.

We are pleased to report that we have again performed better than our target for supply interruptions of ten minutes per property. This is despite the impact of the extreme weather in 2018 and the occurrence of several significant events, which caused considerable disruption for a number of our customers. For example, in April 2018, a third party contractor hit a 20-inch main in Wednesbury in our South Staffs region. As a result, about 15 million litres of water was released through the damaged main, causing extensive flooding in the local area. We set up an incident team to manage the event, which included isolating and repairing the main and returning our customers' water supply to normal. We also received nearly 1,000 customer contacts about interruptions to supply and discoloured water.

And in January this year, a water main ruptured in Smethwick in our South Staffs region, leaving more than 2,000 properties without water for around 12 hours. This was a serious incident for us, which we investigated thoroughly. We found that an issue with a pressure sensor caused too much pressure to build in the water main, causing it to rupture. We have learned the lessons of this incident and have put in place a more robust way of delivering pressure consistently using a combination of analogue and digital monitoring processes. We have also capped the pressure level in the booster that feeds this main to prevent something like this happening again.

Restoring Rivey Tower

In October 2018, we started work to restore a prominent landmark, and one of our assets, in our Cambridge region – the Grade II listed Rivey Tower. Originally built between 1934 and 1936, the 30-metre high Art Deco water tower is located on Rivey Hill near Linton. Surveys of the structure the previous winter had indicated that the brickwork was deteriorating at a rapid pace – making the restoration work necessary. We worked with the Historic Building Officer at South Cambridgeshire District Council's planning department to ensure the repairs and materials we used were in keeping with the tower's original specifications.

The first part of the project involved erecting scaffolding around the tower, after which the brickwork and roof tiles were inspected to assess the full extent of the repairs required. We also repointed $700m^2$ of the brickwork on the south and west sides of the tower, which have more exposure to the prevailing winds. We completed the work on the tower in March this year.

Sedgley Reservoir works completed

Over a period of around six months during 2018/19, we carried out essential maintenance work at Sedgley Reservoir, a large covered drinking water reservoir hidden beneath the surface of Sedgley Beacon in our South Staffs region. The work was necessary to ensure the ongoing provision of high-quality and reliable clean water supplies to our customers.

As part of the project, Stonbury, our approved contractor, excavated 13,000 tonnes of soil across a large area of the site to expose the roof of the reservoir and allow a new membrane to be installed. We worked closely with Birmingham and Black Country Wildlife Trust throughout the project to mitigate any impact to the biodiversity of the Beacon and replaced the soil when we had completed the work. We also created an online portal, through which we were able to keep the local community and regular users of Sedgley Beacon up to date with the project as it progressed.

Blithfield Reservoir – 65 years' young

We celebrated a particular milestone in October 2018 marking 65 years since the Queen Mother opened Blithfield Reservoir in our South Staffs region. The reservoir covers an area of nearly 320 hectares and was created by building a dam across the nearby River Blithe, channelling water into the valley. It took 500 men more than six years to complete.

The reservoir now supplies up to 100 million litres of water each day to more than half a million homes and businesses in parts of the Black Country, East and South Staffordshire, and South Derbyshire. The estate around the reservoir is a designated Site of Special Scientific Interest (SSSI) as it contains areas of ancient woodland and an abundance of wildlife.

An excellent customer experience to customers and the community

How we performed in 2018/19

We have continued to focus on our customer service performance during 2018/19. Our Service Incentive Mechanism (SIM) score, which is a regulatory measure of customer service performance, decreased slightly from the 2017/18 level to 86.4 and has not met our extremely challenging target of 90. That said, we are very pleased to report that we have met our customer satisfaction survey target of 98%.

In addition, we saw a 19% reduction in the number of complaints from customers, and our average response time has reduced from nine days to around five days. By the end of the year, complaints in our South Staffs region had fallen to their lowest-ever level, improving by more than 30%. And our people have also continued to participate in a wide range of community and volunteering activities, and we have exceeded our target by delivering 749 days of community activity during the year.

On the mark for excellent service

In March this year, we were delighted to learn that our contact centre had been awarded the Institute for Customer Service's (ICS) ServiceMark accreditation for the three years from April 2019 to April 2022. This is a national standard that recognises our achievement in customer service and our commitment to upholding that standard.

As part of its assessment, the ICS carried out in-depth interviews with more than 40 members of our customer service team, using an intensive and rigorous process that covered the areas of service planning and delivery and people engagement. It also shared an improvement plan with us, which sets out the areas where we need to focus our attention, such as our email channels and complaint handling processes. As part of our accreditation, the ICS will review our performance every year to ensure we are delivering the actions set out in the plan.

Being at the heart of the communities we serve

In last year's annual report, we reported on the opening of our community hub in our South Staffs region. One year on and we are seeing real benefits from this innovative idea. At the time of writing, nearly 4,000 customers have visited the hub to talk to our people face to face or attend a wide range of events. We have also formed partnerships and relationships with a number of organisations that use the space regularly, such as Citizens Advice, Digital Coaching, JobCentre Plus and Ideal for All. And we have had interest in the concept from other companies in the water sector.

Such has been the success of this approach that we have now appointed a full-time Customer Advisor, who is based at the hub. We have also launched 'pop up' mobile hubs in locations across our South Staffs region so that we can engage with customers face to face more frequently and regularly.

As the provider of an essential public service, we believe it is important to be visible within the communities we serve. So in May 2018, we bought our first media vehicle. This has proved to be a real asset for us. During the long, hot summer, for example, we took it on the road with our 'Water Warriors', engaging with customers and advising them about ways to save water. And in April this year, we launched our first billing roadshows, visiting seven locations across our South Staffs region, and giving customers the opportunity to talk to us face to face about ways to save money on their water bills. We are planning to hold similar events in our Cambridge region during the coming year, and will report on this in next year's annual report.

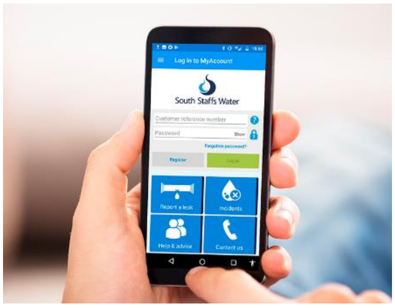
New website for Cambridge customers

Following extensive engagement and feedback, in October 2018 we launched a new website for customers in our Cambridge region. The new site was developed in house, which reduces costs to customers. It features monthly performance information on things like water supply, pressure and quality, as well as the number of complaints we have received. It also features improved security and navigation, as well as scrolling news, which we update regularly. And we have optimised the site for smart phones and tablets, as we know that people are increasingly preferring to access information in this way.

Using new technology to help customers

We know that while some customers prefer to engage with us face to face, others are far more receptive to digital and self-serve approaches. We want our customers to be able to contact us using the communication channel they prefer. So, following engagement with our customers, particularly those with visual impairment, in June 2018, we launched what we believe to be the most comprehensive Alexa skill in the water sector. Our customers can use Alexa, if they have problems with their water supply, for example, or to find out their account balance or submit a meter reading. This enables them to take action easily without necessarily needing to contact us directly.

Alongside this, in April this year, we launched our new mobile app. Developed in house and in conjunction with customers, our easy-to-use app is available on Android and Apple devices. It enables customers to:



- submit meter readings or apply for a water meter;
- view and pay bills;
- report a leak; and
- view any issues with our network.

At the time of writing, over 4,000 customers have downloaded the app, and on the app stores it has an average rating of 4.8 out of 5.

Environmentally sustainable operations

How we performed in 2018/19

Water is a precious and finite resource. So, we must make sure that adequate water supplies and the natural environment are properly maintained to support future generations. We also have wider environmental responsibilities and take care to ensure that our operations do not impact on natural habitats for plants and wildlife.

We are pleased to report that we met our leakage targets for both our South Staffs and Cambridge regions in 2018/19 of 70.5 million litres a day (Ml/d) and 13.5 Ml/d, respectively, having narrowly missed to meet them in 2017/18. This gives us a really solid foundation on which to build for the future. This is important, as we are planning transformational leakage reductions of 25% in our South Staffs region and 15% in our Cambridge region over the five years from 2020 to 2025.

We have also exceeded our target for delivering biodiversity benefits, helped by our very successful SPRING (Slug Pesticide Rethink – Ideas for Nurturing Growth) environmental protection scheme and PEBBLE (Projects that Explore Biodiversity Benefits in the Local Environment) fund. During 2018/19, we have delivered improvements on 138 hectares of land, benefiting both the local environment and local communities (see case studies below).

We are disappointed to have missed our target for water consumption of 128.9 litres per person per day in 2018/19. This is because the prolonged hot summer meant our customers used more water than usual. We will continue to engage with customers to help them find ways to use water wisely as we have stretching targets in this area in the future. This includes building on the things we learned from the year-long trial in our Cambridge region of a digital water efficiency portal.

And we have not met our target for carbon emissions savings. When we set this target in 2013, we expected to be able to install solar panels at several locations to save on energy consumption and lower our emissions. But since then, we have found that it is uneconomic to do this as the solar panels would not generate sufficient energy to offset our costs over their lifespan. This is something that we believe would not be in our customers' best interests. We are continuing to deliver energy efficiency improvements where they are cost beneficial and delivered carbon emissions savings of 635 tonnes in 2018/19.

New approaches to tackle leakage

We know from our research that leakage is a really important issue for customers and that they want us to do more to reduce the volume of water that leaks from our network of pipes. So, over the past year we have been looking at different and innovative approaches to make it easier to locate and repair leaks.

For example, we launched our online leak reporting capability in February this year. This enables customers to easily report leaks in roads and footpaths. Initial feedback from customers at the time of writing suggests that this is a welcome addition to our tools for tackling leakage, with 80% of users saying they would report a leak through this channel in the future.

And in February this year, along with fellow Group company Hydrosave, we welcomed members of Ofwat's engineering team to the Trent Valley training centre in our South Staffs region to take a closer look at HydroSEAL – our innovative new leak-sealing technology. Developed and patented by Curapipe System Ltd and approved for use in England and Wales by the DWI, this technology enables leaks to be sealed from the inside without the need to identify the exact location of the leak, dig up roads or use conventional lining techniques. We used our test rig to demonstrate the technology in action.

Also during the year, we increased the level of support we give to those customers in our South Staffs region who carry out repairs on their own supply pipes. This is because around 35% of all leakage in the region comes from customers' supply pipes. Many customers are not aware of this and are unsure about what to do when they identify a problem. So, we increased the number of free supply pipe repairs we carried out by 290% (720 in total), saving about 2.8 million litres of water a day in the process.

SPRINGing into action with catchment management

We are committed to protecting the environment across both our South Staffs and Cambridge regions. Catchment management is a way of collaboratively working with stakeholders like landowners, other water companies and the Environment Agency to improve raw water quality and the wider environment in our catchments. In our South Staffs region, for example, our SPRING environmental protection scheme is designed to help farmers of land around the River Blithe. Under the scheme, farmers can apply for grants of up to £10,000 towards the costs of infrastructure improvements and land management options designed to protect the environment and improve water quality.

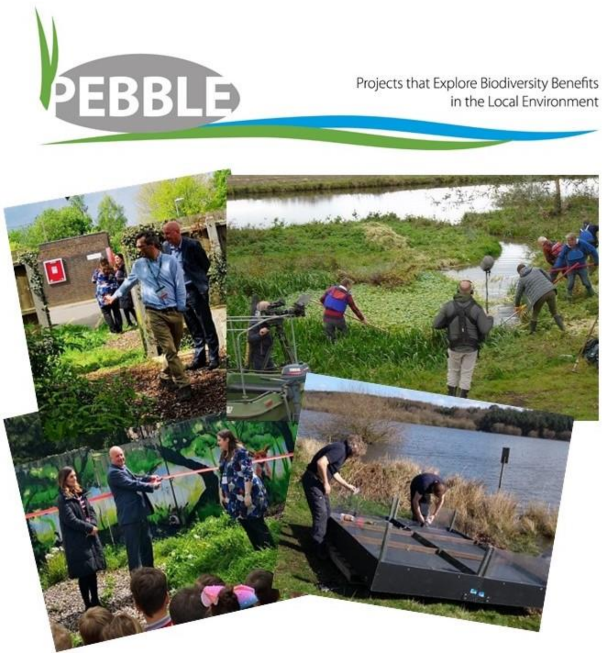
In April 2018, Phil Newland, our Managing Director, joined Nina Yiannoukos-Benton, our Senior Catchment Advisor, for a tour of Atkin Farm, where we have been working in partnership with the farmer, Rob Atkin, for more than two years. Phil was able to see at first hand some of the catchment management work we are doing. He also saw the farm's new Mzuri strip till drill, which cultivates, drills and reconsolidates the ground in one go. This conservation farming method improves soil moisture and organic matter content while reducing soil erosion and run off, which can affect water quality. We also showed the Mzuri drill at the Staffordshire County Show in May 2018, which is a popular event in the agricultural calendar attended by more than 40,000 people.

And in June 2018, Nina Yiannoukos-Benton and Rob Atkin hosted the first South Staffs Water open farm event at Atkin Farm. More than 100 local farmers attended – seeing for themselves some of the trials that have been taking place there. They were also given the opportunity to learn more about the grants that are available through our SPRING scheme.

Using PEBBLE to cause a ripple

Another way we help to protect the environment and improve the biodiversity of local areas is through our PEBBLE fund. We make grants of between £500 and £10,000 available each year to help community groups and other organisations improve biodiversity in their area by creating, restoring or improving local habitats.

For example, the Cam Valley Forum in our Cambridge region was awarded £4,385 from the PEBBLE fund, among other sources of funding, to carry out work to sensitively remove overhanging branches from the River Cam, as these trap Floating Pennywort. This is an invasive plant, which forms thick, matted clumps of vegetation that blocks out light in rivers and other water courses, thereby altering oxygen levels and impacting on fish and other wildlife. It can also make navigating rivers by boat impossible and increase the risk of flooding. This work came to the attention of the BBC's Countryfile programme, which filmed the Cam Valley Forum team clearing Floating Pennywort from a section of the river in October 2018 for the episode that aired on 1 November 2018.



Also, West Midlands Bird Club was awarded £2,500 from the PEBBLE fund to install a new tern raft on Blithfield Reservoir. Sited in the middle of the reservoir, the raft provides a nesting habitat for Common Terns away from predators and other threats. This is the second raft that the Club has installed on the reservoir with our help. The first has proved to be very popular and it is hoped that the second raft will help increase bird numbers at the reservoir.

And Icknield Primary School in Sawston in our Cambridge region used the £2,000 grant it was awarded from the PEBBLE fund to turn a neglected and overgrown area of its grounds into a nature hotel, providing both a wildlife habitat and an educational resource. The grant also helped pay for equipment for the children, including binoculars, wireless cameras and endoscopes. The facility was officially opened on 10 May 2018 by Ciaran Kelly, Head of Operations in our Cambridge region, Councillor Clare Delderfield and Matt Davey, a parent and Chair of the school's Grants Committee.

Work starts on Crumpwood fish pass

During 2018/19, we started work on a project to build a fish pass at the Grade II listed Crumpwood weir in our South Staffs region. The weir was built between 1807 and 1811 and is an important historical feature in the Churnet Valley landscape.

Working in partnership with the Environment Agency, JCB and Staffordshire Wildlife Trust, this unique structure will improve the passage of fish along the River Churnet. It will also see the river opened up to all river fish, such as brown trout, grayling and chub, helping them to migrate and find the best habitats in which to live and breed. At the moment, the 2.7-metre difference in the height of the water in the weir means it is impossible for fish to navigate.

The fish pass is being built underneath the disused 19th century pump house, which we own. It is the first stage of a project that will hopefully see the pump house restored and part of the Caldon and Uttoxeter Canal reinstated. It is also one step towards delivering the Environment Agency's 25-year plan for naturally-functioning water catchments where wildlife can migrate freely and thrive.

Fair customer bills

How we performed in 2018/19

We believe it is important to keep our bills as low as possible – our customers pay among the lowest water bills (average £145) in England and Wales. We think very carefully about how we spend money and the areas where we invest. We always try to find the right balance, making sure our bills are affordable for all customers, while continuing to invest in our assets to maintain our service for future generations.

Every three months, we survey a representative sample of customers and ask them about whether they think their bill is affordable and if we provide value for money. We are pleased to report that during 2018/19, we received our highest-ever combined value for money and affordability score – at 95%.

We recognise that some customers who struggle to afford their water bills may need some form of additional help or support. We provide a range of schemes to help these customers, tailored to their individual needs. These schemes have continued to grow – with more than 30,000 customers helped during the year, exceeding our target. We are pleased with the continued interest we are seeing in our assistance schemes as it means customers in genuine need are receiving help and do not have to worry about paying for their water supply. We are planning to extend these schemes further in the five years from 2020 to 2025.

Introducing our new customer bill

During 2018/19, we worked with customers and our people to develop a new design for our bill, making it more user friendly and easier to understand. This was the first time we had reviewed our bill design for around 13 years. In response to feedback from our customers, we have made our bill more welcoming, making it easier for them to find their account number and see how much they owe. We have also made it easier to find contact phone numbers and have included information on how to engage with us through social media. Finally, we have included prominent information about our Priority Services Register, the help that is available for customers who may be struggling to pay their bill and, for unmetered customers, information on how to switch to a water meter.

In developing our new bill, we built on previous qualitative research findings, where a number of customer focus groups reviewed our current bill and five potential new designs. For example, customers said they wanted key information to be clear and obvious. In particular, they wanted the amount they owed to feature prominently on the bill. They also preferred an uncluttered design, with lots of white space and a clean, modern look. And they wanted all the key information on the front page of the bill, as few of them appear to look at the reverse side, regarding information placed there to be more relevant for us than them.

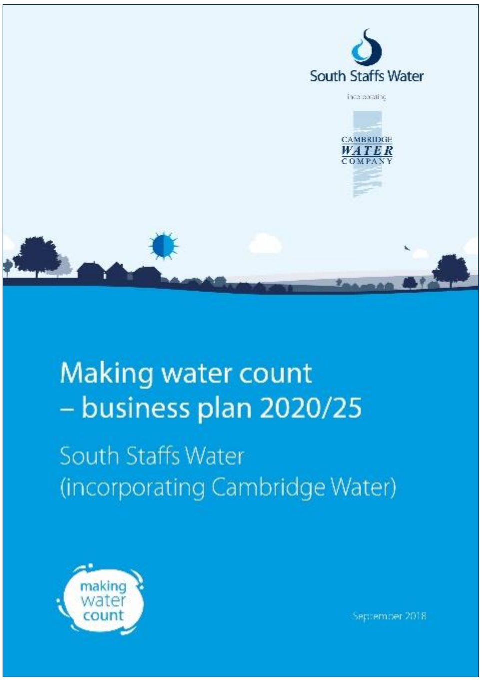
We are launching our new bill design in the summer for metered customers, followed by a wider roll-out for all customers. We will report on this in next year’s annual report.

AI first for collections management

In a first for the water sector in England and Wales, in April this year we implemented a new collections management system from Rimilia. The software uses artificial intelligence (AI) to track changes in payment patterns, enabling us to understand even more about our customers. It also provides real-time customer data, which means we can proactively identify and support those who are at risk of falling behind with their water bill payments and help prevent them from getting into debt. For those already in that position, it helps us to treat them as individuals and come up with tailored solutions, which our engagement tells us is exactly what they want and expect. We will provide an update on Rimilia in next year's report.

Planning for the future

In September 2018, we submitted our business plan for 2020 to 2025 to the regulator Ofwat. This was the culmination of several years of hard work from a number of teams across the business. Titled 'Making water count', our business plan followed consultation and engagement with more than 35,000 customers. It also built on the high levels of trust we already have with them, enjoying levels of support of 84%.



Our plan is ambitious and innovative. Over the five years that it covers, we will invest and spend £588 million – more than we have ever done before – to deliver the significant improvement in services our customers have told us they want. This includes upgrading the Hampton Loade and Seedy Mill water treatment works in our South Staffs region, and delivering transformational reductions in leakage across both our South Staffs and Cambridge regions. At the same time, we want to give our customers the certainty and stability they have told us they want by keeping bills flat in nominal terms over each of the five years of the planning period.

After we submitted our plan, Ofwat carried out an initial assessment, where it compared our plan with those of the other water companies in England and Wales. It tested our plan against nine specific areas, including:

- how we have engaged with customers;
- our approach to addressing affordability and vulnerability;
- the outcomes we will deliver for customers;
- how we will ensure resilient services over the long term; and
- how we have secured confidence and assurance.

Ofwat announced the results of this initial assessment on 31 January this year. Along with most of the other companies in the sector, it placed our plan in the 'slow track' category, which meant we had some more work to do to ensure our plan delivers the outcomes our customers said they want and expect. That said, Ofwat highlighted the quality of our customer engagement, and our performance on costs and customer complaints. It also singled out our innovative flat nominal bill as an example of good practice in the area of affordability.

While we were disappointed that our plan was not placed in either the 'exceptional' or 'fast track' categories, we welcomed the opportunity to look again at things like our:

- long-term bill profile;
- outcome delivery incentives (ODIs);
- approach to resilience in the round; and
- cost adjustment claim for the investment to upgrade our Hampton Loade and Seedy Mill water treatment works.

We resubmitted our business plan on 1 April. Ofwat will make its final decisions on all the companies' business plans in December this year. We will report on the outcome of this in next year's annual report.

How customer engagement is shaping our long-term plans

Since April 2017, we have gained feedback from more than 35,000 customers to help shape our long-term plans. Over the past 12 months in particular, we have:

- asked customers in our South Staffs and Cambridge regions if they supported the proposed upgrade of our two water treatment works and the associated impact on their bills;
- trialled a digital service in our Cambridge region to gain feedback from customers about how we can help them save water and money. We have used the things we learned from this project to develop a blueprint for the information and advice we need to provide to customers;
- engaged with household and non-household customers to check that the promises in our business plan are acceptable to them; and
- engaged with household customers around the role a water company should play in supporting the communities we serve. This engagement is helping to shape our company purpose for the future so that we can continue to retain the high levels of trust our customers have in us.

We have used a wide range of engagement techniques, including interviews, surveys, focus groups and workshops. We have also triangulated customers' responses against other sources of data and insight to ensure the robustness of our engagement.

As a result of this engagement, for example, we have developed our mobile app, online leak reporting tool and voice-activated digital services as customers had told us they were unhappy with our digital service channels.

It has also led us to carrying out a full review of all our IT systems and the ways we manage the work we need to do for our customers so that we can be more proactive, respond quicker and communicate what we are doing more effectively. We want to build our approach around the way customers want to engage with us.

Our people

New appointments strengthen Board

In October 2018, we welcomed two new Independent Non-executive Directors to our Board – the Rt Hon Lord Smith of Finsbury and Catherine May. These appointments will strengthen our Board by bringing new skills and expertise to the business.

Lord Smith is a Life Peer in the House of Lords, having spent more than 20 years as an MP in the House of Commons. He served as Chair of the Environment Agency from 2008 until 2014 and was the founding Chair of the UK Water Partnership. He is currently Master of Pembroke College, Cambridge, a post he has held since 2015. He is also one of our customers.

Catherine May has more than 20 years' experience in corporate leadership, brand management, public policy and governance. She was previously Group Director at SAB Miller Plc, a multinational brewing and drinks company, and Centrica. She is currently Vice-Chair of Stonehaven Campaigns, a reputation management consultancy, and a Non-executive Director of the Pensions and Life Savings Association.

A third Independent Non-executive Director, Michael McNicholas, was also appointed to our Board in October 2018. He resigned from the Board on 1 April 2019 to take up a senior position with a leading infrastructure investor.

New Finance Director for South Staffs Water

In December 2018, we said goodbye to Tim Orange, Finance, Regulation and Business Services Director, who left the business after nearly ten years. During his time with the company, Tim worked for both Cambridge Water and South Staffs Water where, among other things, he was responsible for financial management and business planning.

Tim's replacement, Andrew McGeoghan, joined us as Finance Director in March this year. Andrew is a qualified accountant and brings to the business both significant insight and broad commercial experience. Andrew also spent several years as an Associate Director at Ofwat. On leaving Ofwat, Andrew joined Jacobs UK Limited in 2015 where he set up and led a specialist team advising regulated companies on their reporting and control processes.

Gender and equality

As a company with more than 250 employees, we are legally required to publish a gender pay gap report each year. Our report for the 2018/19 financial year is based on the snapshot date of April 2018. At that time, we directly employed 437 people across our South Staffs and Cambridge regions. Our workforce gender split overall is 77% male and 23% female; across senior management the gender split is 59% male and 41% female.

In terms of the difference between the hourly pay of our men and women, the mean difference is 15.9% (2018: 15.8%), while the median difference is 13.8% (2018: 16.5%). In general, the pay gap for our women has narrowed over the past year. We are committed to reducing the gender pay gap further, but are aware that this will take time. That said, we are actively taking steps to promote gender diversity in all areas of our workforce.

For example, we are continually looking at ways to attract new talent and how we present ourselves as a business. So, our job vacancies are gender neutral, focusing on skills, abilities and opportunities for development. In addition, we work proactively with local schools, colleges and universities – attending careers fairs to engage with young people about the opportunities we have to offer. And we are continuing to develop our approach to flexible working, as we know that more women than men typically prefer a flexible approach to work.

Our full gender pay report for 2019 is available on our website at: www.south-staffs-water.co.uk/media/2593/gender-pay-gap-web-report-april-2019-final.pdf.

Helping our communities through volunteering

Being active in our local communities is an important part of who we are. During 2018/19, our people have taken part in more than 190 volunteering opportunities – ranging from working on community gardens to helping to deliver water efficiency workshops in local schools.

One of the charities we have supported in this way, for example, is Newlife, which helps to change the lives of disabled and terminally ill children. Over the year, we have removed the labels from 71 crates of clothes for this charity, saving it almost £2,500 in staffing costs.

We have also helped the Dorothy Parkes Centre in Smethwick in our South Staffs region on a community allotment project. The aim was to transform a previously overgrown allotment into an outdoor classroom. This will enable people who use the centre to develop their life and horticultural skills, and enhance their employability. And we have engaged with more than 3,200 Key Stage 1 and 2 pupils during the year, helping them to develop their understanding and appreciation of water.

SSC Forum relaunched

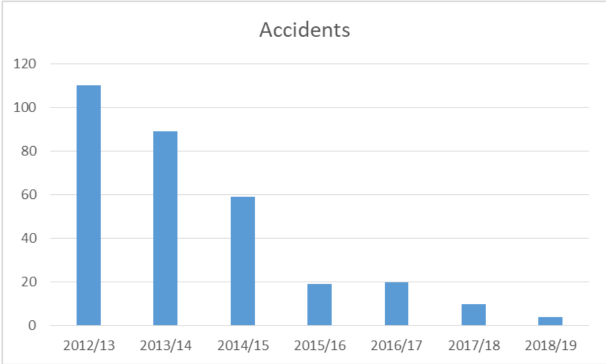
In September 2018, we relaunched our SSC People Forum, which provides a voice for our people across all sites in our South Staffs and Cambridge regions. The main purpose of the Forum is to:

- liaise with the Executive team through scheduled quarterly meetings;
- provide representation and support to all our people in the areas of change management, redundancy, and disciplinary and grievance-related issues;
- attend pay negotiations;
- review company policies;
- organise social events; and
- share and cascade information with representatives across all our sites.

Ultimately, the Forum aims to make a difference to all our people.

Health and wellbeing

In 2018/19, we achieved our best-ever performance for the number of accidents – with only four minor incidents across the business (see graph right), and no reportable incidents under the Health and Safety Executive's RIDDOR (Reporting of Injuries, Diseases and Dangerous Occurrences Regulations 2013). This demonstrates our commitment to changing behaviours associated with work-related accidents and a continued understanding among our people of the risks around their roles.



We have also been proactive in using our internal communications channels to link to external health management initiatives, such as Mental Health Awareness Week, for example. The aim is to raise awareness among our people. Looking ahead, we are focusing our attention on more targeted health and wellbeing initiatives. This includes providing training for our First Aiders and members of our SSC Forum as mental health coaches, and putting in place voluntary buddy arrangements. We will report on the outcomes of this work in next year's annual report.

GDPR training for all our people

The new General Data Protection Regulations (GDPR) came into force on 25 May 2018. The aim of the regulations is to strengthen and enhance existing data protection legislation, giving individuals greater rights over what organisations can do with their personal data and making those organisations more accountable for the data they hold. As part of our preparations for this change, we made an online training module available for all our people, which was accompanied by an internal communications campaign to inform colleagues about the regulations and to remind them of the importance of compliance. The training was mandatory and was completed by our people over a three-week period in April 2018.

Raising the profile of customer service

During National Customer Service Week, which ran from 1 to 5 October 2018, some of our senior managers took the opportunity to spend time with the customer teams in our contact centre. Throughout the week they listened to customer calls and gained genuine insight into the work these teams do and the duties they perform every day. National Customer Service Week is run by the ICS. It aims to raise awareness of customer service and the important role it plays in successful business practice and the growth of the UK economy.

Bringing Westminster to Walsall – MP visit for South Staffs Water

We were pleased to welcome Eddie Hughes, Conservative MP for Walsall North, for a visit on 15 February this year. The Green Lane offices in our South Staffs region are located in Mr Hughes' constituency. During the visit, Mr Hughes met with a number of our people, talking with them to understand how we maintain the water supply to our customers and how we make sure that it is good quality. He also saw our contact centre in action and spoke to members of the customer service team about improvements in digital technology and the ways in which we can support customers who are struggling to pay their water bills.

Water challenge course in Cambridge

Members of our catchment management team were in our Cambridge region in January this year to deliver a water challenge course with Cambridge Academy of Science and Technology, a school that specialises in STEM subjects – Science, Technology, Engineering and Maths. This was the third year we have run the course in partnership with the Environment Agency, Anglian Water and Hobson's Conduit Trust, which is responsible for preserving the environment around Hobson's Conduit, a 4km-long waterway that is part of Cambridge's local heritage. The course aims to help students develop their research and team work skills. It includes a walk along Hobson's Conduit to help them identify the problems facing the river and develop an action plan to address these issues.

Financial performance

We operate within a regulatory framework overseen by Ofwat and other sectoral regulators. Our budget is set as part of an annual process by combining the required regulatory and operational targets, and comparing these with historical and future performance. We monitor and manage how we perform against our budget on a monthly basis through reports to the Directors and Executive team.

Our ODI targets represent our commitment to deliver what our customers have said was important to them at the last price review. The performance of our Directors and Executive team is measured against them, our budget for the year and the final determination as set by Ofwat. We use a number of financial key performance indicators (KPIs), which include, but are not limited to:

- turnover;
- operating costs;
- EBITDA (excluding infrastructure renewals expenditure – or IRE);
- operating profit;
- cash generation, net debt and gearing;
- return on regulated equity (RORE). This is a measure Ofwat uses to assess the impact of regulation and price controls on water companies' performance and returns; and
- total expenditure (totex) by price control. This is a regulatory financial KPI that combines capital and operating expenditure. We discuss this in more detail in the annual performance report (part 2 of this document).

A brief overview of our financial performance for the year is as follows.

Turnover increased by £4.7m to £128.8m in 2019 (2018: £124.1m), with appointed turnover increasing in line with the allowed below inflation increase and additional income from the hot, dry summer in 2018.

We continue to see growth in the non-appointed side of the business, with turnover of £5.7m (2018: £5.2m) driven by our Aqua Direct spring water business.

The hot summer and the legacy of the freeze thaw event challenged our teams and our network. Both events resulted in significant additional retail and wholesale costs of £1.3m, specifically in the areas of:

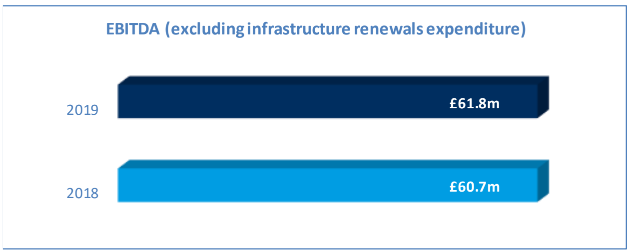
- power;
- chemicals;
- leakage detection and repair; and
- manpower expenditure.

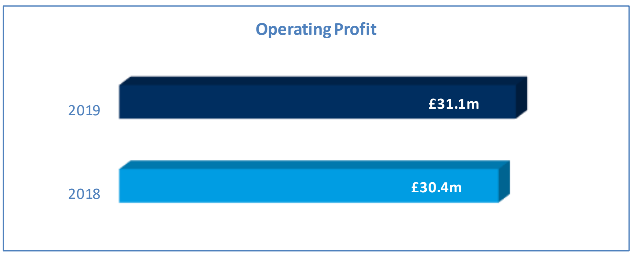
Despite these challenges, the business still delivered strong financial performance. EBITDA (excluding IRE) was £61.8m (2018: £60.7m), an increase of £1.1m, while operating profit was £31.1m, (2018: £30.4m) an increase of £0.7m.

The appointed RORE for the first four years of the current planning period averaged 8.34% using book net debt, or 6.29% using the covenant net debt. This is higher than that allowed at the final determination of 5.98% with outperformance on ODIs and retail costs driving this. See pages 175 and 176.

The outperformance has also driven the average investor return for the first four years of the period. Based on book debt and including inter-company interest, investor returns were 18.9%. Using covenant debt and excluding inter-company interest, the return was 14.9%, 4.0% above that allowed at the 2014 price review (PR14). See page 155 for more information.

Further information on the financial performance of the appointed business is set out on page 102 of the annual performance report (part 2 of this document).





£m	2019	2018
Operating profit	**£31.1m**	**£30.4m**
Depreciation : non-infrastructure assets	£19.8m	£19.1m
Depreciation : infrastructure assets	£3.8m	£3.6m
Infrastructure renewals expenditure	£9.8m	£10.1m
Amortisation of capital contributions	£(2.7m)	£(2.4m)
EBITDA (excluding infrastructure renewals expenditure)	**£61.8m**	**£60.7m**

Finance charges increased by £0.5m to £12.2m (2018: £11.7m), while the tax charge has stayed in line with last year at £3.3m.

Subsequent to the year end, on 28 May 2019, £15,000,000 intercompany loan was repaid in full (see note 15).

Capital investment

We continued to make good progress in delivering our capital programme to ensure our assets remain in good condition so that we continue to provide high-quality, reliable water supplies to our customers.

Wholesale appointed capital expenditure for the year was £34.2m (net of contributions and IRE). This includes the investment we made to install UV treatment at our Hampton Loade water treatment works and the maintenance work we carried out at Sedgley Reservoir, as discussed earlier in the strategic report on pages 11 and 14.

Dividend payment

In 2019, the dividend comprised:

- £3.5m from the appointed business (2018: £5.0m). This represents 5% of regulated equity (2018: 8%);
- £2.4m from the non-appointed business (2018: £1.3m); and
- £2.5m from intra-group interest to be paid back to the company (2018: £2.0m).

In the year ended 31 March 2018, there was also a one-off payment of £8.4m from the proceeds of the sale of the non-household retail business.

No further dividends are proposed.

Net debt and borrowing covenants

Our net debt includes index-linked debt, bank loans and debenture stock less cash. For covenant reporting purposes, our net debt was £268.4m at 31 March 2019 and represented a ratio of 66% of our regulatory capital value (RCV).

The reconciliation between covenant net debt and book net debt is shown in the notes to the accounts on page 78, along with a full analysis of our borrowings.

We maintain significant headroom in respect of all of our borrowing covenants and liquidity with cash of £0.8m (2018: £2.2m), and undrawn facilities of £17.1m (2018: £17.5m). This gives us total liquidity headroom of £17.9m (2018: £19.7m).

Standard & Poor's (S&P) continues to rate the company as BBB+ with Moody's rating us at Baa2; both are within investment grade.

Approach to taxation

We take the legal and social responsibilities for meeting our tax obligations seriously. We have no operations outside the United Kingdom (UK). As a result, the following information has specific reference to UK taxation only.

We are committed to complying with tax laws in a responsible manner, balancing obligations to the UK Government and the public with our duty to manage our affairs efficiently so that we can deliver cost-effective services to customers, while generating an economic return to investors. We make timely and accurate tax returns that reflect our fiscal obligations to the UK Government. In particular, we:

- do not engage in aggressive tax planning;
- do not engage in artificial tax arrangements;
- seek to maintain a transparent and collaborative relationship with HM Revenue & Customs (HMRC), principally through our Customer Relationship Manager; and
- seek independent professional tax advice on material matters, where the application of tax law is complex or uncertain.

We make use of applicable tax incentives provided by the UK Government within the terms outlined above. These may include, for example, preferential rates of capital allowances or enhanced tax relief for research and development costs, and certain designated capital assets that add efficiency to our operations. Such incentives have been put in place to encourage appropriate business investment. For our regulated water supply business, these incentives have the effect of reducing customers' water bills.

As well as corporation tax, we contribute to the UK Exchequer by means of a number of other taxes and levies in excess of £20 million. This includes, but not limited to:

- employment taxes, National Insurance and the Apprenticeship Levy;
- carbon taxes and other energy-related taxes and levies;
- fuel duty and other vehicle-related taxes;
- business rates; and
- regulatory charges and licences, such as water abstraction charges.

Our approach to risk management applies to tax as it does to other business areas, with key issues escalated to our Board. All material tax matters are discussed with our finance team and significant issues are escalated to our Board. The Group Internal Audit function also reviews significant risk areas where appropriate.

We have identified economic uncertainty as a risk area (within financial risk). This includes risk in relation to the possibility of unexpected tax law and policy changes by the UK Government. We carefully monitor published tax legislation, guidance and policy documents to ensure we can assess the compliance requirements and the economic implications for us. We also engage with HMRC, where our tax position is likely to be materially affected by policy changes.

Treasury policy

The main purpose of our financial instruments, including derivatives, is to finance our operations and limit risk from fluctuations in external indices outside our control, including, where considered appropriate, entering into floating to fixed interest rate swaps. During the reporting year and the previous year, our policy has been that no trading in financial instruments is carried out. In respect of cash, loans receivable and borrowings, our policy is to maintain flexibility with both fixed and floating rates of interest, and long- and short-term borrowings.

Risk review

We recognise that risks exist in all businesses. Our approach to risk reflects our status as a regulated and licensed water undertaker providing an essential public service. We accept that not all risks can be mitigated entirely, but our aim is to ensure that risk management activities reduce the overall estimated impact of risks to a level that is considered to be acceptable and that does not impact on our long-term viability.

Risk management is embedded in all our day-to-day business activities. To facilitate the risk management process, every six months the Executive team reviews our principal business risks as identified and documented by senior managers. They consider the risks on the whole business, as well as the proposed mitigating controls and procedures that are designed to reduce risks to an acceptable level. These risks are then presented to the Audit Committee for review, which challenges and comments on behalf of the Board, with any agreed actions passed on to the relevant senior manager, and any significant issues escalated to the Board.

The objectives of this risk management process are to:

- ensure that the Executive team is able to identify and prioritise all key business risks;
- implement appropriate procedures and controls to mitigate risks to an acceptable level; and
- enable senior managers to highlight, document, prioritise and execute any identified actions.

Each identified risk is assessed and scored against the following factors.

- The impact of the risk on the business.
- The likelihood of this risk occurring.

Probability					
Certain	5	10	15	20	25
	4	8	12	16	20
	3	6	9	12	15
	2	4	6	8	10
Rare	1	2	3	4	5
	Negligible		Impact		Extreme

The impact assessment considers the estimated consequences of the risk on our net assets. But we also take into account other factors, such as the loss of our customers' trust, or damage to our reputation or brand. The overall risk rating is determined by taking the product of the impact and probability scores (impact x probability).

The score between 1 (lowest risk) to 25 (highest risk) allows us to focus on the most important risks.

Where the assessment of the risk score changes between six-monthly assessments, this is highlighted to the Executive team and Audit Committee with recommended actions.

Key risks

Below we set out our key risks, as identified using the process described above. We detail what each risk means for us, the actions we are taking to mitigate its impacts and any change in the risk.

We note that the current uncertainty around Brexit has had implications for water companies that extend beyond financial matters. At the time of drafting the annual accounts, the terms of the UK's departure from the EU remains uncertain. During the year, the business has worked collaboratively with the industry to mitigate the potential risk associated with a 'no deal Brexit'. This has involved participation in the Platinum Incident Management team (PIM) made up of operational leads from across the industry, this body has become the primary facilitator of an industry wide response to facilitate effective management of operational incidents, supply chains, mutual aid, regulator and ministerial updates. A National Incident Management Team (NIM) was also established and continues to be supported by the business, NIM is responsible for the collation of industry wide status data and providing relevant information into PIM.

The most significant risk associated with Brexit is the ability to maintain access to sufficient quantities of imported chemicals for our treatment works in the event of a 'no-deal' Brexit. Within the business a full 'no deal' impact review was completed with stock levels of chemicals and critical spares being increased where appropriate. The business also operated an Event Management Team in preparedness for the planned exit of 31 March. The team was stood down and the situation is being closely monitored and managed by a Steering Group, it is anticipated that the Event Management Team will be reinstated when there is further clarity relating to the timescale and nature of the exit from the European Union.

Ensuring the business and water industry were prepared to deal with the worst case scenario has required a significant amount of time and effort to be expended, this has been recognised by regulators who have complimented industry on the collaborative approach taken and level of resilience which has been demonstrated and communicated to ministers.

We will continue to monitor the progress in the Brexit negotiations. Based on our approach and the planned mitigations that we have implemented, we have not increased our risk for Political, regulatory and economic environment.

What is the risk?	What does this risk mean for us?	How are we mitigating this risk?	Changes in risk score
1. Business plan outcomes	During the year, Ofwat published its initial assessment of our business plan. It noted a number of areas that required further evidence. We resubmitted our business plan in April this year and will receive our final determination in December. There is a risk that our final determination will not allow sufficient funding to deliver the outcomes to which we have committed in our plan.	We firmly believe our resubmitted business plan addressed Ofwat's challenges, and provides further evidence and support. As part of the resubmission process, we have: • engaged third parties, where appropriate, to provide additional evidence and support for our proposals; • responded to Ofwat's challenges, and actively reviewed the feedback on the draft determinations of the three fast-track companies; • continued to respond to information requests from Ofwat; and • continued to engage with our customers.	↔
2. Resilient supply of good quality water	A failure to provide a secure supply of clean, safe drinking water or meet our long-term demand requirements could result in adverse public relations, damaging our customers' trust in us.	We have carried out significant work during the year to mitigate this risk, including completing the installation of UV treatment at our Hampton Loade water treatment works. We also have a number of controls in place to reduce the probability of having insufficient water resources, including: • our water resources management plans for each region; • drought plans that are consistent with our water resources management plans and business plan; • collaborative cross-sector engagement; and • continued investment to maintain our assets.	↔

What is the risk?	What does this risk mean for us?	How are we mitigating this risk?	Changes in risk score
3. Asset reliability and resilience	We have a number of assets that are critical to the provision of clean, safe drinking water. The reliability and resilience of these assets could cause risks around: • delivery capacity, with loss of supplies; and • the impact on our ODIs, including our performance targets for bursts, leakage, low pressure and customer satisfaction.	We were able to demonstrate our strong resilience during the freeze/thaw event and the prolonged hot, dry spell that followed it. We have learned lessons from both events and recognise the need for continual improvement. As part of this, we are considering our long-term plans in the context of managing and maintaining our assets and supply capabilities. We have also: • undertaken significant investment expenditure on our key water treatment works; • carried out a risk-based review of all our assets to ensure they are ready and capable of delivering clean, safe drinking water; and • established preferred portfolios for our business plan, with preparatory activity to be carried out before 2020.	
4. Health and safety	Our risks associated with health and safety include: • things that affect the wellbeing of our people, our contractors and members of the public, including injury and fatalities; • non-compliance prosecutions; • external investigations; and • reputational damage.	We have continued to make good progress in this area and have an aspirational goal of being a zero injury workplace. In a continued drive to improve accident rates and reduce risk further, we are: • continuing to drive a culture that puts health and safety first; • focusing on prompt hazard identification and reporting; • fully utilising the incident and accident database; • looking for improvements, sharing best practice and learning from others; • conducting strategic health and safety working groups; and • carrying out Director and senior management workplace audits.	

What is the risk?	What does this risk mean for us?	How are we mitigating this risk?	Changes in risk score
5. Political, regulatory and economic environment	Risks in this area include, but are not limited to: • regulatory reform – for example, in May this year Ofwat published an early view of its future strategy for regulating the water sector; • changes in UK Government policy that may impact on our ability to deliver our strategic outcomes; • the impact of Brexit and the risks this could present to key supplies; • the effects of an economic downturn; and • regulatory compliance. In addition, renationalising the water companies continues to be a key policy for the Labour Party and remains a possibility in the event of a change of government. One of the main risks for us is around enforced changes to ownership.	To mitigate risks in this area, we are: • carrying out a full assessment of the key points of Ofwat's emerging strategy, with a view to responding with our comments; • working with Water UK, which regularly engages with all political parties to demonstrate our value and the benefits our customers receive as a result of our operational performance and continued investment in our network infrastructure; and • continuing to engage with our customers and report on our performance. • a full 'no deal' impact review was completed • the business also operated an Event Management Team in preparedness for the planned exit	
6. Technology systems and security	The loss of critical IT infrastructure could have a major impact on our business, with specific risks around: • external failures – for example, loss of communication links, power or the Internet; • system failures – for example, failure of hardware or software and reduced performance; • data integrity, including the loss or corruption of files; • IT change management; • lack of access to technical skills; and • cyber attacks.	Our Information Security Steering Group works in tandem with our fellow Group companies to focus on protecting the business and driving improvements through: • the creation of an Information Security Control team; • reviewing and improving our business continuity and resilience. Our IT services provider has achieved ISO 27001 certification; • continued engagement in national and international industry forums; • providing information security awareness training for our people; and • collaboration with others across the water sector to manage threats to national infrastructure.	

What is the risk?	What does this risk mean for us?	How are we mitigating this risk?	Changes in risk score
7. Environmental	We have a number of environmental obligations and reputational outcomes with which we must comply, including: • the Water Framework Directive; • the national water resources and fisheries environmental programme (NEP); • PR14 catchment management schemes and other water quality national environment programme schemes; • adherence to and renewal of abstraction licences; and • pollution incidents arising from mains flushing and burst main events. We also have a wider obligation to look after our environment.	We have various controls in place to mitigate the impact or reduce the probability of non-compliance with our environmental obligations. To deliver these obligations, we: • engage with our customers and other stakeholders, responding to their expectations; • are continuing to work on delivering the sector's environmental programme (WINEP); • regularly monitor our abstraction licence usage; • take sample discharges to give us an early warning of potential pollution failures; • monitor water efficiency and biodiversity through monthly reporting of our performance targets; and • measure our biodiversity and carbon emissions performance against our targets. We also have an established catchment management team, which is making progress in both our South Staffs and Cambridge regions. We are expanding our SPRING environmental protection scheme, which makes grants available to farmers to improve facilities for pesticide use and prevent other water quality problems at source. We summarise all our environmental obligations in our Water Industry Strategic Environmental Requirements (WISER) submission.	

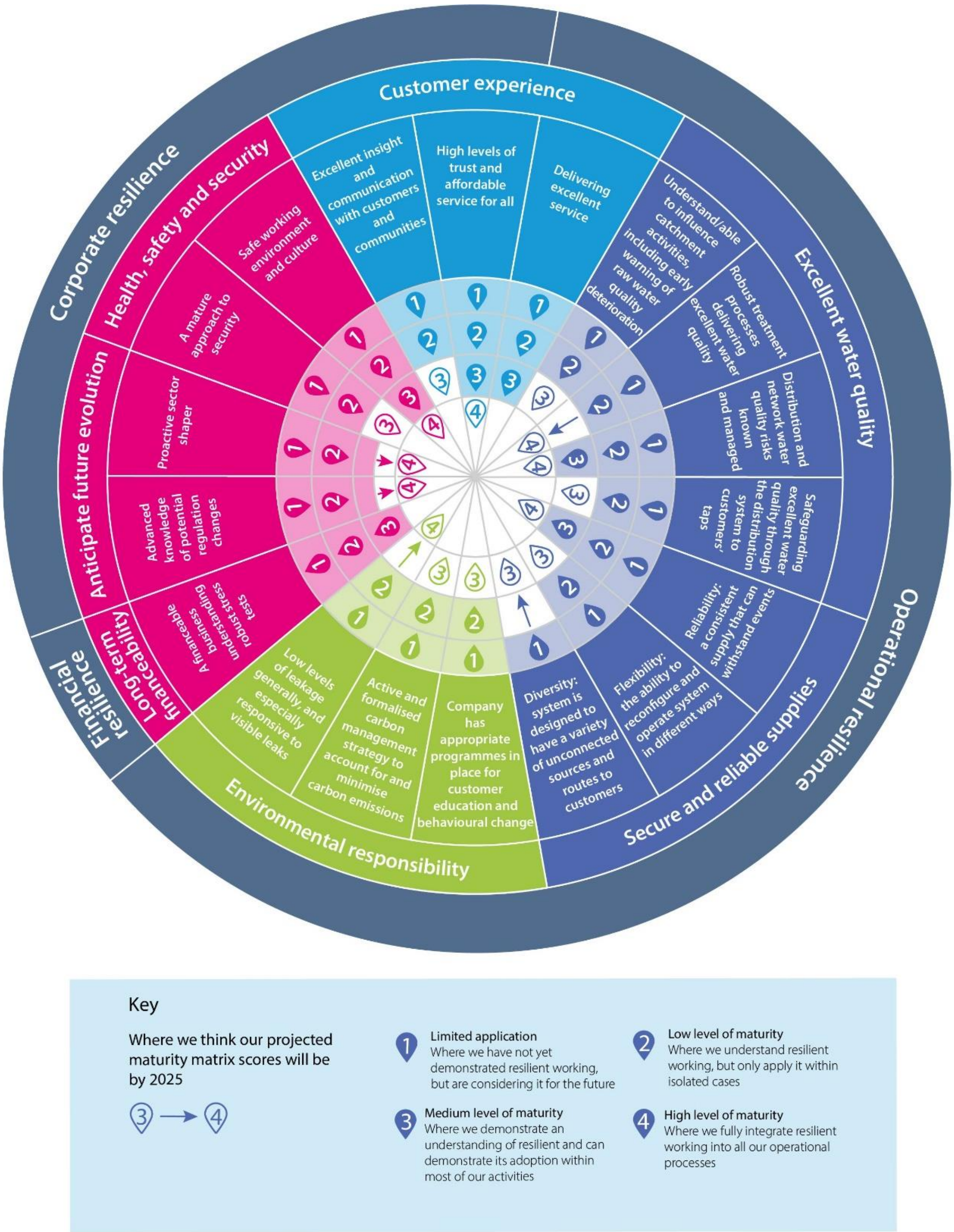
What is the risk?	What does this risk mean for us?	How are we mitigating this risk?	Changes in risk score
8. Financial	This is about us having sufficient financial resources to finance our business over the long term, with risks around: • reduced access to capital markets; • the potential for a lower credit rating; • higher funding costs; and • levels of fixed-cost embedded debt. Changes in risk scoring by the leading rating agencies (Fitch, Moody’s and S&P) could lead to some or all of the above.	To mitigate financial risks, we have: • engaged with external advisors on options for reducing our cost of embedded debt; • reduced our gearing levels; • refinanced; • employed hedging strategies; and • put in place rolling credit facilities. We also monitor markets regularly, and have regular cash flow reporting and monitoring processes in place.	
9. Customer service	The impact of increasing customer expectations and standards of customer service may lead to: • failure to meet our customers’ expectations; • a reduction in our SIM score and poor performance in dealing with complaints; and • an increase in the number of customers in debt.	To mitigate the risks in this area, we have: • made further investment to improve the customer service journey; • introduced new digital channels (such as our Alexa skill and mobile app); • revised our governance and reporting structure in debt management, and have invested in new systems in this area; and • significantly increased levels of engagement with customers, with oversight provided by the Independent Customer Panel.	

Protecting your service – being resilient in the round

We are totally reliant on our assets – be they above or below ground, technology related, natural assets or people. Along with other companies in the water sector, we have been challenged by Ofwat to demonstrate that we are resilient 'in the round'. This means having financial, operational and corporate resilience, and a culture within the business to ensure this is embedded in all our decision making.

Underpinning and reinforcing this approach is our 'resilience lens' and maturity matrix. This represents a number of key business objectives, which broadly align with our outcomes for customers, and a selection of desired states for our business. It enables us to consider and compare a range of investment options that add up to the best plan for our customers and our business, and that will allow us to assess our progress in delivering them from the perspective of how resilient we are. We illustrate the resilience lens on page 37.

We have also taken steps to formalise the culture across our business to ensure these components of resilience in the round are further embedded in all our decision making. This covers everything we do – from the strategic decisions taken by our Board about how the business is run and the financial oversight of the Audit Committee, to the decisions our field-based teams take, for example, to ensure a leaking pipe is repaired first time, so that it does not impact of the service we deliver to customers.



Financial resilience

Being financially resilient is about our ability to avoid, cope with and recover from any disruption to our finances now and over the long term. During 2018/19, we have taken a number of steps to ensure our long-term financial resilience, considering, for example, our long-term viability (see page 103) using a range of different scenarios.

We operate in a stable regulatory environment, with incentive mechanisms that protect us – and more importantly – our customers. These incentive mechanisms give us flexibility to adjust investment and respond to events, which also demonstrates our operational resilience.

Operational resilience

Operational resilience is the ability of our infrastructure – and the skills needed to operate that infrastructure – to avoid, cope with and recover from disruption to any aspect of our performance and ensure we continue to deliver the secure and reliable supplies our customers expect. It is also about managing the impact of our activities on the environment.

It is here that we consider the effects that climate change has on our business, our environment and our customers in many ways. Climatic resilience in an overarching theme within our environmental responsibility section of our lens. This is because we expect that there will be more climatic extremes in the future which could lead to more extreme and more frequent hot summers (like 2018), dry spells and potentially droughts. It could also give rise to extremes like the March 2018 'Beast from the East' and major flooding.

In 2018, we experienced two real-world scenarios – the freeze/thaw event, on which we reported in last year's annual report, and the long, hot summer that followed it – that tested the resilience of all our operational processes and systems in very different ways. While we think both events demonstrated our overall resilience and provided assurance that a number of our existing plans and processes are robust, we recognise that there is still room to improve.

Following the freeze/thaw event, for example, we updated our winter contingency plans. This included reviewing our Priority Services Register and the support we offer to hospitals and care facilities that do not have appropriate response plans in place, and maintaining a 24-hour social media presence. It also included more proactive communication with customers about preparing for winter. As part of this, in November 2018, we launched our 'Give your home a HUG' campaign to get customers ready for winter and avoid burst pipes. And during the summer we actively promoted our water efficiency messages and monitored our water supplies to ensure we met the demand for water. We also used a range of channels to communicate with customers about the need to use water wisely.

As a key component of our environmental stewardship we have assessed and responded to the changing climate in many ways. These include a scientifically robust assessment of the climate change impact on our future supply and demand balance as set out in our Water Resources Management Plan (WRMP). This assessment followed guidance and used the UKCP09 climate data. We will use the UKCP18 (United Kingdom Climate Projections 2018) to inform our next round of plans. We also produce a Climate Change Risk Assessments (CCRA) every 5 years. Although this is a voluntary initiative we confirmed to Defra in November 2018 our intention to report under the third round of Adaptation Reporting Power. We supplied climate change data to HR Wallingford in March 2019 in support of the third CCRA.

In terms of environmental stewardship, as outlined on page 18, we are using our SPRING environmental protection scheme to encourage sustainable farming practices, such as catchment management, and biodiversity. We currently have 48 farmers covering 4,410 hectares in the River Blithe catchment in our South Staffs region signed up for our SPRING scheme. Of these, 214 hectares provide additional biodiversity benefits.

Also during the year, we considered at length and in detail the impact that Brexit could have on our operations. So, as well as setting up a Brexit Steering Group, we also put an incident team in place and joined a number of national networks. Our focus for this has been on working with our trade body, Water UK, and key companies in our supply chain to make sure contingencies are in place to ensure our continued access to chemicals and key components in the event of a no-deal Brexit.

Corporate resilience

Having corporate resilience is about making sure we have the appropriate governance, accountability and assurance processes in place to enable us to avoid, cope with and recover from disruption of all types, and to anticipate trends and the variability of our business operations.

In 2018/19, we focused our attention on succession planning. For example, we currently have nine apprentices across the business and will be recruiting another four this year, bringing our total to 13. We were also the first company in the water sector to run a supervisor management development programme for new line managers or to upskill current line managers within our operational teams. The course is aligned to ILM Level 3 and aims to provide line managers with the skills they need to manage their teams, but also identify those who have the capabilities for further progression. We will be running the ILM Level 3 programme again this year and expect to achieve a 100% pass rate.

In addition, we are currently making our submission for the water sector's Competent Operator Scheme, which ensures that our operational people involved with the production of water are appropriately trained. The Competent Operator Scheme is a framework agreed by the DWI, Water UK, and Energy and Utility Skills. It states that training and assessment is carried out against the National Occupational Standards for operating process plant. We will report on the outcome of this in next year's annual report.

Looking ahead, we will make ourselves accountable by monitoring and publishing the results of the engagement we carry out with our people. As part of this, we are aiming to achieve Investors in People accreditation by 2020/21, and will report on our progress towards this in next year's annual report.

Long-term viability statement

Please refer to page 103 of the annual performance report (part 2 of this document) for our long-term viability statement.

Our governance

Our Board, Directors and Executive team

Board structure

Details of the terms of reference of all the committees, their membership and activities during the year are reported on pages 53 to 58.

Board of Directors

Our Board comprises:

- the Independent Chair;
- the Managing Director;
- the Group Chief Executive; and
- six Non-executive Directors.

Three of the Non-executive Directors are considered to be independent in addition to the Independent Chair. The largest single group of Directors on the Board during the year was that of Independent Non-executive Directors, including the Independent Chair.

Sir James Perowne – Independent Non-executive Chair

Appointed Independent Chair in April 2017, and an Independent Non-executive Director since January 2011. Sir James spent 37 years in the Royal Navy, where he was appointed Flag Officer Submarines in 1996 and also served as Deputy Supreme Allied Commander Atlantic at NATO. He was Chair of the Central Region of the Consumer Council for Water (CCWater), serving for eight years before joining South Staffs Water. Sir James brings strong customer and strategic insight experience to the Board.

External appointments: Constable and Governor of Windsor Castle; President of the Submariners Association; Trustee of the British Forces Foundation; President of ARNO/RNBSO.

Phil Newland – Managing Director

Appointed Managing Director in April 2014. From 2006, Phil worked within the South Staffordshire Plc Group as Managing Director of Echo Managed Services Ltd, supplying technology and retail services to the water sector. He was previously a management consultant with Automatic Data Processing (ADP) and Terence Chapman Associates.

External appointments: Director, Pennon Water Services Ltd.

Adrian Page – Group Chief Executive, South Staffordshire Plc

Appointed as a Director in July 1998. Adrian was appointed as Group Chief Executive for South Staffordshire Plc in January 2013, having been Group Finance Director since April 2004. He was previously the Group Finance Director of South Staffordshire Group Plc from 1998 to 2002, and with ACT Group and KPMG.

External appointments: Director, Pennon Water Services Ltd; Director of the Water Companies Pension Scheme Trustee Company.

Catherine May – Independent Non-executive Director

Catherine was appointed as an Independent Non-executive Director in October 2018. She has seven years' experience as a non-executive director, Senior Independent Director, as well as a finance, remunerations and nominations committee member and chair. Previously, Catherine worked on the Executive Committees of RELX plc, Centrica plc and SAB Miller plc.

External appointments: Independent Non-executive Director and Audit Chair, Pensions and Life Savings Association (PLSA); Senior Independent Director and Remuneration Chair, English National Opera; Vice-Chair, Stonehaven Campaigns. She is also principal of an executive leadership coaching practice.

Rt Hon Lord Smith of Finsbury – Independent Non-executive Director

Lord Smith was appointed as an Independent Non-executive Director in October 2018. He is a Life Peer in the House of Lords. Lord Smith has extensive senior leadership experience in both the political world and the public sector, having previously held the posts of Chair of the Environment Agency and Founding Chair of the UK Water Partnership. He is also a Cambridge Water customer.

External appointments: Since 2015 Lord Smith has been Master of Pembroke College, Cambridge, and is responsible for the strategy and planning for the college.

Stephen Kay – Independent Non-executive Director

Appointed as an Independent Non-executive Director in April 2013. Stephen is a Chartered Engineer who has spent his career in the water sector, both in the UK and internationally. He was the Managing Director of Cambridge Water PLC until March 2013 and brings strong water industry, engineering and compliance experience to the Board.

External appointments: Independent Non-executive Director of Jersey Water; Chair of the Water Regulations Advisory Service (until November 2018); Director of the Water Companies Pension Scheme Trustee Company; Trustee of the Arthur Rank Hospice Charity; Director of Watersafe Ltd.

Keith Harris – Non-executive Director and Arjun Infrastructure Partners Representative

Appointed as an Independent Non-executive Director in April 2015. Keith became a Non-executive Director and Arjun Infrastructure Partners Representative on 25 October 2018, following the sale of the Group and the company. Keith is the owner of the advisory business Lorraine House and spent 20 years at Wessex Water, including a period of time at ENRON/AZURIX, where he was global Head of Regulation. At Wessex Water he held various senior executive and Board positions, including CFO and deputy CEO, and brings strong financial and regulatory experience to the Board.

External appointments: Independent Non-executive Director of Ervia, the parent company of Irish Water; Gas Networks Ireland and Aurora Telecom Industry Partner with Arjun Infrastructure Partners; Associate with OXERA.

Peter Antolik – Non-executive Director and Arjun Infrastructure Partners Representative

Peter was appointed as a Non-executive Director and Arjun Infrastructure Partners Representative on 25 October 2018. He is a Partner of Arjun Infrastructure Partners and his background covers regulated companies, transport regulation, and the management of infrastructure funds and investments.

External appointments: Peter joined Arjun Infrastructure Partners from the Office of Rail and Road, and was previously Strategy and Regulation Director at Thames Water.

Michihiko Ogawa – Non-executive Director and Mitsubishi Corporation Representative

Michihiko joined Mitsubishi Corporation in 2011 and was appointed as a Non-executive Director on 25 October 2018. He is a Manager in Mitsubishi Corporation's Water Business Department.

External appointments: Before he joined Mitsubishi Corporation, Michihiko worked for the Japan Bank for International Cooperation, where he was involved in financing multiple utility and transportation infrastructure projects.

Executive team

Pete Aspley – Wholesale Director

Pete has a well-established background in the water sector, having worked within the South Staffordshire Plc group for 25 years. He trained as a mechanical and electrical engineer within the manufacturing sector, before joining the Group as a water treatment manager in 1990.

Pete has since obtained a wealth of operational and management experience in the abstraction, treatment, storage and distribution of potable water. In 2004, he set up and became managing director of Integrated Water Services Ltd (IWS) – a new Group company providing a wide range of specialist support services to water and related industries. IWS has since gone from strength to strength and in 2015 saw its revenue increase to £48 million. Pete joined South Staffs Water in 2015.

Andrew McGeoghan – Finance Director

Andrew was appointed on 18 March 2019, having previously worked at Jacobs as Head of Economic Regulation and Assurance.

He has diverse experience in both the public and private sectors, having held a variety of senior finance positions. He spent several years with Ofwat as an Associate Director before joining Jacobs in 2015 to set up and lead a specialist team advising regulated companies on their reporting and control processes.

Marcella Nash – Director of Human Resources

Marcella was appointed in January 2014, having previously worked within South Staffordshire Plc as Head of Human Resources for Echo Managed Services Ltd. She has extensive generalist HR experience and is currently responsible for organisational capability and people performance, as well as Health and Safety standards, performance and culture.

Prior to this she was a Senior HR Manager in the Severn Trent Group and Severn Trent Water.

Directors' report

The Directors are pleased to present their report and accounts for the year ended 31 March 2019. The Directors confirm that they consider the report and accounts to be fairly presented and understandable. It provides investors and other stakeholders with the necessary information to assess South Staffs Water's performance for the year ended 31 March 2019, its business model and its strategy.

Directors

The Directors who held office during the year and subsequently, along with the number of Board meetings attended by each Director, while holding office during the year, are as follows.

Director	Director type	Date appointed	Date resigned	Meetings attended
Sir James Perowne	Independent Non-executive Chair	01/01/2011		8/8
Phil Newland	Managing Director	01/04/2014		8/8
Adrian Page	Group Chief Executive – South Staffordshire Plc	01/07/1998		8/8
Rt Hon Lord Smith of Finsbury	Independent Non-executive Director	25/10/2018		3/4
Catherine May	Independent Non-executive Director	25/10/2018		4/4
Stephen Kay	Independent Non-executive Director	01/04/2013		8/8
Michael McNicholas	Independent Non-executive Director	25/10/2018	01/04/2019	4/4
Keith Harris	Non-executive Director	30/04/2015		8/8
Michihiko Ogawa	Non-executive Director	25/10/2018		4/4
Peter Antolik	Non-executive Director	25/10/2018		2/4
Ram Kumar	Non-executive Director	30/07/2013	03/07/2018	2/2
Ryan Miller	Non-executive Director	30/11/2017	03/07/2018	1/2

No Director had any material interest in any contract of significance with the company.

The largest single group of Directors on the Board are Independent Non-executive Directors, including the Independent Chair.

Financial results

The company's financial results are shown in the accounts on pages 72 to 97.

Dividends of £8.4m were paid during the year (2018: £16.7m), including appointed dividends of £3.5m (2018: £5.0m). A breakdown of the dividend payment for the year along with a comparison to the prior period is contained in the financial performance section on page 86.

Details of future developments can be found in the strategic report.

Payment of creditors and commercial arrangements

The company's policy is to pay suppliers in line with the terms of payment agreed with each of them, when contracting for their products or services. Trade creditors at 31 March 2019 represent 52 days (2018: 51 days) of purchases. The company is not reliant on any single commercial arrangement.

No political donations were made during the financial year (2018: nil).

Corporate social responsibility

South Staffs Water regards the implementation of responsible social and ethical standards and the health, safety, wellbeing and fair treatment of its people, including disabled persons, and those who become disabled while in the company's employment, as fundamental to the company. Compliance with relevant environmental laws is also integral.

The company has an equal opportunities and non-discrimination policy. Every reasonable effort is made to provide disabled people with equal opportunities for employment, training and promotion.

During March 2019, working with sector colleagues and Water UK, we helped shape Industry positioning on the Social Mobility Pledge. The Pledge is a cross-party campaign to improve social mobility across the whole of the UK. Signing up to that pledge demonstrates our commitment to partner with schools and colleges in our areas, to let them know more about who we are and what we do, and to give access to our jobs and apprenticeship opportunities. This is mirrored in our community hub, where jobs are available for all to access. We believe our entry points are achievable for all. We don't aim for the 'best of the academic best' and we don't automatically de-select potential talent based on school results. Taking this approach opens up a level playing field for all.

The company also places considerable value on the engagement of its people and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the company's performance. This is achieved through formal and informal meetings and a regular email newsletter. Employee representatives are consulted regularly on a wide range of matters affecting their current and future interests through the SSC People Forum. Further details regarding the company's people can be found on pages 23 to 26 of the strategic report.

The company does not consider human rights issues to be a material risk for the business. This is because of existing regulatory requirements in the UK and the nature of the supply chain.

Further information on the company's corporate social responsibility activities is provided in the strategic report on pages 44 to 45.

Corporate governance

A detailed corporate governance report is set out on pages 46 to 62. The Group structure is shown in the chart on page 47.

Risk management

The company's practices in respect of risk management are set out on pages 29 to 39 of the strategic report.

Going concern

The company's statement on going concern and the basis for the going concern assumption are set out on page 52.

Independent Auditor

In accordance with the provisions of section 418 of the Companies Act 2006, the Directors confirm that, as far as they are aware, there is no relevant audit information of which the company's auditor is unaware.

The Board has taken all reasonable steps to make itself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

A resolution proposing the reappointment of Deloitte LLP as independent auditor will be put to the Board.

Approved by the Board and signed on its behalf by:

Andrew McGeoghan
Company Secretary

Registered Office: Green Lane, Walsall, West Midlands, WS2 7PD. Registered in England and Wales, number 2662742.

Corporate governance report

The Directors of South Staffs Water have always placed good governance at the core of the business. They are aware of their obligations to ensure effective leadership and appropriate governance arrangements are in place within the company. Following the publication of Ofwat's principles on Board leadership, transparency and governance in January 2014, the company developed its own corporate governance code ('the SSW Code'), which seeks to not only meet but exceed these principles. A copy of the SSW Code can be found on the company's website at: https://www.south-staffs-water.co.uk/media/2678/ssw-corporate-governance-code-2019.pdf.

In January 2019, Ofwat published updated principles on Board leadership, transparency and governance, which came into effect on 1 April 2019. The company supports these updated principles, and will be reviewing and updating the SSW Code to incorporate these principles – in particular, taking account of principle 2.1, which focuses on the requirement for the Board to establish the company's purpose, strategy and values, and be satisfied that these and its culture reflect the needs of all those it serves.

Although the company is not publicly listed, its Board of Directors recognises that because of public interest in how the company performs and the regulated environment in which it operates, it should act as if it were. The SSW Code has specifically drawn on Ofwat's principles and certain principles of the UK Corporate Governance Code ('the UK Code') – in particular, those considered applicable and appropriate to a privately owned but regulated company providing essential services. The company believes this approach enforces effective leadership and appropriate governance arrangements. Details of how the company follows these principles are set out below. The company also applies the Walker Guidelines on transparency and disclosure. The company frequently monitors corporate governance best practice and the appropriateness of developments to it. Any changes to the company's governance arrangements are implemented within agreed timescales.

Details of how the company preserves value over the long term, its business model and how it delivers this and its strategy are provided in the strategic report.

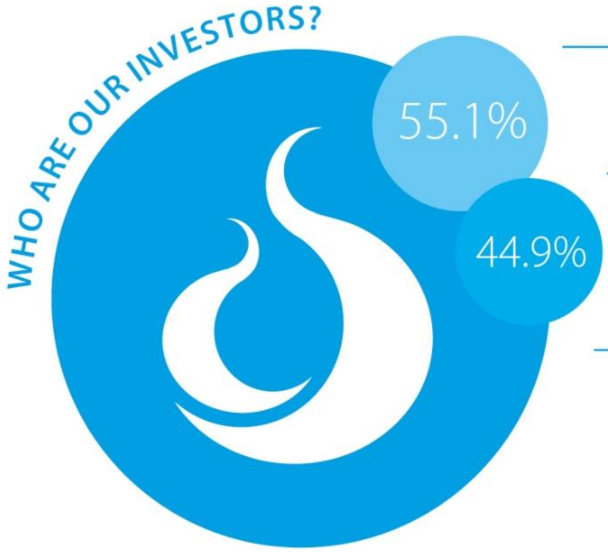
Group structure

Until 3 July 2018, the company was controlled by the Global Infrastructure Fund of the investment business KKR & Co. L.P. (KKR), which is quoted on the New York Stock Exchange and which held a majority controlling interest in the Group, together with certain co-investors.

On 3 July 2018, the Global Infrastructure Fund of KKR together with its co-investors, sold their 75% equity stake in the Group to pension funds and other institutional investors advised and managed by Arjun Infrastructure Partners Limited. These investors then sold a 19.9% stake to Mitsubishi UFJ Lease & Finance Company with Mitsubishi Corporation retaining its 25% interest.

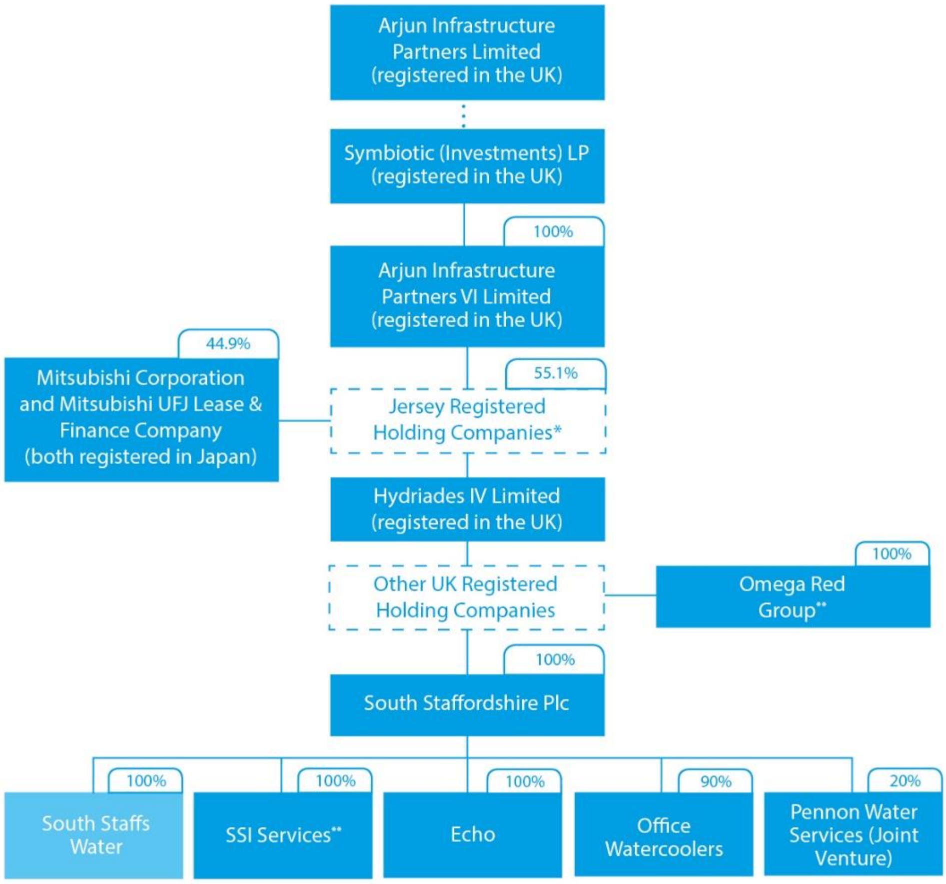
South Staffordshire Plc, as the immediate parent company of South Staffs Water, ensures through its comprehensive knowledge of its subsidiaries and the water sector that it understands the duties and obligations of a regulated company. This includes Condition P of its licence and, although some Directors sit on both Boards, South Staffs Water acts, with the support of the Group, as if it were a separate listed company. South Staffordshire Plc provides management, professional and administrative support services to South Staffs Water and its other subsidiaries at cost. There was no direct interaction between South Staffs Water and the ultimate controlling party, Arjun Infrastructure Partners Limited.

Details of the borrowings of South Staffs Water are provided in the accompanying reported accounts and the financial performance section of the strategic report. Similarly, details of the borrowings of South Staffordshire Plc are provided in its own annual report and accounts. Details of the Group structure since 3 July 2018 are set out below



Long-term pension scheme and institutional investors, advised by Arjun Infrastructure Partners which acquired a majority controlling interest in the Group from KKR in July 2018

Mitsubishi Corporation, a global integrated trading business, which acquired a 25% equity interest in the Group in March 2016 and now manages a 44.9% stake in the Group following a further 19.9% investment by Mitsubishi UFJ Lease & Finance Company in July 2018



* Jersey registered holding companies are UK resident for tax purposes.

** Omega Red is managed within the SSI Services division.

% represents economic equity interest held.

Relations with investors and the immediate holding companies

During the year, there were a number of UK registered intermediate holding companies above the immediate parent South Staffordshire Plc in the Group structure, headed by Hydriades IV Limited. There are intermediate holding companies above Hydriades IV Limited, which are registered in Jersey, but are resident in the UK for tax purposes. From 3 July 2018, with the change in the Group structure set out on page 47 above, there are a number of UK registered entities above the companies registered in Jersey and the ultimate controlling party is now Arjun Infrastructure Partners Limited, a company registered in the UK.

Two of the UK-registered holding companies have loans payable to South Staffs Water, both of which bear interest that is paid in full each year. One of the loans was repaid on 24 May 2019. Any UK tax losses surrendered to South Staffs Water from other companies in the structure are paid for at their net tax value.

In March 2016, Mitsubishi Corporation acquired a 25% equity interest in Selena Bidco Limited, one of the holding companies registered in Jersey, and so during the year held a 25% equity interest in the South Staffordshire Plc Group and the company. In July 2018, Mitsubishi UFJ Lease & Finance Company acquired a 19% equity interest in South Staffordshire Plc Group. Mitsubishi UFJ Lease & Finance's equity interest in the Group is managed by Mitsubishi Corporation.

Arjun Infrastructure Partners Limited, AIP Holdings Limited (the controlling shareholder of Arjun Infrastructure Partners Limited) and Mitsubishi Corporation have signed Condition P undertakings in accordance with the company's Instrument of Appointment. The companies giving the Condition P undertakings agree to:

i) provide the company with all information needed to comply with its obligations; and to procure that their subsidiaries will;
ii) refrain from taking any action which might cause the company to breach any of its obligations; and
iii) ensure that the Board of the company contains no less than three Independent Non-executive Directors, or such higher number to ensure that the Independent Non-executive Director are the largest single group on the Board, who are persons of standing with relevant experience.

There is a regular dialogue between the Board and investors to ensure that their objectives and priorities are carefully considered. This dialogue is achieved through Board meetings, with investors having representation on the Board of Directors and through other less formal communication.

The Board of Directors

The Directors are collectively responsible for the company's long-term success. They may be appointed by the company by Ordinary Resolution or by the Board. As set out in the company's Articles of Association, a Director appointed by the Board will hold office until the next Annual General Meeting (AGM). At each AGM, one-third of the Directors will retire by rotation and will submit themselves for re-election at least once every three years.

All Directors are aware of the procedure to seek independent legal and other professional advice. The Board also has access to the advice and services of the Company Secretary, who is also responsible for monitoring corporate governance matters.

Insurance and indemnities

The Company maintains Directors' and Officers' liability insurance in respect of legal action that might be brought against its Directors and Officers. As permitted by the Company's Articles of Association (the 'Articles'), and to the extent permitted by law, the company indemnifies each of its Directors and other Officers against certain liabilities that may be incurred as a result of their positions with the company. The indemnity was in force throughout the tenure of each Director during the last financial year, and is currently in force.

Board membership

Sir James Perowne was appointed Independent Non-executive Chair on 1 April 2017.

Senior Executives of KKR, who were Directors on the Board until 3 July 2018, were Ram Kumar and Ryan Miller. They were both Directors of all holding companies above South Staffordshire Plc and Non-executive Directors of the company's immediate parent, South Staffordshire Plc. On 3 July 2018, both of these Directors resigned from all of the Group companies, of which they were Directors, as part of the KKR Global Infrastructure Fund's and its co-investors' sale of their 75% equity interest in the Group.

From 25 October 2018, Peter Antolik, a partner of Arjun Infrastructure Partners Limited, and Michihiko Ogawa, a Manager of Mitsubishi Corporation, were appointed as Non-executive Directors of the company and are also Non-executive Directors of the company's immediate parent, South Staffordshire Plc. Peter Antolik is a Director of all of the UK holding companies above South Staffordshire Plc in the Group structure as at 31 March 2019.

Keith Harris was appointed as an Independent Non-executive Director in April 2015. As an industry partner of Arjun Infrastructure Partners Limited on 25 October 2018, he became a Non-executive Director following the sale of the Group and the company.

On 25 October 2018, the Rt Hon Lord Smith of Finsbury, Catherine May and Michael McNicholas (resigned 1 April 2019) were appointed as Independent Non-executive Directors.

At 31 March 2019, Adrian Page was also an Executive Director of the immediate parent and all of its UK subsidiaries and holding companies.

Stephen Kay is considered by the Board to be independent in both character and judgement. While Stephen was a former Managing Director of Cambridge Water PLC until 2013, he has never served as an Executive Director of South Staffs Water. It is considered that he brings to the Board valuable industry knowledge, engineering skills and experience, and extensive links and knowledge of the Cambridge supply region, all of which are important attributes to the balance of the Board's composition. In addition, the appointment of Stephen Kay is consistent with the commitment given to the Competition Commission (now the Markets and Competition Authority) to have a Non-executive Director on the Board with links to the Cambridge region.

Jason Goodwin resigned as Company Secretary on 10 May 2019 and was replaced by Andrew McGeoghan.

Functions of the Board

Under the SSW Code, the company should have an effective Board. The Board's primary focus is to develop, implement and fulfil the strategy to deliver the service and performance to meet the needs of:

- customers;
- the environment;
- the business;
- employees;
- investors; and
- other stakeholders.

The Board should also be in a position to make well-informed, high-quality and sustainable decisions, which are in the company's best interests, and that are consistent with its statutory and regulatory duties.

The Board sets standards of conduct to promote the company's success, provide leadership, and review the company's internal controls and governance structure. It approves major financial and investment decisions above senior management thresholds, and evaluates the company's performance as a whole by monitoring reports received directly from Directors and senior management. The Non-executive Directors, led by the Independent Chair, are responsible for overseeing this work, and scrutinising management performance. They constructively challenge and help develop proposals on strategy.

In conjunction with the Audit Committee, the Board is also responsible for the company's systems of internal control, and for evaluating and managing significant risks to the company.

On joining the Board, Directors receive induction material appropriate to their needs and responsibilities. This may include, but is not limited to:

- information on the regulatory framework in which the company operates;
- operational activities;
- financing structure;
- strategic and financial plans; and
- the wider Group structure.

The Directors and Executive team carry out site visits to maintain familiarity with the company's operations and to refresh their skills and knowledge. The Directors also keep up to date with legal and regulatory changes and developments by receiving written and verbal updates from both internal and external advisers and regulators.

The Directors are supported by an Executive team and by other senior managers, who are responsible for assisting them in the development and achievement of the company's strategy, and in reviewing its financial and operational performance. Along with the Directors, the Executive team is responsible for monitoring policies, procedures and other matters that are not reserved for the Board. There are procedures providing a framework of authorisation levels for key decision making. Details of the Executive team's skills and experience can be found in their biographies on page 43.

In accordance with the SSW Code, a formal evaluation of Board and individual members' performance is carried out by reviewing the effectiveness of the Board as a whole and of the individual members of the Board. This year, the Board carried out an internal evaluation. The results of this review are set out in the Board effectiveness section on page 62. We are pleased to report that the Board, its Committees and individual Directors continue to operate effectively.

Matters reserved for the Board

A schedule of matters specifically reserved for the Board's decision has been adopted based on the Institute of Chartered Secretaries and Administrators (ICSA) best practice. The terms include, but are not limited to:

- ensuring observance of all matters required by the company's Instrument of Appointment;
- approval of the Directors' assurance statements to Ofwat, including but not limited to:
  - the business plan for the period from 2020 to 2025;
  - the annual performance report;
  - the annual statement of business viability;
  - the setting of water tariffs; and
  - other regulatory assurance as required.
- material submissions to Ofwat, the Competition and Markets Authority and similar regulators, agencies or bodies;
- reviewing and approving capital and operating budgets;
- reviewing and approving the company's strategy and performance;
- reviewing and approving any significant changes to the company's capital structure and borrowings;
- reviewing and approving financial reports;
- contracts that are material, either strategically or by reason of size, according to specified limits;
- appointment and removal of any Director;
- prosecution, defence or settlement of litigation above £1 million, or being otherwise material;
- material changes to the company's pension arrangements;
- ensuring maintenance of a sound system of internal control and risk management;
- considering the balance of interests between investors, employees, customers and the community; and
- powers to delegate authority.

The Directors maintain a flexible approach to Board matters, with the delegation of power to a

Committee, with precise terms of reference, being used for specific routine purposes. Both the terms of reference and composition of the Committees are reviewed regularly to ensure their ongoing effectiveness.

While South Staffs Water acts as though it were a separate public listed company, a limited number of matters in respect of this subsidiary company also need the approval of the Board of South Staffordshire Plc, its immediate parent company. These include:

- material submissions to Ofwat, particularly in respect of price reviews and major structural reform;
- contracts that are material either strategically or by reason of size, according to specified limits;
- appointment and removal of any Director, in its role as shareholder;
- prosecution, defence or settlement of litigation above £1 million or being otherwise material; and
- material changes to pension arrangements, where operated on a Group basis.

Board meetings

The Board holds regular scheduled meetings throughout the year. During the year ended 31 March 2019, there were eight scheduled Board meetings.

In compliance with the SSW Code, all Directors are provided with sufficient information before a Board meeting to allow appropriate preparation to ensure that they can properly discharge their duties.

The attendance by individual Directors at scheduled meetings of the Board during the year, is shown in the table in the Directors' report on page 44.

Organisational structure

A defined organisational structure exists for the company, with clear lines of responsibility, accountability and appropriate division of duties.

The Directors set an overall strategy and have delegated the necessary authority to the Executive team and business departments to deliver that strategy. This is communicated to employees by way of published policies and procedures, and regular management and employee briefings.

The company's extensive financial regulations specify authorisation limits for individual managers, with all material transactions being approved by a member of the Executive team, a Director or by the Board collectively. In addition, formal Treasury policies are in place. Where appropriate, commercial and financial responsibility is clearly delegated to the Executive team and supported by the Directors.

Risk management

The company's approach to risk reflects its status as a regulated and licensed water undertaker providing an essential public service. It balances the need to effectively manage exposure to risk, while aiming to deliver high standards of operational and financial performance. A strong risk management and control framework is in place to understand and manage identified risks. The Board and Audit Committee discuss and review the effectiveness of the company's risk management and internal control systems on a regular basis. The company's Executive team is required to monitor risk and its management, with any significant changes in business risk and any subsequent procedures or controls to mitigate the risk being reported to the Board and the Audit Committee. Further details of risk management and principal risks are set out on pages 29 to 39 of the strategic report.

Regulatory reporting

South Staffs Water makes significant efforts to produce regulatory documentation and information that is reliable, robust and accurate, and that is supported by suitable systems and procedures. The Board, including Independent Non-executive Directors, are involved in the approval process for key regulatory information. This process supports the governance in place, the review of information by an independent technical auditor (Jacobs), the audit work and certain agreed-upon procedures in respect of the extraction of specific information performed by the external independent auditor (Deloitte LLP). Where identified as necessary by the company's assurance framework, the Group's internal audit function will review processes and data to provide appropriate assurance.

The company places great emphasis on regulatory reporting to ensure it continues to have sufficient processes and internal systems of control to fully meet its obligation for the provision of information to Ofwat, other regulators and stakeholders. It is important to the company that this information is robust, not just for its external credibility, but to also allow it to manage the performance of the business and make appropriate decisions with reference to this data.

The company's regulatory accounts are set out in the annual performance report on pages 142 to 183.

Going concern and basis for assumption

The Directors consider that it is appropriate to prepare the accounts on a going concern basis. This is based on a review of the company's budget for the year ending 31 March 2019, the longer-term plan and financial forecasts to 31 March 2025, and the related stress testing performed on this plan as detailed in the long-term viability statement on pages 103 to 109 of the annual performance report. This assertion is also based on:

- the company's investment programme;
- the final determination for the five years from 2015 to 2020 and the company's plan in relation to it;
- the committed borrowing facilities available to the company together with cash balances, actual and forecast compliance with borrowing covenants and other important financial metrics and ratios; and
- its access to capital markets to fund operations in the future.

The company is confident it has sufficient access to capital markets, and relationships with banks and other lenders to refinance borrowing facilities that mature within 12 months of approval of the annual report and accounts. In addition, the Directors are required to certify to Ofwat under Condition I of the company's Instrument of Appointment that sufficient financial resources are available for at least the next 12 months.

The company's business activities, its business model and strategy together with the factors likely to affect its future development, are set out in the strategic report on pages 11 to 22. The company's financial position, its liquidity position and available borrowing facilities are set out on the balance sheet on page 73 and in note 23 to the accounts, which includes:

- its objectives for managing its financial risks;
- details of its financial instruments and hedging activities; and
- its exposure to interest, credit and liquidity risk.

The company has a large number of household customers, none of whom make up a significant proportion of turnover. Amounts due from non-household retailers are secured by appropriate collateral arrangements. The company has significant undrawn borrowing facilities, as well as its cash balances and has significant headroom in respect of all of its borrowing covenants, both on a historic and forward-looking basis.

Audit Committee

Membership for the year ended 31 March 2019


Catherine May (Chair)


Sir James Perowne


Stephen Kay


Keith Harris


Michihiko Ogawa

Director	Role	Meeting attendances
Catherine May	Member and Chair	0/0
Michael McNicholas	Chair – February 2019 meeting	1/1
Keith Harris	Chair – June 2018 meeting	2/2
Sir James Perowne	Member	2/2
Stephen Kay	Member	2/2
Michihiko Ogawa	Member	1/1

Michael McNicholas was appointed Chair of the Audit Committee to replace Keith Harris. Following Michael McNicholas' resignation on 1 April 2019, Catherine May was appointed Chair of the Audit Committee. Audit Committee meetings are also regularly attended by:

- Deloitte LLP, the company's external independent auditor;
- the Finance Director and Company Secretary;
- the Director of Regulation;
- the Financial Controller; and
- the Group Internal Audit Manager.

Roles and responsibilities

The Audit Committee is responsible for reviewing and monitoring the company's financial statements, internal controls and systems for mitigating the risk of financial and non-financial loss. This includes:

- assessing the integrity of financial statements;
- considering changes to accounting policies;
- reviewing financial reporting procedures and risk management processes; and
- monitoring systems.

The Committee is responsible for recommending to the Board the appointment, reappointment and – if necessary – the removal of the external auditor, and monitoring the auditor's independence, performance and effectiveness. Responsibilities extend to approving the nature and scope of external audits and the auditor's remuneration.

Key terms of reference

- Reviewing and appraising the work of the external auditor by meeting with the auditor twice a year, reviewing the results of its work, discussing the quality of the audit with senior management, reviewing the level of non-audit fees and the nature of non-audit services provided, and reviewing the auditor's own assessment of its independence.

- Monitoring, reviewing and challenging, when necessary, the integrity of the company's financial statements, including its statutory accounts, annual performance report, interim accounts and any other formal announcement relating to its financial performance, and reviewing significant financial reporting issues and judgements which they contain.
- Keeping under review the effectiveness of the company's internal audit arrangements, internal controls, and risk management policies and practices.
- Reporting to the Board of Directors on how it has discharged its responsibilities.

Audit Committee activities

In the year ended 31 March 2019, the Committee focused on the key business risks as set out on pages 30 to 35 of the strategic report. It also focused on the areas of significant judgement and estimate as identified by the external auditor. These are primarily revenue recognition, recoverability of receivables and capitalisation of fixed assets.

Business functions are responsible for identifying, quantifying, reporting and controlling risks relevant to their activities. Risk reports are produced and reviewed by the Audit Committee twice a year.

During 2018/19, particular emphasis was placed on the primary business risks, which are identified as business planning for 2020 to 2025 and water quality.

With regards to business planning for 2020 to 2025, the Committee required senior management to provide comfort to the Committee that the appropriate assurance was carried out on the business plan.

The Committee also required senior management to provide details of how water quality risks will be mitigated and proactively managed in the future. It has been confirmed that water quality is a high priority in the business plan for 2020 to 2025 and future plans have been incorporated. The Committee also received feedback from senior management with regards to the internal operational audit programme, which will now be reported specifically to the Committee.

In reviewing the significant financial reporting risks surrounding revenue recognition, recoverability of receivables and capitalisation of fixed assets, the Committee worked with senior management to ensure that these risks were mitigated and that the company's practices are in line with applicable accounting regulations, and satisfied the requirements of our external auditors.

Alongside this, the Committee reviews and challenges papers and feedback from senior management, external auditors' reports, reports from Group Internal Audit and the company's risk register. It also discusses areas of judgement and estimation, making comment and recommendations, where appropriate, and seeks further management clarification, where required.

Financial reporting and forecasting

The Board, supported by the Audit Committee, recognises the need to present a balanced, understandable and clearly defined assessment of the company's operational and financial performance and position, including its future prospects. This is provided by a review of the company's operations and performance as set out in the strategic report.

Business plans, annual profit and loss budgets, cash flow budgets and forecasts, longer-term financial forecasts and investment proposals for the company are formally prepared, reviewed and approved by the Board, supported by the Audit Committee. Actual financial results and cash flows, including a comparison with budgets and forecasts, are regularly reported to the Board with variances being identified and used to initiate any action deemed appropriate.

Details of the company's actual and forecast future compliance with its borrowing covenants are also prepared on a regular basis, and forecasts of its level of undrawn and available borrowing facilities for liquidity purposes are also prepared and reported to the Board.

As set out in the annual performance report, stress testing has been carried out on the company's longer-term financial forecasts to ensure its long-term viability. This ensures the company has the ability to withstand a series of severe, plausible and reasonable events. The Audit Committee is integral in assessing the tests carried out and the conclusions formed so that the Board is assured of the company's long-term viability and financial resilience.

Internal control

The Board, supported by the Audit Committee, attaches considerable importance to the company's system of internal control and reviews its effectiveness. This includes ensuring reasonable steps are taken to safeguard the company's assets, and to prevent and detect fraud and other irregularities. The internal control system can provide only reasonable and not absolute assurance against material mis-statement or loss, as it is designed to manage rather than eliminate the risk of failure to achieve business objectives. The company has an established internal control framework that is continually reviewed and updated, taking into account the nature of its operations.

The Audit Committee is closely involved in challenging the company's processes for identifying, evaluating and managing significant risks. A detailed review of the current assessment of these can be found on pages 30 to 35 of the strategic report.

The Audit Committee has also challenged the company to identify and mitigate against upcoming risks; this has ensured close attention has been paid to current issues, such as Brexit and cyber security.

Internal audit

The company benefits from independent reviews of performance by an internal audit function operated by its parent company. This service is dedicated to ensuring internal control activities remain a priority within the Group. It also provides valuable support to the company in maintaining good systems of internal control, providing assurance over the quality of information (depending on the assurance framework categorisation) and helps ensure appropriate corporate governance.

An internal audit plan is presented to the Audit Committee each year; this is subject to challenge and approval. The plan combines the need for regulatory and financial reporting assurance, risk management and control evaluation with the provision of independent resource to enhance the company's operations. The Audit Committee monitors progress against the plan through the reporting of findings and recommendations at each meeting.

During 2018/19, Group Internal Audit was heavily involved in providing one of the layers of assurance around the company's business plan for 2020 to 2025.

The internal audit arrangements in operation are considered to be appropriate to the company's size and complexity, an assessment which the Board will continue to review through the Audit Committee.

External independent auditor

The Board, supported by the Audit Committee, reviews the external independent auditor's performance each year considering effectiveness, independence and fees, including the level of non-audit services and related non-audit fees.

In evaluating the external auditor, the Audit Committee assesses the calibre of the audit firm, the audit scope and plan (which is agreed in advance with the Audit Committee through discussions with the Chair) and the level and nature of audit communications, including the reporting to the Audit Committee of any significant issues.

The responsibilities of the external independent auditor in the area of financial reporting are set out in its report relating to each year's financial statements.

The current external audit provider, Deloitte LLP, has been the company's auditor since 2003, with a change in the audit partner occurring every five years. Based on current legislation, Deloitte can be re-appointed for all financial years up to and including the year ending 31 March 2022. Thereafter, auditor rotation is required once every ten years, extendable to 20 years, if a tender is conducted after ten years.

Nomination Committee

Membership for the year ended 31 March 2019

Sir James Perowne (Chair)

Rt Hon Lord Smith of Finsbury

Stephen Kay

Keith Harris

Michihiko Ogawa

Director	Role	Meeting attendances
Sir James Perowne	Chair	1/1
Keith Harris	Member	1/1
Stephen Kay	Member	1/1
Adrian Page (resigned 27/06/2019)	Member	1/1
Ram Kumar (resigned 03/07/2018)	Member	0/0
Rt Hon Lord Smith of Finsbury (appointed 27/06/2019)	Member	0/0
Michihiko Ogawa (appointed 27/06/2019)	Member	0/0

The Nomination Committee primarily comprises Independent Non-executive Directors and is chaired by the company's Independent Chair. Meetings are convened as required to discuss changes or appointments to the Board of Directors. One meeting was held in 2018/19 to interview, recruit and appoint new Non-executive Directors and new investor Non-executive Directors.

On 27/06/2019, Adrian Page resigned from the Nomination Committee. Michihiko Ogawa and the Rt Hon Lord Smith of Finsbury were appointed to the Nomination Committee on 27/06/2019.

Roles and responsibilities

Considerable attention is given by the Committee, to the composition of the Board. This includes reviewing the balance of skills, knowledge, experience, diversity (including gender), and the level of non-executive and independent challenge.

External search advisors are engaged to assist the Nomination Committee where considered appropriate, but are not considered necessary for all appointments.

Key terms of reference

- Preparing an appropriate specification for open Board positions.
- Ensuring any appointment to the Board carefully considers the balance of the Board composition.
- Ensuring successful candidates have the necessary skills, experience, information and knowledge to fulfil their duties.

Diversity

Information about the company's gender diversity can be found on page 23 of the strategic report.

Remuneration Committee

Membership for the year ended 31 March 2019


Sir James Perowne (Chair)


Rt Hon Lord Smith of Finsbury


Stephen Kay


Keith Harris


Michihiko Ogawa

Director	Role	Meeting attendances
Sir James Perowne	Chair	1/1
Keith Harris	Member	1/1
Stephen Kay	Member	1/1
Adrian Page (resigned 27/06/2019)	Member	1/1
Ram Kumar (resigned 03/07/2018)	Member	0/0
Rt Hon Lord Smith of Finsbury (appointed 27/06/2019)	Member	0/0
Michihiko Ogawa (appointed 27/06/2019)	Member	0/0

The Committee primarily comprises Independent Non-executive Directors and is chaired by the company's Independent Chair.

On 27/06/2019, Adrian Page resigned from the Remuneration Committee. Michihiko Ogawa and the Rt Hon Lord Smith of Finsbury were appointed to the Remuneration Committee on 27/06/2019.

Roles and responsibilities

The Committee is responsible for the remuneration policy and for setting the remuneration packages of the Board, the Executive team and other senior management. The Committee meets at least once a year.

Key terms of reference

- Agreeing remuneration that will ensure the Executive Directors and the Executive team are provided with appropriate incentives to achieve high standards of performance and reward them for their individual contributions to the company's success.
- Ensuring the performance-related elements of remuneration for the company's Executive Directors relate to standards of performance for customers and wider society.
- Determining remuneration packages and arrangements with regard to any relevant legal requirements and associated guidance and to obtain reliable, up-to-date information about remuneration in other companies.
- Ensuring contractual terms on termination are fair and that failure is not rewarded.
- Overseeing any material changes in employee benefits structures throughout the company.

A detailed remuneration report is set out below.

Remuneration report

Remuneration policy

Remuneration packages and fees are designed to attract, retain and motivate high-calibre Directors and Executive team members. The Remuneration Committee has overall responsibility for determining Board Directors' remuneration packages and considering those of the Executive team.

The total remuneration packages of Board Directors and the Executive team include basic salary, benefits and annual and deferred bonuses, which are linked to business targets and personal performance-related objectives. The performance-related objectives are designed to encourage and reward continuing improvement in the company's performance over the longer term. Annual salary, benefits and annual bonus awards are normally pensionable, whereas deferred bonuses are not.

The Remuneration Committee recognises that transparency on the relationship between pay policy and outperformance will help customers see how performance pay is earned in providing an essential service. The company has an obligation under Section 35A of the Water Industry Act 1991 to make a statement in relation to remuneration that is linked to standards of performance.

Board and Executive terms of engagement

As Group Chief Executive, Adrian Page is appointed to the company's Board in accordance with the requirements of his Group-wide role.

Peter Antolik and Keith Harris were appointed to the Board as representatives of Arjun Infrastructure Partners Limited and Michihiko Ogawa was appointed to the Board as a representative of Mitsubishi; their appointments have no fixed term.

Sir James Perowne, Stephen Kay, the Rt Hon Lord Smith of Finsbury and Catherine May, as Independent Non-executive Directors are appointed to Board for fixed terms of three years. They can be re-appointed for up to a further two periods before being required to stand down after a maximum of nine years' service. In accordance with their appointment, the Independent Non-executive Directors are required to commit the appropriate time needed to sufficiently fulfil their duties within a regulated utility business.

The Managing Director and Executive team are employed on service contacts of no fixed term, with notice periods of either six or three months. They are entitled to:

- basic pay;
- private medical insurance;
- a company car or car allowance;
- fuel allowance; and
- payments made to a Group money purchase pension scheme.

As noted, the Committee recognises the need to attract and retain high-performing individuals. Base salary and allowances are set reflecting the market value of the role and with consideration of the respective director's skills, experience and performance.

Committee believes it is important that, for Executive Directors and senior management, that a proportion of the remuneration package should be performance-related. Therefore, there is participation in the bonus scheme. Bonus awards are linked to personal objectives, as well as being aligned to the company's standards of performance in the areas of:

- customer service (based on SIM and complaints performance as reported to Ofwat);
- achievement of ODI performance targets (as reported in table 3a of the annual performance report); and
- financial performance based on profitability, operating costs and cash generation.

Bonus awards are linked to the standards of performance outlined above as the Remuneration Committee considers such arrangements will drive and reward performance, whilst maintaining consistency between the objectives of the Directors and principal stakeholders, including customers and investors.

The company's standards of performance are aligned with the targets set out in our business plan and personal objectives are set at the start of every year and. All of the standards of performance are subject to defined quantitative targets. The measures, weighting and threshold levels may be adjusted in future years.

Salaries are reviewed annually and any changes are effective from 1 July each year. In normal circumstances, Executive salary increases will not be materially different to general employee pay increases.

The Remuneration Committee reviews annually the standards of performance to which bonuses are linked to ensure this consistency continues to be maintained. Following the financial year end the Committee, following consideration of the outturn against target, assesses to what extent the targets are met and determines bonus levels accordingly. In doing so the Committee takes into account overall Company performance and in exceptional circumstances may exercise its discretion and adjust the bonus to reflect any specific factors.

As Group Chief Executive and an Executive Director of the parent company, South Staffordshire Plc, Adrian Page has, as part of his remuneration package, an element of his bonus specifically linked to the company's performance.

Further details in respect of the Managing Directors and Executive team's remuneration are set out on page 60 below, while a more detailed breakdown of bonus awards is available on page 61, including the detail in respect of Adrian Page.

Ram Kumar, Ryan Miller, Peter Antolik and Michihiko Ogawa were not remunerated by the company or South Staffordshire Plc during the year.

Board £'000														
Name	Basic salary		Bonus[1]		Other benefits and pay[2]		Fees		Total emoluments		Pension contributions[3]		Total remuneration	
	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018
Sir James Perowne	-	-	-	-	-	-	40	40	40	40	-	-	40	40
Phil Newland	178	168	59	61	16	15	-	-	253	244	21	21	274	265
Adrian Page[4]	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Catherine May	-	-	-	-	-	-	13	-	13	-	-	-	13	-
Lord Smith of Finsbury	-	-	-	-	-	-	13	-	13	-	-	-	13	-
Stephen Kay	-	-	-	-	-	-	30	30	30	30	-	-	30	30
Keith Harris[5]	-	-	-	-	-	-	17	30	17	30	-	-	17	30
Michael McNicholas	-	-	-	-	-	-	13	-	13	-	-	-	13	-
Peter Antolik[4]	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Michihiko Ogawa[4]	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Ryan Miller[4]	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Ram Kumar[4]	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total	178	168	59	61	16	15	126	100	379	344	21	21	400	365
Executive team £'000														
	Basic salary		Bonus[1]		Other benefits and pay[2]		Fees		Total emoluments		Pension contributions[3]		Total remuneration	
	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018
Total	279	363	76	85	32	54	-	-	387	501	45	48	432	549
Average	93	73	25	17	11	11	-	-	129	101	15	10	144	111

Notes: 1. Bonus figures include any deferred amounts paid in the year and approved figures in respect of the year ended 31 March 2019. 2. 'Other benefits and payments' combines company car benefit in kind, car cash and benefit allowances, fuel allowances, and the taxable value of private medical insurance provision. 3. Pension contributions are payments by the company in respect of money purchase pension schemes.4. These Directors were remunerated either by the immediate parent company, South Staffordshire Plc, or received no remuneration for their services during the year. 5. This Director was an independent Non-executive Director until 25 October 2018, at which date his status changed to a Non-executive Director as an industry partner of Arjun Infrastructure Partners.

Bonus awards

The maximum levels of bonus available to the Managing Director and Executive team are 60% and 40% (average). For the year ended 31 March 2019, the Remuneration Committee awarded average bonus payments of 33% and 24%, reflecting the level of performance of individuals and the company during the year.

As an Executive Director, Phil Newland is due an approved bonus of £59,400 in respect of the performance outlined in this annual report and individual targets in respect of the year ended 31 March 2019, reflecting the performance of the business in the year. This bonus is payable following the year end. It is less than that paid in respect of the previous year, reflecting that operational and financial performance in a number of areas was less than expected.

The bonus awarded to Phil Newland is based on a sliding scale, with the bonus award in each category increasing with performance up to a specified maximum award for excellent performance. In addition, Phil had a number of personal targets to achieve for the year, primarily focused on the development of a high-quality business plan for the five years from 2020 to 2025 and the required customer engagement. Progress has largely been as expected and a bonus of 7.5% of possible 10% has been proposed to be paid.

The following performance against target was achieved during the year.

Standard of performance	Target	Actual	Maximum % of salary awarded
Customer service	Improve SIM and reduce customer complaints	Target partially achieved. Significant improvement in complaints, however upper quartile on SIM not achieved	7.5% of 15%
ODIs	Achieve target for key operational performance	Target partially achieved. Leakage and supply interruptions target achieved, however water quality targets missed	10% of 15%
Financial performance	Achieve profitability, cost and cash generation	Target partially achieved. Profit and cost target not achieved due to additional costs of hot summer weather, however cash generation target achieved	8% of 20%

As discussed earlier in this annual report, an element of the bonus in the year for Adrian Page of £35,000 is specifically linked to the company's performance, including delivering our outcome delivery incentive targets and the development of a high-quality business plan, of which only half is proposed to be paid. This reflects operational performance in the year.

Executive pay ratio

There is increased scrutiny being placed upon the pay for Board members in the water sector (and other public service organisations), particularly when set against that of the lowest paid employees within an organisation. A 20:1 ratio has been discussed within political and social forums as an acceptable maximum multiplier with regards to the gap between the lowest paid employees and highest paid Board member.

The company is committed to paying the foundation living wage to employees. Based on a 37-hour a week contract at £9.00 an hour (2018 rate for outside London), this would give an annual salary of £17,316. All our people, with the exception of our apprentices, are paid at or higher than the foundation rate. In comparison to Phil Newland, the highest paid directly employed Board member, this gives a ratio of 10:1 against basic salary and 15:1 against total remuneration, both of which sit within the 20:1 ratio.

Board effectiveness

In accordance with the SSW Code, the Board's effectiveness is reviewed periodically, and individual Directors' performance is evaluated each year. As we have already noted, we must also demonstrate through our annual reporting how we are meeting Ofwat's principles on Board leadership, transparency and governance. As discussed on page 99 of the annual performance report (part 2 of this document), Ofwat has introduced two new provisions, against which we have to report. These formally come into effect for the 2019/20 reporting year.

The first of these new provisions is that the Board monitors and assesses values and culture to satisfy itself that behaviour throughout the business aligns with the company's purpose, taking action if it finds misalignment. The second is that the Board evaluates its performance each year, taking into account the balance of skills, experience, independence, knowledge and diversity of the Board, along with how stakeholders' needs are addressed and how the company's overarching objectives are met. The outcome of this is reported in our annual report and accounts, with any weaknesses on acted on and explained.

This year, the Chair, supported by the Company Secretary, conducted an internally-facilitated evaluation using a survey of Board members. As part of our commitment to be an early adopter of Ofwat's new principles, the questions in the survey were framed within the context of the areas outlined above. When the evaluation process was complete, the Chair shared the findings with the Board.

As part of the observations, it was noted that there is a culture of openness in the Board's discussions and that many meetings focus on creating better value and improvements for customers. As discussed in our governance report on pages 46 to 62 above, there have been a number of changes in Board membership during 2018/19 and it is noted that the age, diversity and gender balance of the Board has improved. At the same time, we acknowledge that this is an area where we can make further progress as we continue to refresh our Board.

The Board also acknowledged that there are areas where we could do better as a company, including benchmarking our committee structure against best practice. As part of its specific actions, the Board made a commitment to review the findings in more detail at its next strategy day and to consider the links between our culture, purpose and values.

Directors' responsibilities statement

The following statement, which should be read in conjunction with the auditor's statement of its responsibilities, as set out on pages 64 to 71, is made with a view to distinguishing for investors the respective responsibilities of the Directors and of the auditor in relation to the accounts.

The Directors are required by company law, and under Condition I of the Instrument of Appointment by the Secretary of State for the Environment, as a water undertaker under the Water Industry Act 1991, to prepare financial statements for each financial year, which give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss for the financial year. Under company law, the Directors have elected to prepare the financial statements in accordance with UK Generally Accepted Accounting Practice (UK Accounting Standards and applicable law), including FRS 102, 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'.

In preparing the accounts the Directors are required to:

- select suitable accounting policies (see pages 79 to 82) and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the company will continue in business, in which case there should be supporting assumptions or qualifications as necessary; and
- keep proper accounting records, which comply with Condition I.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors have the responsibility for the maintenance and integrity of the company's website. Information published on the Internet is accessible in many countries with different legal requirements. Legislation in the UK governing the preparation and dissemination of the financial statements may differ from legislation in other jurisdictions.

Independent Auditor's report

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTH STAFFORDSHIRE WATER PLC

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of South Staffordshire Water PLC (the 'Company'):
- **give a true and fair view of the state of the company's affairs as at 31 March 2019 and of its profit for the year then ended;**
- **have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and**
- **have been prepared in accordance with the requirements of the Companies Act 2006.**

We have audited the financial statements which comprise:
- the profit and loss account;
- the balance sheet;
- the statement of comprehensive income;
- the statement of changes in equity;
- the cash flow statement;
- the notes to the cash flow statement; and
- the related notes 1 to 26.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Revenue recognition in relation to unbilled revenue • Valuation of the provision for bad and doubtful debts within trade receivables • Classification of costs between operating and capital expenditure
Materiality	The materiality that we used in the current year was £1.9m which was determined on the basis of EBITDA, excluding infrastructure renewals expenditure and amortisation of capital contributions.

Scoping	We have considered which account balances, classes of transactions and disclosures are at greatest risk of misstatement and we designed our audit procedures to specifically address these areas.
Significant changes in our approach	There have been no significant changes to our audit approach for the year ended 31 March 2019.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

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

We have nothing to report in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Revenue Recognition in relation to unbilled revenue	
Key audit matter description	Revenue is made up of the supply of water in the year, together with an estimation of amounts supplied but not yet billed at year end. As disclosed in note 15, as at 31 March 2019, the accrued income recognised is £11.8m (31 March 2018: £11.1m). We have identified a key audit matter in relation to the valuation of accrued income for household metered water customers. For these customers, revenue is recognised based on the value of water supplied with estimates made at an individual customer level and based on historical meter reading data. This is used to estimate consumption since the date of the last invoice (which itself could be estimated), and to determine the unbilled income to be accrued at the year-end date. Significant judgement is required by management in forming these estimates and we considered the risk of inappropriate bias to be a potential area for fraud through possible manipulation of the balance. The accounting policy related to metered water consumption is disclosed in note 1.

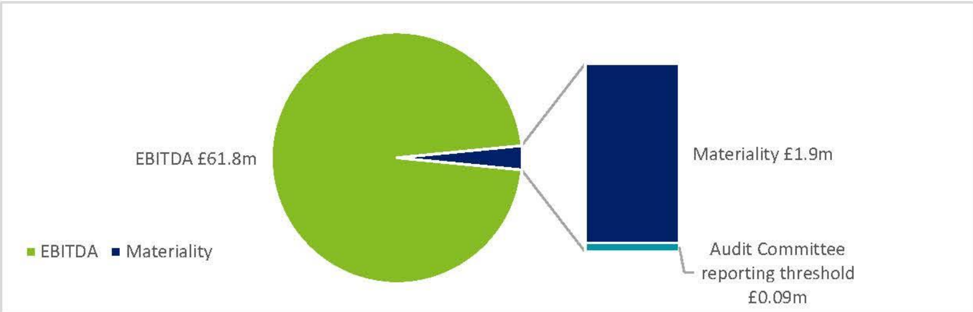
How the scope of our audit responded to the key audit matter	• We have evaluated the design and tested the implementation and operating effectiveness of controls over the recognition of accrued income and general IT controls over the billing system; • Our data specialists have performed a re-calculation of the accrued income balance and assessed the difference to the amount recognised in the accounts; • We have tested the accuracy and completeness of the source data from which the historic billed consumption data is derived; • We have assessed the methodology used by management which forms the estimated consumption data; and • We have reviewed the accounting practices in place in relation to revenue in accordance with FRS 102.
Key observations	Overall, the accrued income calculations and revenue recognition policies are reasonable and consistent with the prior year.
Valuation of the provision for bad and doubtful debts within trade receivables	
Key audit matter description	As disclosed in note 15, the Company holds £14.1m (31 March 2018: £12.6m) of receivables from customers at 31 March 2019, which is stated net of a provision for bad and doubtful debts. The total amount of the provision included within the above, as at 31 March 2019 was £32.2m (31 March 2018: £34.1m). The key estimate is the level of bad debt provision which is recorded against the Company's debtors. The bad debt provision is calculated by management with reference to the anticipated amount of cash that they expect will be collected as a percentage of the amount billed per annum. Management monitor the debt collection profile for each billing year and review the calculation of the bad debt provision to ensure the provision continues to be reasonable relative to recent actual collection experience. Significant judgement is required by management in forming these estimates and we considered the risk of inappropriate bias to be a potential area for fraud of the balance.
How the scope of our audit responded to the key audit matter	• We have evaluated the design and tested the implementation and operating effectiveness of controls over the calculation of the bad debt provision. • We have reviewed and challenged the method used to calculate the bad debt provision to assess whether it is reasonable by considering the most recent collection experience, consistency of the method with prior years and any changes in our understanding of the business; • We have obtained the year end bad debt provision calculation and reviewed the accuracy of management's calculation in the context of historical trends and plans for future collection and to test whether it is calculated in line with the Company's policy; • Our IT specialists have performed procedures to gain assurance over the historical cash collection rates information derived from the billing system; and • We tested the control environment including the IT controls within the accounting system and billing system to ensure that these systems have an effective control environment
Key observations	Overall, the valuation of trade receivables is reasonable.

Classification of costs between operating and capital expenditure	
Key audit matter description	Water companies make a significant investment each year in the infrastructure network and above ground assets, which includes repairs, infrastructure renewals, upgrades on tangible fixed assets and new capital expenditure. Identifying which expenditure represents capital expenditure rather than renewal expenditure may include significant judgement. Property, plant and equipment ("PPE") additions in the year were £44.6m disclosed in Note 11 (31 March 2018: £45.4m). Expenditure in relation to increasing the capacity or enhancing the network is treated as capital expenditure. Capital projects may contain a combination of enhancement and maintenance activity which are not distinct and therefore there is a key audit matter that PPE is valued incorrectly as a result of items of renewal expenditure being misclassified. Due to the level of judgement involved, we have determined that there is a potential for fraud of the balance. The accounting policy related to the classification of costs between operating and capital expenditure is disclosed in note 1.
How the scope of our audit responded to the key audit matter	• We have tested the design, implementation and operating effectiveness of controls over the capitalisation of expenditure; • We selected a sample of capital additions to test that they went through the documented approval process and we agreed amounts capitalised to supporting invoices; • We have reviewed and audited a sample of the assets in the course of construction including a consideration of whether the assets were in use at year end and if they meet the classification criteria; • We have performed a critical assessment and challenge of the process for the capitalisation of internal labour costs and overheads and the assessment of which costs are suitable to be capitalised. A sample of those costs have been selected to test whether they have been appropriately capitalised in accordance with the requirements of FRS 102; and • We have obtained a detailed understanding of a sample of infrastructure renewals to assess whether these have been appropriately allocated as expenses.
Key observations	Overall, we are satisfied that the classification of costs between capital assets and operating expenditure is appropriate.

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality	£1.9m (2018: £1.8m)
Basis for determining materiality	3% (2018: 3%) of earnings before interest, tax, depreciation, amortisation and excluding infrastructure renewals expenditure and amortisation of capital contributions. ('EBITDA, excluding infrastructure renewals expenditure and amortisation of capital contributions').
Rationale for the benchmark applied	We have used EBITDA, excluding infrastructure renewals expenditure and amortisation of capital expenditure as the benchmark for determining materiality as this benchmark is deemed to be a key driver of business value, is a critical component of the financial statements and is a focus for users of those financial statements. This approach is consistent with prior years.



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £93,000 (2018: £91,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our audit was scoped by obtaining an understanding of the entity and its environment, including internal control, and assessing the risks of material misstatement. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated

We have nothing to report in respect of these matters.

in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

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

Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

Identifying and assessing potential risks related to irregularities
In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- enquiring of management, internal audit and the audit committee, including obtaining and reviewing supporting documentation, concerning the company's policies and procedures relating to:
    - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
    - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
    - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations;
- discussing among the engagement team and involving relevant internal specialists, including tax, pensions, IT, financial instruments and industry specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the following areas: Revenue recognition in relation to unbilled revenue, valuation of the provision for bad and doubtful debts within trade receivables and classification of costs between operating and capital expenditure; and
- obtaining an understanding of the legal and regulatory framework that the company operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the company. The key laws and regulations we considered in this context included the UK Companies Act and tax legislation.

Audit response to risks identified

As a result of performing the above, we identified revenue recognition in relation to unbilled revenue, valuation of the provision for bad and doubtful debts within trade receivables and classification of costs between operating and capital expenditure as key audit matters. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters. As a result of performing the above, we did not identify any key audit matters related to the potential risk of fraud or non-compliance with laws and regulations.

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

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of management, the audit committee and in-house legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance and reviewing correspondence with regulatory authorities; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

We have nothing to report in respect of this matter.

Other matters

Auditor tenure

Following the recommendation of the audit committee, we were appointed by the board on 31 July 2002 to audit the financial statements for the year ending 31 March 2003 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 17 years, covering the years ending 31 March 2003 to 31 March 2019.

Consistency of the audit report with the additional report to the audit committee

Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Scott Bayne

Scott Bayne, FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
Leeds
United Kingdom
15 July 2019

Financial statements

Profit and loss account – for the 12 months ended 31 March 2019

	Note	Mar 2019 £'000	Mar 2018 £'000
Turnover	2	128,781	124,082
Operating costs (net)	3	(97,709)	(93,712)
Operating profit		31,072	30,370
Finance charges (net)	7	(12,237)	(11,697)
Profit before taxation		18,835	18,673
Taxation on profit ordinary activities	8	(3,346)	(3,317)
Profit for financial year		15,489	15,356
Earnings per share			
Basic	10	729.5p	723.2p
Diluted	10	729.5p	723.2p

The results above are derived from continuing operations.

The accompanying notes are an integral part of these financial statements.

Balance sheet – as at 31 March 2019

	Note	Mar 2019 £'000	Mar 2018 £'000
Fixed Assets			
Tangible assets	11	531,869	511,021
Current Assets			
Stocks	14	2,366	1,714
Debtors - amounts recoverable within one year	15	47,398	30,407
Debtors - amounts recoverable in more than one year	15	28,424	43,547
Investments	16	2	2
Cash at bank and in hand		764	2,192
		78,954	77,862
Borrowings - amounts falling due within one year	17	-	(2,041)
Other creditors - amounts falling due within one year	17	(58,068)	(59,183)
Net current assets		20,886	16,638
Total assets less current liabilities		552,755	527,659
Borrowings - amounts falling due after more than one year	18	(269,114)	(260,902)
Other creditors - amounts falling due after more than one year	18	(16,590)	(12,727)
Accruals and deferred income - falling due after more than one year	13	(152,310)	(146,496)
Provisions for liabilities - falling due after more than one year	20	(39,732)	(39,336)
Net Assets		75,009	68,198
Capital and reserves			
Called up share capital	21	2,123	2,123
Share premium account		495	495
Capital redemption reserve		4,450	4,450
Revaluation reserve		33,987	34,441
Profit and loss account		40,361	32,842
Hedging reserve		(6,407)	(6,153)
Shareholders' Funds		75,009	68,198

The accompanying notes are an integral part of these financial statements.

The financial statements of South Staffs Water (company number 2662742) were approved by the Board of Directors and authorised for issue on 15 July 2019.

Phil Newland

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

	Mar 2019	Mar 2018
	£'000	**£'000**
Profit on ordinary activities after taxation	15,489	15,356
Movement in hedging reserve (gross of deferred tax)	(306)	1,358
Deferred tax impact of movement in hedging reserve	52	(231)
Total comprehensive income	15,235	16,483

Statement of changes in equity – as at 31 March 2019

	Called up Share Capital	Share Premium Account	Capital Redemption Reserve	Revaluation Reserve	Profit and Loss Account	Hedging Reserve	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Balance at 1 April 2017	2,123	495	4,450	34,894	33,773	(7,280)	68,455
Profit for financial period	-	-	-	-	15,356	-	15,356
Change in value of hedging instruments - cash flow hedges (gross of deferred tax)	-	-	-	-	-	1,177	1,177
Deferred tax impact of change in value of hedging instruments	-	-	-	-	-	(200)	(200)
Amounts recycled to profit and loss (gross of deferred tax)	-	-	-	-	-	181	181
Deferred tax impact of amounts recycled to profit and loss	-	-	-	-	-	(31)	(31)
Amounts transferred to profit and loss	-	-	-	(453)	453	-	-
Total comprehensive income/(loss)	2,123	495	4,450	34,441	49,582	(6,153)	84,938
Dividends (note 9)	-	-	-	-	(16,740)	-	(16,740)
Balance at 31 March 2018	2,123	495	4,450	34,441	32,842	(6,153)	68,198
Balance at 1 April 2018	2,123	495	4,450	34,441	32,842	(6,153)	68,198
Profit for financial period	-	-	-	-	15,489	-	15,489
Change in value of hedging instruments - cash flow hedges (gross of deferred tax)	-	-	-	-	-	(484)	(484)
Deferred tax impact of change in value of hedging instruments	-	-	-	-	-	82	82
Amounts recycled to profit and loss (gross of deferred tax)	-	-	-	-	-	178	178
Deferred tax impact of amounts recycled to profit and loss	-	-	-	-	-	(30)	(30)
Amounts transferred to profit and loss	-	-	-	(454)	454	-	-
Total comprehensive income/(loss)	2,123	495	4,450	33,987	48,785	(6,407)	83,433
Dividends (note 9)	-	-	-	-	(8,424)	-	(8,424)
Balance at 31 March 2019	2,123	495	4,450	33,987	40,361	(6,407)	75,009

Cash flow statement

As at 31 March 2019

	Note	Mar 2019 £'000	Mar 2019 £'000	Mar 2018 £'000	Mar 2018 £'000
Cash inflow from operating activities			50,934		47,591
Corporation tax paid			(2,069)		(1,933)
Net cash inflow from operating activities	(a)		48,865		45,658
Cash flows from investing activities					
Purchase of tangible fixed assets		(44,251)		(46,547)	
Proceeds from sale of tangible fixed assets		567		527	
Proceeds from disposal of assets to fellow group undertaking		-		8,400	
Capital contributions received		8,515		10,047	
Part repayment of long-term balance with group undertaking		-		(8,992)	
Interest received		2,545		2,545	
Net cash outflow from investing activities			(32,624)		(34,020)
Cash flows from financing activities					
Interest paid		(9,638)		(8,881)	
Equity dividends paid		(8,424)		(16,740)	
(Repayment)/draw down of bank loans		(2,050)		2,050	
Additions to bank term loans		2,443		5,402	
Net cash outflow from financing activities			(17,669)		(18,169)
Decrease in cash			(1,428)		(6,531)
Cash or cash equivalents at the beginning of the year			2,192		8,723
Cash or cash equivalents at the end of the year			764		2,192

Purchase of tangible fixed assets relates to the cash paid out in the year in relation to fixed asset additions. The difference in what was paid £44,251,000 and additions reported in the fixed asset note 11 of £44,602,000 is due to an increase in year of creditors relating to capital purchases of £351,000.

Notes to the cash flow statement

(a) Reconciliation of operating profit to net cash inflow from operating activities

	Mar 2019		Mar 2018	
	£'000	**£'000**	**£'000**	**£'000**
Total operating profit		31,072		30,370
Depreciation	23,654		22,660	
Amortisation of capital contributions	(2,701)		(2,413)	
Profit on disposal of tangible fixed assets	(663)		(499)	
		20,290		19,748
(Increase)/decrease in stocks	(652)		34	
Increase in debtors	(1,868)		(6,538)	
Increase in creditors	2,092		3,977	
Cash inflow from operating activities		(428)		(2,527)
Corporation tax paid		(2,069)		(1,933)
Net cash inflow from operating activities		48,865		45,658

(b) Reconciliation in movement in net debt

	Mar 2019	**Mar 2018**
	£'000	**£'000**
Decrease in cash	(1,428)	(6,531)
Movements in finance lease (non-cash)	-	218
Draw down of bank loans (cash)	(393)	(7,452)
Bank term issue cost amortisation (non-cash)	45	(38)
Movement on index-linked debt (non-cash)	(5,823)	(5,618)
Increase in net debt in year	(7,599)	(19,421)
Net debt brought forward	(260,751)	(241,330)
Net debt carried forward	(268,350)	(260,751)

Notes to the cash flow statement (continued)

	Balance at 1 Apr 2018 £'000	Cash Flow £'000	Non-Cash Movements £'000	Balance at 31 Mar 2019 £'000
Cash at bank and in hand	2,192	(1,428)	-	764
Short-term bank loans	(2,041)	2,050	(9)	-
	151	622	(9)	764
Irredeemable debenture stock	(1,652)	-	-	(1,652)
Bank loans (net of issue costs)	(35,318)	(2,443)	54	(37,707)
Index-linked debt (net of issue costs and including premium)	(223,933)	-	(5,823)	(229,755)
Net debt	(260,751)	(1,821)	(5,778)	(268,350)

It is noted that the covenant net debt value as opposed to the book net debt value is used by stakeholders, including investors, lenders and rating agencies, to monitor key financial metrics such as the net debt/RCV as shown above.

	31 Mar 2019 £'000	31 Mar 2018 £'000
Book net debt (as reported above)	(268,350)	(260,751)
Exclude book premium on issue of index linked debt	13,447	13,768
Difference between long-term RPI assumption and actual RPI inflation	7,673	7,840
Exclude unamortised issue costs	(1,819)	(1,814)
Exclude accrued interest	215	209
Net debt reported for borrowing covenants	(248,834)	(240,748)
Regulatory Capital Value	380,092	364,318
Covenant Net Debt/Regulatory Capital Value	65.5%	66.1%

Notes to the financial statements

1. Statement of accounting policies

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and to the preceding year.

The company meets the definition of a qualifying entity under FRS 102 and has therefore taken advantage of the disclosure exemptions available to it in respect of its related parties, financial instruments and remuneration of key management personnel. South Staffs Water is consolidated in the financial statements of its ultimate holding company in the UK company, Hydriades IV Limited, which may be obtained from Companies House in the UK. The holding company's registered address is Green Lane, Walsall, West Midlands, WS2 7PD.

a) General information and basis of accounting

Although South Staffs Water is not publicly listed, its Board of Directors recognises that because of public interest in how the company performs and the regulated environment in which it operates, it should act as if it were. It is incorporated in the UK under the Companies Act 2006 and is registered in England and Wales. The address of the registered office is Green Lane, Walsall, West Midlands, WS2 7PD. The nature of the company's operations and its principal activities are set out in the strategic report on pages 2 to 39. The financial statements have been prepared under the historical cost convention, modified to include certain items at fair value, and in accordance with FRS 102 issued by the Financial Reporting Council. The functional currency of the company is considered to be pounds sterling because that is the currency of the primary economic environment in which the company operates.

b) Turnover

Turnover comprises the value of sales (excluding VAT and similar taxes) of goods and services in the normal course of business. For water supplied, turnover includes amounts billed for water supplied in the year together with an estimation of amounts supplied but unbilled at the year end. Further information on the company's revenue recognition policy is shown on page 121 of the annual performance report. Other income includes rental income, which is recognised over the term of the lease.

c) Tangible fixed assets and depreciation

Tangible fixed assets comprise infrastructure assets (water mains, impounding and pumped raw water storage reservoirs and dams), operational structures (pumping stations, treatment stations, boreholes and service reservoirs) and other assets.

Infrastructure assets

Infrastructure assets comprise a network of systems, including two regional network assets, that, as a whole, are intended to be maintained in perpetuity at a specified level of serviceability by the continuing replacement and refurbishment of their components. Expenditure on infrastructure assets relating to increases in capacity or enhancements of the networks is treated as additions which are capitalised at cost.

IRE, the annual expenditure required to maintain the operating capability of the network, is not capitalised within tangible fixed assets, but is expensed within operating costs for the year. In accordance with FRS 102, new infrastructure assets are depreciated over their useful economic life of 100 years.

The deemed cost of existing infrastructure assets determined as part of the transition to FRS 102 gave rise to a revaluation reserve of £36m, net of deferred tax, which is being depreciated on a straight-line basis over the estimated remaining economic life of 80 years.

Operational structures and other fixed assets

Operational structures and other fixed assets are stated at cost less accumulated depreciation and provisions for impairment. Depreciation is provided on a straight-line basis to write off the cost, less estimated residual value, over the estimated useful lives of the assets, with the exception of land, which is not depreciated. Assets in course of construction are not depreciated until commissioned. The estimated useful lives of the assets are as follows.

Boreholes, mains and dams:	100 yrs
Buildings and service reservoirs:	50–80 yrs
Fixed plant:	20–30 yrs
Meters:	15 yrs
Mobile plant:	5 yrs
Office equipment:	5–7 yrs
Motor vehicles:	3–7 yrs

d) Capital contributions

Capital contributions, including those in respect of infrastructure assets, are treated as deferred income and released to operating costs over the useful lives of the assets concerned.

e) Leased assets

Assets financed by leasing agreements, which transfer substantially all of the risks and rewards of ownership to the company, are included within fixed assets, and the net obligation to pay future rentals is included in creditors. Rentals are apportioned between finance charges and a reduction of the outstanding liability for future rentals so as to produce a constant charge to the profit and loss account based upon the capital outstanding.

f) Stocks

Stocks and work in progress are valued at the lower of cost and net realisable value. Cost includes materials and an appropriate element of overheads. Provision is made for obsolete, slow-moving or defective items where appropriate.

g) Pensions

For the defined contribution schemes the amount charged to the profit and loss account is the contributions payable in the year. Both sections of the defined benefit scheme (South Staffs and Cambridge) are closed to new entrants and have ceased future accruals. In accordance with the agreed policy in the company and the Group, as the scheme is a multi-employer scheme with deferred members of the scheme also being employees of other Group companies, the company is not able to identify its share of the scheme's assets and liabilities on a reasonable and consistent basis. Therefore, in accordance with the stated policy the amount charged to the company's profit and loss account is equivalent to the deficit contributions payable in the year by the company with the profit and loss items, actuarial gains and losses and assets and liabilities relating to the scheme being accounted for in the accounts of South Staffordshire Plc, the immediate holding company.

h) Research and development

Research and development is charged to the profit and loss account in the year in which it is incurred.

i) Taxation

Current tax is charged on estimated taxable profits at the current rate.

Deferred taxation is provided in respect of capital allowances in excess of depreciation and all other timing differences that have originated but not reversed at the balance sheet date using the future rate of tax anticipated at the time of reversal based on legislation changing rates enacted or substantively enacted at the balance sheet date.

j) Financial instruments

Financial assets

All financial assets, being cash and cash equivalents, trade debtors and loans receivable are measured at amortised cost. Cash and cash equivalents comprise cash at bank and in hand and short-term deposits.

Financial liabilities

Financial liabilities are initially measured at fair value and subsequently measured at amortised cost. The premium/discount and costs of issue are amortised over the life of the instrument, with the amortisation being included in the effective interest rate of the instrument which is included in finance charges (net) in the profit and loss account.

k) Hedge accounting

The company has entered into derivative financial instruments to hedge exposure to floating interest rates. These derivative financial instruments are recorded on the balance sheet at fair value on inception and at each balance sheet date. Movements in fair value are recorded in the profit and loss account except where the company has adopted hedge accounting.

The company designates certain hedging instruments as cash flow hedges. At inception of the hedge relationships, the company documents the relationships between the hedging instruments and the hedged items along with the company's risk management strategy and objectives in relation to each hedge. At the inception of the hedges, and on an ongoing basis, the company documents whether the hedging instruments are highly effective in offsetting changes in cash flows of hedged items.

The effective proportion of changes in fair value of hedging instruments that are designated and qualify as cash flow hedges are deferred in equity in a hedging reserve net of deferred tax. The gain or loss relating to the ineffective proportion is recognised immediately in the profit and loss account. Hedge accounting is discontinued when the company de-designates the hedging relationships, the hedging instruments expire, are terminated or are sold, or they no longer qualify for hedge accounting. Amounts deferred in the hedging reserve are recycled to the profit and loss account in the periods when the hedged items are recognised in the profit and loss account. When forecast transactions are no longer expected to occur, the cumulative gains or losses are recognised immediately in the profit and loss account.

l) Dividends

Dividends are recognised if they have been paid or if they have been approved by the company's Board and investors before the period end.

m) Exceptional items

The company separately presents certain items on the face of the profit and loss account as exceptional. Exceptional items are material items of income or expense that, because of their size or incidence, are presented separately to allow an understanding of the company's financial performance and comparison to the prior year. They are not expected to be incurred on a recurring basis.

Principal accounting judgements, estimates and assumptions

In the application of the accounting policies, which are described above, the Directors are required to make judgements, estimates and assumptions in respect of the carrying amounts of assets and liabilities recognised in the financial statements. These are based on historical experience, future forecasts and other factors that are considered to be relevant. It is recognised that historical experience and forecasts change over time and these judgements, estimates and assumptions are therefore reviewed and amended where necessary on a regular basis. However, it is also recognised that the actual outcomes may still differ to the judgements, estimates and assumptions made. Provided below are details of the principal accounting judgements, estimates and assumptions that the Directors have made when applying the company's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

The more significant judgements were:

Hedge accounting

In applying the company's interest rate hedging strategy and the corresponding hedge accounting applied in the financial statements a judgement has been made that there will be highly probable floating interest rate payments over the term of the interest rate derivatives. Underlying this judgement is the assessment that the future refinancing of bank facilities is highly probable. The basis for this judgement includes:

- the company's long-term 25-year water supply licence;
- its related long-term business model and regulated asset base;
- its ability to access capital markets, including the bank debt market;
- its strong investment grade credit rating; and
- the stability and predictability of the regulated UK water sector as a whole.

Tangible fixed assets – determining costs which are capital in nature

Judgement is required to determine whether costs incurred when work is carried out on company assets are capital or revenue in nature. This work includes:

- repairs;
- like-for-like replacement;
- new assets; or
- replacement of assets with an element of asset enhancement or increased capacity.

Identifying which element of expenditure represents capital expenditure rather than revenue expenditure may include judgement that the company's two regional infrastructure networks each represent single infrastructure assets. In order to apply the appropriate accounting, a judgement is made as to whether it is probable that the expenditure will generate future economic benefits and also if the costs can be measured reliably.

The key accounting estimates were:

Accrued income

An estimate of water consumption by metered customers since the date of the last water bill and an estimate of the corresponding income that remains unbilled at the end of the year (accrued income) is required to be made each year. This estimate uses a historical water consumption rate for each customer from the company's billing system and applies this consumption rate to the unbilled period and the related tariff to estimate unbilled income for that period. The accrued income for metered customers as at 31 March 2019 was £11,786,000 (2018: £11,132,000).

Amortised cost of index-linked borrowings

In order to record the company's index-linked borrowings at amortised cost an estimate of the long-term average inflation rate (Retail Price Index – or RPI) per annum is required to be made. In forming this estimate, financial market data such as the long-term yields for fixed-rate and index-linked (RPI) gilts is obtained and considered with the difference between these yields being the market implied long-term inflation assumption. The net book value of index-linked borrowings as at 31 March 2019 was £229,755,000 (2018: £223,933,000).

Bad and doubtful debt provision

The recoverability of trade debtors, and therefore the amount of bad and doubtful debt provision held against trade debtors in the balance sheet at each year end, requires judgement. This judgement requires consideration of the historical and forecast debt collection rates in respect of different categories of customers and trade debt, usually calculated as a percentage of the total amount billed in each year. This information is used to estimate the level of debt outstanding at the end of the year which is expected to be irrecoverable after following the processes of collection that the company adopts. This estimate represents the appointed year end bad and doubtful debt provision, which was £32,193,000 as at 31 March 2019 (2018: £34,123,000).

Tangible fixed assets – assessment of useful economic lives

There is a requirement to estimate the useful economic lives of the company's tangible fixed assets in order to depreciate the cost or deemed cost of these assets and make an appropriate charge to the profit and loss account over that period for each asset. This estimate is based on a combination of engineering data, experience of similar assets and on the company's forecast replacement or rehabilitation cycle and its investment plan. Industry practice is also considered as part of the overall estimate of asset lives.

The total net book value of tangible fixed assets as at 31 March 2019 was £531,869,000 (2018: £511,021,000).

2. Segmental information

The Directors consider that the company operates substantially in the UK in one class of business, that being water supply. No analysis of turnover, profit before tax or net assets, by geographical area or class of business, is considered necessary. Revenue from UK operations in the year was £128,781,000 (2018: £124,082,000).

3. Operating costs (net)

	Mar 2019 £'000	Mar 2018 £'000
Operating costs (net) were as follows:		
Other operating income (see note 6)	(1,137)	(1,250)
Raw materials and consumables	5,085	4,656
Staff costs (see note 4)	19,573	20,233
Own work capitalised	(8,588)	(8,399)
Depreciation : non-infrastructure assets	19,839	19,105
Depreciation : infrastructure assets	3,815	3,555
Infrastructure renewals expenditure (net of contributions)	9,807	10,078
Amortisation of capital contributions	(2,701)	(2,413)
Other operating costs	52,016	48,147
	97,709	93,712

Auditor remuneration is analysed as follows:

	Mar 2019 £'000	Mar 2018 £'000
Fees payable to the company's auditor for the audit of the company's annual accounts	87	73
Other services pursuant to legislation	34	33
	121	106

There are £16,000 of non-audit services payable in the period (2018: £16,000).

4. Staff costs

	Mar 2019 £'000	Mar 2018 £'000
Wages and salaries	15,788	15,528
Social security costs	1,587	1,572
Pension costs (see note 22)	2,198	3,133
	19,573	20,233

	Mar 2019 Number	Mar 2018 Number
Monthly average number of employees	420	410

5. Directors' remuneration

	Mar 2019 £'000	Mar 2018 £'000
Emoluments	379	344
Pensions	21	21
	400	365

The highest paid directly-employed Director received emoluments of £253,000 (2018: £244,000) and received a contribution of £21,000 (2018: £21,000) paid by the company in respect of defined contribution pension schemes during the year.

During the year and the prior year, certain Directors received no emoluments as Directors of the company. These Directors were remunerated by the immediate parent company, South Staffordshire Plc, (or received no remuneration for their services) and the total of their emoluments received during the year was £363,000 (2018: £352,000). Contributions in respect of money purchase pension schemes for these Directors was £63,000 (2018: £58,000).

No Directors (2018: nil) who held office at the end of the year were accruing benefits due in the year under a defined benefit pension scheme and two Directors (2018: two) were contributing members under a money purchase scheme.

The remuneration report on pages 58 to 62 gives further detail around the remuneration of the Directors and Executive team.

6. Other operating income

	Mar 2019 £'000	Mar 2018 £'000
Profit on disposal of fixed assets	663	499
Rental income	474	751
	1,137	1,250

7. Finance charges (net)

	Mar 2019 £'000	Mar 2018 £'000
Interest payable and similar charges:		
Index-linked debt (cash)	7,604	7,385
Index-linked debt (non-cash)	5,822	5,618
Bank loan and other interest	1,110	991
Debenture interest	68	67
	14,604	14,061
Interest receivable:		
Loans to parent undertakings	(2,545)	(2,545)
	12,059	11,516
Other finance charges:		
Amounts recycled from hedging reserve	178	181
	12,237	11,697

8. Taxation on profit on ordinary activities

	Mar 2019 £'000	Mar 2018 £'000
Current tax:		
UK corporation tax at 19% (2018: 19%)	3,321	3,533
Adjustments in respect of prior periods	(423)	(4,787)
Total current tax charge/(credit)	2,898	(1,254)
Deferred tax:		
Origination and reversal of timing differences	361	254
Adjustments in respect of prior periods	87	4,317
Total deferred tax charge	448	4,571
Total tax charge	3,346	3,317
Tax included in statement of comprehensive income		
Deferred tax:		
Movement in hedging reserve	(52)	231
Total tax charge	(52)	231

Factors affecting the total tax charge

The tax assessed on the profit on ordinary activities for the year is lower than the standard rate of corporation tax in the UK of 19% (2018: 19%). The differences are reconciled below.

	2019 £'000	2018 £'000
Profit on ordinary activities before tax	18,835	18,673
Profit on ordinary activities multiplied by standard UK corporation tax rate of 19% (2018: 19%)	3,579	3,548
Expenses not deductible for tax purposes (net)	145	269
Deferred tax provided at lower rate	(42)	(30)
Adjustments in respect of prior years	(336)	(470)
Total tax charge	3,346	3,317

Factors that may affect the future tax charge

A reduction in the future UK corporation tax rate from 18% to 17% was substantively enacted in October 2016 and will take effect in April 2020.

Deferred tax has been recognised at 17% on the basis of the expected reversal period.

No deferred tax has been recognised on capital gains rolled over against the cost of acquisition of certain property and structures owned by the company. The gains will come into charge if the assets are sold and not replaced by suitable qualifying assets. As the properties are essential assets of the water supply business it is regarded as unlikely that the gains will come into charge.

The potential deferred tax amounts to £1,858,000 (2018: £1,858,000).

9. Dividends paid

	Mar 2019 £'000	Mar 2018 £'000
Equity Interests		
Ordinary Dividends paid of 396.8p (2018: 788.4p) per share	8,424	16,740

In 2019, the dividend comprised:

- £3,486,000 from the appointed business (2018: £5,000,000);
- £2,393,000 from the non-appointed business (2018: £1,340,000); and
- £2,545,000 from intra-group interest to be paid back to the company (2018: £2,000,000).

In the year ended 31 March 2018, there was also a one-off payment of £8,400,000 from the proceeds of the sale of the non-household retail business. Further details of the dividend paid in the year are provided on page 28 of the strategic report.

10. Earnings per share

The calculation of earnings per share is based on the profit on ordinary activities after taxation divided by the weighted average number of shares in issue during the year.

The calculations of earnings per share are based on the following profits and number of shares.

	Mar 2019 £'000	Mar 2018 £'000
Profit on ordinary activities after taxation and profit for earnings per share	15,489	15,356

	Mar 2019 Number of Shares	Mar 2018 Number of Shares
Weighted average number of shares for basic and diluted earnings per share	2,123,210	2,123,210

11. Tangible fixed assets

	Specialised Operational Assets	Non Specialised Operational Assets	Infrastructure Assets	Other Tangible Assets	Total
	£'000	£'000	£'000	£'000	£'000
Cost					
At 1 April 2018	222,696	23,238	469,948	205,170	**921,052**
Transfers	1,000	(1,946)	-	946	**-**
Additions	14,209	20	11,853	18,520	**44,602**
Disposals	-	(107)	-	(485)	**(592)**
At 31 March 2019	**237,905**	**21,205**	**481,801**	**224,151**	**965,062**
Depreciation					
At 1 April 2018	100,541	7,584	181,494	120,412	**410,031**
Charge for the year	6,800	217	3,815	12,823	**23,655**
Disposals	-	(23)	-	(470)	**(493)**
At 31 March 2019	**107,341**	**7,778**	**185,309**	**132,765**	**433,193**
Net Book Value					
At 31 March 2019					
Owned	130,214	13,427	296,492	91,103	**531,236**
Leased	350	-	-	283	**633**
	130,564	**13,427**	**296,492**	**91,386**	**531,869**
Net Book Value					
At 31 March 2018					
Owned	121,802	15,654	288,454	84,476	**510,386**
Leased	353	-	-	282	**635**
	122,155	**15,654**	**288,454**	**84,758**	**511,021**

Tangible fixed assets financed by leasing and hire-purchase contracts amounted to £7,375,000 (2018: £7,375,000) less accumulated depreciation of £6,742,000 (2018: £6,739,000).

Tangible fixed assets include freehold land of £2,337,000 (2018: £2,337,000) which is not subject to depreciation.

Tangible fixed assets in the course of construction or commissioning included in the above table had a cost of £31,341,124 at 31 March 2019 (2018: £36,537,000).

12. Commitments

Capital commitments outstanding at 31 March 2019 were £7,501,000 (2018: £10,572,000).

13. Capital contributions – accruals and deferred income

	Infrastructure Assets	Other Assets	Total
	£'000	£'000	£'000
Balance at 1 April 2018	136,388	10,108	146,496
Capital contributions received	5,728	2,787	8,515
Amortised in year	(1,716)	(985)	(2,701)
Balance at 31 March 2019	**140,400**	**11,910**	**152,310**

An amount included in the above balance is expected to be amortised in the next year. However, due to the varied timing of receipts, the movement of associated projects from work in progress to completion, and general changes in the work carried out as part of the capital programme, this balance has not been segregated.

14. Stocks

	Mar 2019	Mar 2018
	£'000	£'000
Raw materials and consumables	2,366	1,714

Stock is stated at lower of cost and net realisable value. There is no material difference between the balance sheet value of stocks and their replacement costs.

15. Debtors

	Mar 2019	Mar 2018
	£'000	£'000
Amounts recoverable within one year:		
Trade debtors	14,143	12,554
Other debtors	73	80
Amounts due from other group undertakings	1,916	1,916
Amounts due from parent undertakings	15,443	364
Prepayments and accrued income	15,823	15,493
	47,398	30,407
Amounts recoverable in more than one year:		
Loans receivable from parent undertakings	25,000	40,000
Other amounts due from parent undertakings	3,424	3,547
	28,424	43,547
	75,822	73,954

Amounts due from parent undertakings was £43,867,000 (2018: £43,911,000). Amounts of £40,000,000 are considered as loans, with £25,000,000 (2018: £25,000,000) identified as loans with no fixed repayment date and £15,000,000 (2018: £15,000,000) due to be repaid by March 2020. On 28 May 2019, this was repaid in full. These loans attract interest with 7% for the £25,000,000 loan and 5.3% for the £15,000,000 loan.

Detail of provision against bad debt are shown in note 23 on page 96.

16. Investments

	Mar 2019 £'000	Mar 2018 £'000
Investments	2	2

The balance represents the cost of investment of £1,596 related to 798 'A' ordinary shares and 8% of unsecured loan stock of WRc PLC, a research-based group, providing consultancy in the water, waste and environment sectors, incorporated in England and Wales.

17. Creditors – amount falling due within one year

	Mar 2019 £'000	Mar 2018 £'000
Bank loans (unsecured and net of issue costs)	-	2,041
Borrowings	-	2,041
Payments received in advance	22,369	22,014
Trade creditors	18,073	18,767
Other creditors	7,778	7,812
Amounts owed to other group undertakings	7,507	8,554
Corporation tax payable	1,745	916
Other taxation and social security	596	1,120
Creditors	58,068	59,183
	58,068	61,224

Included within amounts falling due within one year for the year ended 31 March 2018 was the gross bank loans (unsecured) of £2,050,000 used for covenant reporting purposes but, in accordance with FRS 102, is stated above net of unamortised issue costs. This matured in March 2019 and the company entered a further facility of £15,000,000, which is shown in note 18.

18. Creditors – amount falling due after more than one year

	Mar 2019	Mar 2018
	£'000	£'000
Irredeemable debenture stock (unsecured) (note 19)	1,633	1,633
Perpetual debenture stock (unsecured)	19	19
Bank loans (unsecured and net of issue costs):		
payable between one and two years	29,967	-
payable between two and five years	7,740	35,318
Retail Price Index-linked debt (unsecured)	229,755	223,933
Borrowings	269,114	260,902
Payments received in advance	3,716	-
Other creditors	9,417	9,754
Amounts owed to other group undertakings	1,304	1,304
Derivative financial liabilities	2,153	1,669
Creditors	16,590	12,727
	285,704	273,629

The gross bank loans (unsecured) of £37,844,000 (2018: £35,402,000) included in amounts falling due after more than one year is used for covenant reporting purposes but, in accordance with FRS 102, is stated above net of unamortised issue costs. These consist of:

- three loans at a total of £30,000,000 (2018: £30,000,000), which mature in December 2020;
- a facility of £10,000,000 of which £2,544,000 (2018: £5,402,000) was drawn; and
- another facility of £15,000,000 of which £5,300,000 (2018: £nil) was drawn at 31 March 2019, maturing in March 2023 and March 2024, respectively. The value of bank loans over five years is nil.

Derivative financial liabilities represent the market value (obtained from a third party) of floating to fixed rate interest rate swaps designated as cash flow hedges.

The book value index-linked debt of £229,755,000 (2018: £223,933,000) is stated above at amortised cost in accordance with FRS 102. The indexed principal of £210,097,000 (2018: £203,835,000) is used for borrowing covenant reporting purposes. Details of the terms of our index-linked debt is shown in note 23 on page 93.

19. Irredeemable debenture stock

	Mar 2019	Mar 2018
	£'000	£'000
3.5%	476	476
4.0%	627	627
5.0%	500	500
	1,603	1,603
Net premium on irredeemable debenture stock	30	30
	1,633	1,633

20. Provisions for liabilities

	Deferred Taxation £'000
At 1 April 2018	39,336
Charged to profit and loss account	448
Credit to other comprehensive income	(52)
At 31 March 2019	39,732

Analysis of deferred tax	Mar 2019 £'000	Mar 2018 £'000
Accelerated Capital Allowances	41,199	40,592
Timing differences in respect of hedging reserves	(1,312)	(1,260)
Timing differences in respect of finance charges	(169)	(174)
Other timing differences	14	178
Provision for deferred tax	39,732	39,336

Deferred tax assets and liabilities are offset only where the company has a legally enforceable right to do so and where the assets and liabilities relate to taxes levied by the same taxation authority.

21. Share capital

	Mar 2019 £'000	Mar 2018 £'000
Authorised:		
8,800,000 Ordinary shares of £1 each	8,800	8,800
Allotted, called-up and fully-paid:		
2,123,210 Ordinary shares of £1 each	2,123	2,123

22. Pension retirement benefits

The company operates a number of funded pension schemes for the benefit of its employees. It participates in the Water Companies Pension Scheme, by way of separate sections (the South Staffordshire section and the Cambridge section), which provides benefits based on pensionable pay.

The schemes were closed to all future benefit accrual with effect from 1 April 2015 and as such only funding deficit contributions are now being paid by the company into the schemes. During the year ended 31 March 2019 the funding into the schemes was made indirectly through the parent company. This was to the value of £1,350,000 (2018: £1,814,000 for the South Staffordshire section and £442,000 for the Cambridge section).

The assets and liabilities of the South Staffordshire section of the scheme are accounted for in the accounts of the immediate parent undertaking, South Staffordshire Plc. The assets and liabilities for the Cambridge section of the scheme are accounted for within Cambridge Water PLC.

In addition, the company participates in a defined contribution Money Purchase Pension Scheme. The assets of all schemes are held separate from those of the company, and are invested by fund managers.

The contributions to the defined contribution scheme is charged against profits as incurred with the amount for the year ended 31 March 2019 being £848,000 (2018: £877,000).

Additional disclosures regarding the defined benefit pension scheme are required by FRS 102. The latest actuarial valuation of the South Staffordshire section of the scheme as at 31 March 2019, prepared for the purposes of the consolidated financial statements of the parent company under FRS 102 rather than on the actuarial basis used for funding purposes, shows a surplus before deferred tax of £52,400,000 (2018: surplus of £52,974,000). The market value of the assets in this section of the scheme and the present value of the liabilities in the scheme that were accounted for in the parent company at the balance sheet date were as follows.

	Mar 2019 Valuation £'000	**Mar 2018 Valuation £'000**	**Mar 2017 Valuation £'000**
Growth assets including equities and diversified growth funds	2,844	25,066	91,736
High yield bonds/gilts and liability driven investments	202,862	187,406	136,390
Emerging markets multi-asset funds	20,097	19,941	16,937
Cash	886	1,599	769
Market value of assets	226,689	234,012	245,832
Present value of scheme liabilities	(174,289)	(181,038)	(213,658)
Surplus in the scheme before deferred tax	52,400	52,974	32,174
Related deferred tax liability	(8,908)	(9,006)	(5,470)
Surplus after deferred tax	43,492	43,968	26,704

23. Financial assets and financial liabilities

The analysis of the company's financial assets and liabilities included below includes:

- cash;
- loans receivable;
- borrowings;
- trade creditors; and
- trade debtors.

Borrowings represent:

- bank loans;
- finance lease obligations;
- index-linked borrowings; and
- irredeemable and perpetual debenture stock.

The main purpose of these financial instruments is to finance the company's operations. It is, and has been throughout the period under review, the company's policy that no trading in financial instruments shall be carried out. The company's policy in respect of cash, loans receivable and borrowings is to maintain flexibility with both long- and short-term debt while not exposing the company to significant risk of market movements (see below). The company is not exposed to any material foreign exchange risk.

Bank loans bear interest that is linked to LIBOR plus a bank margin which is applied to the drawn down element of each loan, some of which are hedged through interest rate swaps.

Interest rate risk profile – borrowings

The interest rate profile of the borrowings (stated at book value) of the company as at 31 March 2019 was as follows.

	Fixed rate financial liabilities £'000	Floating rate financial liabilities £'000	Retail Price Index-Linked debt £'000
31 March 2019	31,619	7,740	229,755
31 March 2018	31,600	7,410	223,933

Floating rate loans that are hedged by the floating to fixed interest rate swaps are shown above as fixed rate. The company's cash balances earn interest at floating rates linked to LIBOR or the Bank of England base rate. The company's trade debtors and trade creditors are not subject to interest unless considered to be overdue. For all financial assets and liabilities, the book values and fair values are not materially different, except for the RPI-linked loan and the RPI-linked bond shown in the table below.

	Mar 2019 £'000	Mar 2018 £'000
Retail Price Index-Linked Loan		
Un-indexed Loan Value	111,400	111,400
Indexed/Covenant Loan Value	163,786	158,669
Book Value	180,896	176,447
Fair Value	356,124	328,808
Retail Price Index-Linked Bond		
Un-indexed Bond Value	35,000	35,000
Indexed/Covenant Bond Value	46,312	45,166
Book Value	48,859	47,486
Fair Value	60,270	59,686

Fixed-rate borrowings

	Weighted average interest rate %	Weighted average period for which rate is fixed Years
31 March 2019	2.8	1.8
31 March 2018	2.8	2.8

Borrowing facilities

The company has various borrowing facilities available to it. The undrawn committed facilities available at 31 March 2019 in respect of which all conditions precedent have been met were as follows.

	Mar 2019 £'000	Mar 2018 £'000
Expiring in one year or less	-	12,950
Expiring in more than two years but not more than five years	17,156	4,598
	17,156	17,548

In addition to the above at 31 March 2019, the company had cash balances of £764,000 (2018; £2,192,000) increasing liquidity headroom, to £17,920,000 (2018: £19,740,000).

The company is confident it has sufficient access to capital markets and relationships with banks and other lenders to refinance borrowing facilities that mature within 12 months of approval of the annual report and accounts.

Financial risks

The company's activities result in it being subject to a limited number of financial risks, principally credit risk as the company has financial assets receivable from third parties. Management of financial risks focuses on reducing the likely impact of these risks to a level that is considered acceptable. The company has formal principles for overall risk management, as well as specific policies to manage individual risks.

1) Interest rate risk

Interest rate risk arises from borrowings issued at floating rates including those linked to LIBOR and the RPI that expose the company's earnings and cash flows to changes in LIBOR and RPI. Risks of increases in LIBOR are managed by limiting the value and proportion of the company's borrowings that are linked to this variable and by entering into floating to fixed rate swap contracts. Risks associated with increases in RPI are effectively hedged against the revenues and the RCV of the regulated water business, both of which are also linked to RPI.

2) Credit risk

As is market practice, the company grants customers credit on amounts due for the services it supplies, leading to limited risk over the recovery of the amounts receivable from these customers. Full details of the way this risk is managed are provided below. Credit risk also includes the risk of over-recovery of loans receivable. This risk is managed by ensuring that loans are only made to entities with sufficient financial resources to both service and repay the loans.

3) Liquidity risk

Liquidity risk represents the risk of the company having insufficient liquid resources to meet its obligations as they fall due. The company manages this risk by regularly monitoring actual and forecast cash flows and ensuring that the payment of its obligations are at least matched with cash inflows and availability of adequate banking facilities, including sufficient headroom. The table above details the undrawn committed borrowing facilities available to the company to manage this risk.

Sensitivity analysis

The following analysis illustrates the sensitivity to reasonably possible movements during the year, in variables affecting financial liabilities, being LIBOR and the long-term forecast for RPI on the company's pre-tax profit and loss account for the year ended 31 March 2019. There is no impact on reserves other than the impact on the profit and loss account after tax.

	Mar 2019 £'000	Mar 2018 £'000
RPI +0.25%	(553)	(527)
RPI -0.25%	553	527
LIBOR +1.00%	(198)	(206)
LIBOR -1.00%	198	206

We have chosen a long-term RPI forecast change of +/- 0.25% as "reasonably possible movements" in the year as a good estimate for possible variations in the long-term forecast RPI over the period based on market data. LIBOR has remained at particularly low and stable levels over recent years, and +/- 1.0% is reasonable.

The impact on the pre-tax profit and loss account for 2019 detailed above has been calculated by assuming that the illustrated changes to the variables occurred on 1 April 2018 and remained different to the actual variables recorded by the stated amount during the year and with all other variables remaining at the actual amounts. The comparative figures have been calculated using the same methodology assuming the change to the variables occurred on 1 April 2017.

Maturity of financial assets and liabilities

	Mar 2019 £'000	Mar 2018 £'000
Borrowings		
In one year or less or on demand	-	2,050
In more than two years, but not more than five years	37,844	35,402
In more than twenty years	211,749	205,487
	249,593	242,939
Other Financial Liabilities		
In one year or less or on demand	58,068	59,183
In more than one year, but not more than two years	596	479
In more than two years, but not more than five years	6,436	3,497
In more than five years, but not more than twenty years	9,559	8,751
	324,252	314,849

The table above excludes future interest payments and future indexation on financial liabilities. Index-linked borrowings of £210,097,000 (2018: £203,835,000) included in the table above are stated at the principal amount indexed by RPI to the balance sheet date. The estimated redemption value of index-linked borrowings at redemption in 2045 is £358,265,000 (2018: £358,265,000) and at redemption in 2051 is £118,379,000 (2018: £118,379,000).

Debtors recoverable in more than one year of £43,424,000 (2018: £43,547,000) principally represent loans receivable from the company's parent companies of £40,000,000 (2018: £40,000,000) with £15,000,000 (2018: £15,000,000) due to be repaid by 31 March 2020 and £25,000,000 having no fixed repayment date (2018: £25,000,000).

Trade debtors

Provision is made within the trade debtor values detailed below, based on judgement by senior management for amounts considered to be unrecoverable due either to their nature or age. The total amount charged to the profit and loss account in the year to March 2019 in respect of such provisions was £3,021,000 (2018: £3,205,000). Total trade debtors as at 31 March 2019 were £14,143,000 (2018: £12,554,000). The total amount of the provision included in the above, as at 31 March 2019, was £32,193,000 (2018: £34,123,000).

In accordance with the market conditions prescribed by MOSL, the wholesale market operator, we hold collateral where required and in line with market rules from retailers that purchase water from the company. This collateral is held in the form of:

- parent company guarantees;
- bank guarantees;
- letter of credits;
- credit insurance; and
- cash collateral balances totalling £182,752 at year end (2018: £104,458).

The Directors consider that debtors that are neither past due nor impaired are of a high quality and were considered, at the balance sheet date to be fully recoverable at their net book value.

An ageing analysis of trade debtors that are invoiced but not impaired is provided below.

Regulated	**< 1 year**	**1 - 2 years**	**2 - 3 years**	**3 - 4 years**	**4 - 5 years**	**5 years +**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
2019	8,369	2,427	1,619	1,126	831	555	14,927
2018	7,540	2,189	1,441	957	418	347	12,892

Non-Regulated	**<1 month**	**1-2 months**	**>2 months**	**>3 months**	**Total**
2019	738	60	74	25	897
2018	504	379	14	40	937

Non-regulated debtors that are considered to be impaired and so netted out of the figure above are to the value of £70,000 (2018: £68,000) and were all more than two months past due. An ageing analysis of appointed debtors that are considered to be impaired is provided below.

Regulated	< 1 year	1 - 2 years	2 - 3 years	3 - 4 years	4 - 5 years	5 years +	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
2019	3,919	3,128	2,662	2,517	2,276	17,621	32,123
2018	3,872	3,383	3,384	3,298	3,226	16,892	34,055

The Directors consider that the carrying value of trade and other debtors including loans receivable, net of provisions, detailed in note 15 approximates to their fair value.

24. Related party transactions

Historical agreements were put in place with a holding company in the Group structure to offset the impact on South Staffs Water of certain hedging relationships entered into with a third party bank, on both cash flow and the profit and loss account. The balance due from Selena Bidco Limited in respect of these transactions at 31 March 2019 was £3,788,000 (2018: £3,911,000). In accordance with applicable accounting standards, the impact of both arrangements on the profit and loss account has been netted off with no overall impact.

During the year the company provided wholesale water services to the retailer Pennon Water Services Limited (PWSL) and its subsidiary SSWB, and turnover of £20,267,000 (2018; £22,299,000) in relation these transactions was recognised with £1,000 outstanding at the year end (2018: £1,774,000). Also at 31 March 2019, an amount of £348,000 was payable to PWSL for cash collected during the year that has not been paid over (2018: £516,000). As the company provides management services, a fee of £140,000 is payable from PWSL and remains outstanding at year end. (2018: £145,000 and £nil respectively).

Remuneration for key personnel is reported on page 60.

25. Ultimate controlling party

The immediate parent company is South Staffordshire Plc, which is registered in England and Wales and is the smallest group preparing consolidated accounts that include South Staffs Water. During the year, the ultimate parent company in the UK was Hydriades IV Limited, also registered in England and Wales, which was the largest UK group preparing consolidated accounts that include South Staffs Water at 31 March 2019. The consolidated accounts for both these companies can be obtained from the company's registered office, Green Lane, Walsall, West Midlands, WS2 7PD. The ultimate controlling party is Arjun Infrastructure Partners Limited, a company registered in England and Wales, which controls and manages and is the General Partner of a UK registered investment entity that acquired a majority equity interest of a holding company of South Staffs Water and therefore of the Group.

26.Subsequent event

On 28 May 2019, £15,000,000 intercompany loan was repaid in full (see note 15).

Part 2: Annual performance report

Introduction

We publish our annual performance report (APR) with our annual report and accounts each year. It provides information about the appointed business in the following areas.

1. Regulatory accounts primary statements.
2. Price review and segmental reporting.
3. Performance summary.
4. Additional regulatory information.

Our statutory accounts on their own are considered insufficient to assess the performance of a vertically integrated, price-controlled monopoly such as South Staffs Water. This is particularly relevant in a water sector with long-life assets and where there is still an absence of competitive markets for different parts of the value chain. These regulatory accounting statements use audited information and comply with Ofwat's published regulatory accounting guidelines (RAGs), which can be found on its website at: www.ofwat.gov.uk.

Content of the APR

The APR comprises:

- a suite of data tables forming the regulatory accounts;
- a table on outcome performance for the year;
- narrative covering outcomes, totex and a reconciliation to price controls;
- a long-term viability statement covering the period to 2030;
- a statement confirming our compliance with the ring-fencing conditions of our licence (F6A); and
- a risk and compliance statement confirming that we have a full understanding of, and are meeting, all our relevant statutory, licence and regulatory obligations.

To avoid repetition, we have signposted some of the required disclosures in our statutory accounts.

We present the APR to the Audit Committee and the Board for approval.

Assurance of the APR

The APR, including the regulatory accounts, is a key document providing information to Ofwat on our performance for the year. Rating agencies and other stakeholders also use it to assess our performance. As with all publications, it is vital that the information it contains is accurate.

As in previous years, the financial information (regulatory accounts, and price review and segmental reporting) has been audited by our external auditors, Deloitte LLP, as required by Ofwat. Deloitte has also carried out agreed-upon procedures on the relevant cost allocation tables in the sections on price review and segmental reporting and additional regulatory information.

There is also a section on ODIs and the indicators that carry a financial reward or penalty; this has been audited by Jacobs. A summary report is set out on page 133. The remaining reputational ODIs have been reviewed by Group Internal Audit and the summary report can be found on page 137.

Jacobs has also audited the financial flows submission and our long-term viability statement.

Board leadership, transparency and governance

We need to demonstrate through our annual reporting how we are meeting Ofwat's principles on Board leadership, transparency and governance. The current principles, which have been in place since 2014, remained in place until 31 March 2019. So, as in previous years, we are reporting against these in our APR.

While the new principles do not come into effect until the 2019/20 reporting year, we are required to set out the steps we have taken to ensure we will meet the objectives of these new principles going forward. There are two provisions in particular that require new disclosure.

- The first is that the Board monitors and assesses values and culture to satisfy itself that behaviour throughout the business is aligned with the company's purpose. Where it finds misalignment, it must take corrective action.
- The second is an annual evaluation of the Board's performance. This considers the balance of skills, experience, independence and knowledge, its diversity, how stakeholder needs are addressed and how the overarching objectives are met. The approach is reported in the annual report, and any weaknesses are acted on and explained.

Please see the 'Board effectiveness' section on page 62 of the annual report (part 1 of this document) for more information.

Summary of regulatory performance

Performance commitments

Outcome	ODI name	Unit of measurement	Year 2015/16 Actual	2016/17 Actual	2017/18 Actual	2018/19 Target	2018/19 Actual	2019/20 Target	Target achieved	Performance against last year
1 Excellent water quality	Mean Zone Compliance	%	99.884	99.982	99.943	100.00	99.915	100.00	✗	Declining
	Acceptability of water to customers	Contacts per thousand population	1.96	1.66	1.42	1.23	1.51	1.23	✗	Declining
2 Secure and reliable supplies	Interruptions to supply	Minutes and seconds per property	04:14	05:11	08:32	10:00	07:09	10:00	✓	Improving
	Asset health infrastructure	Category	Stable	Stable	Stable	Stable	Stable	Stable	✓	Stable
	Asset health non-infrastructure	Category	Stable	Stable	Stable	Stable	Stable	Stable	✓	Stable
3 Excellent customer experience	Service Incentive Mechanism	Score	86.3	84.4	87.0	90.0	86.4	90.0	✗	Declining
	Customer satisfaction	%	98	99	97	98	98	98	✓	Improving
	Community engagement	Days	257	222	425	400	749	400	✓	Improving
4 Environment	Leakage South Staffs region	Megalitres per day	69.9	69.9	72.4	70.5	70.5	70.5	✓	Improving
	Leakage Cambridge region	Megalitres per day	13.2	14.3	14.4	13.5	13.2	13.5	✓	Improving
	Water efficiency	Litres per person per day	129.59	129.85	133.09	128.91	136.41	128.31	✗	Declining
	Biodiversity	Hectares of land	76	92	119	116	138	116	✓	Improving
	Carbon emissions	Tonnes of carbon saved	178	285	550	3742	635	5210	✗	Improving
5 Fair customer bills	Value for money and affordability satisfaction	%	93	91	94	90	95	90	✓	Improving
	Support for customers in debt	Number of customers	19621	23895	29036	27400	30838	30000	✓	Improving

Appointed financial performance

- Revenue for the year ended 31 March 2019 was £123.8m, with an operating profit of £21.2m. Tax charged in the year was £2.8m.
- We paid a dividend of £6.0m during the year of which £3.5m is from the appointed business, representing 3.0% of regulated equity. The remaining £2.5m was from intra-group interest to be paid back to the company.
- The regulatory book net debt stood at £268.4m, providing a gearing ratio of 70.6% against an RCV of £380.1m. The covenant net debt stood at £248.8m, with gearing of 65.5%. This is in line with our desire to maintain a gearing ratio of around 66%.
- Across the asset management period (AMP) to date, an actual investor return of 18.9% has been achieved, which is 8.0% higher than the notional return in the final determination at PR14. A more appropriate calculation, using covenant net debt and interest on debt is 15.0%.
- Retained value for the AMP to date averaged 12.4%, 5.6% higher than the notional retained value in our final determination.
- The RORE averaged 8.34%, or 6.29% using the covenant net debt. This is higher than that allowed in the final determination of 5.98%, with outperformance on ODIs driving this. More details are set out on page 176.

Wholesale and retail performance

- Wholesale revenue for the year was broadly in line with that assumed in the price control.
- Wholesale totex for the year was £80.8m (2012/13 prices), which was £2.9m higher than allowed in the final determination. Over the AMP to date, totex was £1.3m higher than that allowed in the final determination, 0.4% above the final determination.
- Household retail revenue for the year was £16.6m, which was broadly in line with that allowed in the final determination.
- Retail costs stood at £12.0m. This is £2.7m lower than that assumed in the price control. We have continued to make savings across the business.

Outcome delivery incentives

- We incurred total rewards of £0.23m for the year ended 31 March 2019, comprising:
  - a reward of £0.84m for outperforming our target for interruptions to supply;
  - a penalty of £0.16m, which is the result of missing our 100% Mean Zonal Compliance target; and
  - a penalty of £0.45m, which is the result of missing our target for the acceptability of water to customers.
- Over the AMP to date, our net reward position is £1.34m.

Long-term viability statement

We have carried out an assessment of the company's long-term financial liability. This involves considering our expectation of performance for the period to 2030 and then applying a number of plausible scenarios or 'stress tests' to consider the impact on our financial resilience.

Stress testing

We have stress-tested our financial projections against a number of plausible scenarios that could realistically impact on our business. We have taken into account the key risks facing the business and the impact they could have on customers and other stakeholders. These are set out on pages 29 to 35 and consider financial, operational and regulatory risks.

In assessing the impact on financial resilience we have considered the impact on:

- profitability;
- cash flows;
- liquidity;
- borrowing capacity;
- credit ratings; and
- compliance with borrowing covenants.

Where a scenario impacts on our ability to maintain an investment grade credit rating, we have then considered the actions we would take to mitigate the impact.

Consistent with the Board's objective of maintaining a strong investment grade and taking Ofwat's feedback into account, we are targeting a credit rating of Baa1/BBB+. We believe this maintains our current level of credit quality and provides some headroom to enable the company to remain financially resilient. Moody's current guidance ranges for RCV gearing and AICR are set out in the table below.

Moody's credit rating	RCV gearing	AICR
Baa1	65% – 72%	1.5x – 1.7x
Baa2	72% – 80%	1.3x – 1.5x

Moody's also takes specific sector factors into account – for example, more headroom as a result of the strong regulatory framework. Any breach of these ratios would also need to be "persistent" to trigger a possible downgrade. But in our assessment, an AICR of >1.5 is considered the standard to achieve the target credit rating, while maintaining covenant net debt to RCV below 72%.

To maintain a credit rating with S&P of BBB+, we require a minimum FFO/net debt of 9% for the appointed business. This is consistent with the target ratio of other water companies with the same target credit rating.

Our base plan, which we have used to carry out stress tests, is consistent with our business plan resubmission in April 2019 and excluding the non-appointed business. This not only covers the five years to 2025 being assessed as part of the price review process, but also the subsequent five years to 2030. Our detailed plans are available on our website at: www.south-staffs-water.co.uk/media/2599/south-staffs-water-final-business-plan-2020-to-2025-for-submission-1-apr-2019.pdf.

Below we set out the specific scenarios we have modelled. This is based on the assumption that Ofwat accepts our business plan submission.

Scenario	Size of the impact	Explanation
High inflation	CPIH 1% higher than forecast in years 4 and 5 of AMP7.	In our business plan, we have committed to a flat nominal bill throughout the next price control period. We have assumed that CPIH inflation is 2% a year. There is a risk that actual inflation is higher than our assumption. This means we would face higher costs with our allowed revenue remaining unchanged during AMP7 and deferred to AMP8. We assumed the higher than forecast inflation is in years 4 and 5 of AMP7, as we believe it is reasonable to assume there would be more risk that the actual inflation diverges from UK Treasury forecast as we move further towards the end of the AMP than the first few years.
Overspend on our treatment works expenditure	20% overspend (£12m) over the first three years of AMP7.	In our business plan, we have proposed a significant investment in our two treatment works in the South Staffs region at a cost of £63m. This investment is required to ensure we can continue to supply high-quality drinking water to customers and also improve our operational resilience. There is a risk that the cost of delivering this investment may be more expensive than planned. This could be because of possible changes in scope or that contractors tender prices that are higher than expected. We also assumed that this overspend would be shared between investors and customers based on a 50% sharing rate, hence 50% of the overspend recovered from customers in AMP8.
Lower cost of capital	20bps reduction for AMP7 and AMP8.	In our business plan, we used Ofwat's early view of the cost of capital, which was published as part of its final methodology in December 2017. There is a risk that the allowed cost of capital is lower in the final determination.
Extreme weather event	£1.3m higher than assumed operating expenditure (opex) in 2022/23 and 2027/28.	Over the past 18 months, we have experienced the effects of both a severe winter (the freeze/thaw event) and a hot summer. Both events resulted in additional costs incurred as a result of, for example, additional pumping costs and the cost of repairing burst mains. There is a risk that something similar could happen again in the future. We have based the estimated impact on the cost we actually incurred.

Scenario	Size of the impact	Explanation
ODI penalty for the Compliance Risk Index (CRI), leakage and interruptions to supply	CRI P10 penalty (£0.6m/year). Leakage P10 penalty (£0.6m/year). Interruptions to supply (0.8m/year) in years 2 and 3 of AMP7.	In our business plan, we have put forward stretching performance commitments with the intention of achieving upper quartile performance. There is a risk that we fail to achieve our targets and this results in us incurring a penalty. There are three performance commitments, which carry the largest risks and we have run a scenario assuming we hit the penalty on all three for two successive years in AMP7. In our business plan, we have committed to a flat nominal bill throughout AMP7, and the financial incentives to be deferred to AMP8. Therefore, the impact of ODI penalties on the financial metrics will apply in AMP8.
Penalty in C-MeX and D-MeX	C-MeX Customer measure of experience (C-MeX) penalty of 6% of retail revenue (£0.7m/year). D-MeX Developer measure of experience (D-MeX) maximum penalty of 2.5% of developer revenue (£0.3m/year).	C-MeX and D-MeX measure how satisfied our customers and developers have been with our service. They are relative measures to the rest of the water sector. There is a risk that our performance deteriorates compared to other companies. For C-MeX, we have had a good track record over the years in terms of our customer service performance. Although we do not envisage that we would be lower quartile, we could potentially fall to below average. Although we do not yet know the specific bandings for the level of reward or penalty that Ofwat will set for C-MeX, we have assumed a penalty of 1.2% of retail revenue a year. Our performance on developer services has improved from lower quartile in 2015/16 and 2016/17 to average in 2017/18 and 2018/19. We are continuing to look at ways to improve our service and consider we can move further. There is a risk that this improvement reverses relative to other companies. We have assumed that in this scenario we are below average and incur a penalty of 2.5% of developer services revenue a year.
Financing	Interest rates on new debt financed at 2% above expectation from year 3 of AMP7 onwards.	As a result of our significant increase in investment for AMP7, we will need to raise additional funding on the financial markets. There is a risk that the interest paid on this debt is higher than expected. We have assumed that rates are 2% above expectation from year 3 of AMP7 onwards.

Scenario	Size of the impact	Explanation
Combined scenario (lower cost of capital, overspend on our treatment works expenditure, extreme weather, and ODI penalty)	Lower cost of capital 20bps reduction for AMP7 and AMP8. Overspend 20% overspend (£12m) over the first three years of AMP7. Extreme weather £1.3m higher than assumed opex in 2022/23 and 2027/28. ODI penalty CRI P10 penalty (£0.6m/year). Leakage P10 penalty (£0.6m/year). Interruption to supply (£0.8m/year) in years 2 and 3 of AMP7.	We recognise that it is possible that a number of the scenarios outlined above could happen together. In fact, the impact of one scenario may impact on another; for example, an extreme weather event may impact on our ODI performance. We recognise that this combination of scenarios is extreme, but is still plausible and from a risk perspective it is important to understand its impact on our business.

We also considered pension liability risks. However, our final salary pension scheme is currently in surplus, as set out on note 22 page 91. So we do not think that this represents a significant risk to the business.

Stress-testing results

As described on page 103 above, we have considered the impact of the stress tests on a range of factors. But we consider the most important of these is our ability to maintain an investment grade credit rating.

Below we set out the impact of each of our stress tests on our plan along with the mitigating factors we have considered where there is a risk to financeabilty. This sets out the key financial metrics after each stress test as an average, as well as the lowest year in the period, but before management action to mitigate them. We have identified where we fall below our targeted metrics as follows.

- **Green** – the metric remains consistent with our target credit rating (Baa1/BBB+) and gearing remains at or below 70%, based on covenant debt.
- **Amber** – the metric falls below our target rating, but is still at investment grade (Baa2/BBB) and/or gearing is between 70% and 85% (highly geared but still complying with our bond and bank covenants).
- **Red** – the metric falls below that required to maintain an investment grade and/or gearing is above 85% (dividend lock up).

To maintain an investment grade credit rating of Baa2 with Moody's we would require AICR to be above 1.3. For S&P, an investment grade of BBB would require FFO/net debt to be above 7%.

		AMP7			AMP8		
		AICR (Moody's)	FFO/Net Debt (Ofwat alternative)	Gearing	AICR (Moody's)	FFO/Net Debt (Ofwat alternative)	Gearing
Base Case (Based on April Submission)	Lowest year	1.6	10%	70%	1.5	9%	70%
	Average	1.9	11%	69%	1.5	9%	70%
High Interest	Lowest year	1.5	9%	70%	1.3	8%	72%
	Average	1.9	11%	69%	1.3	8%	71%
High Inflation	Lowest year	1.4	8%	70%	1.5	9%	69%
	Average	1.8	11%	69%	1.5	9%	69%
Overspend on Treatment Works Capex	Lowest year	1.5	9%	71%	1.5	8%	71%
	Average	1.9	11%	70%	1.5	9%	71%
Lower WACC	Lowest year	1.5	9%	70%	1.3	8%	72%
	Average	1.8	11%	69%	1.4	8%	71%
Extreme Weather Event	Lowest year	1.6	10%	70%	1.4	8%	71%
	Average	1.9	11%	69%	1.5	9%	70%
ODI Penalty	Lowest year	1.6	10%	70%	1.4	8%	71%
	Average	1.9	11%	69%	1.4	9%	70%
C-Mex and D-Mex Penalty	Lowest year	1.6	10%	70%	1.3	8%	71%
	Average	1.9	11%	69%	1.4	8%	71%
Combined Scenario	Lowest year	1.4	9%	72%	1.2	7%	75%
	Average	1.8	10%	71%	1.3	8%	74%

The outputs show that under all scenarios, we are below our targeted credit metrics in at least one of the years. We do, however, maintain an investment grade except under the combined scenario where in one year the Moody's metric falls below investment grade.

Mitigations considered

Based on the outputs from the stress testing we have considered the actions senior management could take to ensure we maintain an investment grade. We believe that one or a combination of them would restore the financial metrics to an acceptable range.

Mitigation	Explanation
Risk management	We have a risk management process in place to ensure we understand the key risks facing our business. We assess each identified risk against the impact it has on our business and the likelihood of the risk occurring. We determine the overall rating of each risk by multiplying the impact and likelihood scores. This enables us to focus on the most important risks and ensure that appropriate controls are put in place to minimise them.
Reprioritising capital investment	We have a good track record historically of delivering our capital expenditure programmes. Even where we have experienced unexpected cost increases, we have been able to take actions to manage this and reprioritise our overall programme to ensure we can offset these costs while still delivering for customers. For example, in the current planning period (2015 to 2020), we have accommodated the need to install UV treatment at our Hampton Loade and Seedy Mill water treatment works by reducing our expenditure on our mains replacement programme. All our investment needs are appraised through our Investment Optimisation tool, which captures the costs associated with delivery and also the anticipated benefits that our customers will see. Combined with internal review and challenge, this allows us to re-prioritise our investment needs and fully understand the impact this will have on service. So, we believe we can offset any underperformance in the short term.
Lower dividends / capital injection	Although we are projecting a low dividend yield of 2%, we could restrict dividend payments further to save cash and maintain investment grade credit metrics.

Mitigation	Explanation
Regulatory mechanisms	There are a number of regulatory mechanisms in place for water companies that protect them from significant shocks. These include: • totex sharing allowances that share the out- or underperformance of costs between customers and investors; • a revenue true-up mechanism for wholesale over- or under-recovery; • the impact of indexation of the cost of new debt mechanism to be introduced in the next price control period (2020 to 2025); • uncertainty mechanisms; and • the substantial effects determination. We have also proposed a protection mechanism from the flat nominal bill as result of high inflation. This would also ensure that the company would be protected from significant inflation risk. In addition to these, the current price review process allows us to make representations on Ofwat's draft determination. This may allow us to mitigate potential risks. One example in relation to our stress tests would be if the cost of capital was lower than Ofwat's early view. Here, we would consider submitting an adjustment to the cost of capital to reflect the fact that we are a small water only company and do not benefit from the portfolio effect in raising debt.
Non-regulated business	The metrics set out above relate to the regulated part of our business, operating as a completely ring-fenced entity from any non-regulated activity. Rating agencies determine their ratings based on the whole company, including the non-regulated parts of the business. This gives us an additional buffer on the key metrics as including the non-regulated business adds around 0.5 to the AICR metric. So, in extreme circumstances, this could act as short-term protection.

For each stress test scenario, where we would be below the targeted credit metric for at least one year, we have set out the most appropriate mitigations we could use.

Scenario	Risk management	Reprioritise capex	Lower dividend	Regulatory mechanism
High inflation				✓
Overspend on our treatment works expenditure	✓	✓		✓
Lower cost of capital			✓	✓
Extreme weather event	✓	✓		✓
ODI penalty for CRI, leakage and interruptions to supply	✓		✓	
Penalty in C-MeX and D-MeX	✓		✓	
Financing	✓		✓	✓
Combined scenario	✓	✓	✓	✓

Overall, we believe that the mitigations outlined above would enable us to maintain an investment grade credit rating while still delivering on our commitments to customers.

Assurance

We have followed a two-stage process to assuring our long-term viability statement. We have used independent internal audit to carry out a review of all the calculations of the stress testing outputs to ensure that the change from the base position is consistent with what would be expected from the particular scenario.

We have then carried out external assurance using Jacobs to ensure that our statement is consistent with these calculations and that it covers the requirements set out by Ofwat.

Long-term viability statement Board statement

The Board of South Staffs Water ('the company') is responsible for the efficient running of the company and for ensuring that it is resilient. In making the declarations below the Board has been guided by Ofwat's information notice on expectations for companies' long-term viability statements (IN 19/07).

Based on the financial projections, the stress tests performed and the mitigations available, the Board declares that, in its opinion, the company is financially viable for the 11 years to 2030. This is on the key assumption that our PR19 Final Determination is in line with our business plan submission.

The 11-year period has been selected because:

- the five years from April 2020 are covered by the PR19 process; the company has submitted a financeable plan, which has been stress tested;
- the Board also has confidence that the regulatory system, under which the company is licensed, will ensure that it will remain financeable in future periods provided the business operates efficiently and Ofwat continues to make proportionate decisions regarding the weighted average cost of capital (WACC) and other key factors; and
- specific stress testing has been performed until March 2030 based on assumptions used in the company's business plan submission.

The Directors also declare that the company has carried out appropriate stress testing of its proposed performance over the next 11 years, and that the results of these tests show the business to be financially resilient.

- Details of the tests carried out are described on pages 104 and 106 above.
- These tests are considered to cover, severe, plausible and reasonable scenarios for key variables relevant to the company.
- Appropriate multiple scenarios have been considered.
- The stress testing considers the need for and availability of new funding and is based on the realistic assumption that the company continues to have its existing access to capital markets to fund its required investment programme and provide sufficient liquidity.
- The stress testing considers the implications on key metrics utilised by rating agencies.

The Directors also declare that they have received appropriate assurance that the testing carried out is both appropriate and accurately performed.

- Testing has been performed internally by expert staff within the company.
- The calculations used in this testing have been externally verified by independent internal audit.
- The basis and logic for the scenarios tested has also been verified by Jacobs.
- This assurance is in line with the company's assurance framework.

Phil Newland
15 July 2019

Company direction and performance statement

This short statement sets out how we are delivering for our customers and how our customers are central to everything we do, including the setting of our targets and aspirations.

Our vision is to make sure all our customers have access to clean, high-quality and affordable drinking water every day. And to make sure all our people are empowered to provide excellent service that our customers, communities and wider stakeholders can trust - now and in the future.

We have a long history of delivering clean water every day and in all weathers to our customers, providing an essential public service that touches everything they do. This guiding purpose enables the 1.7 million people and around 45,000 businesses across our South Staffs and Cambridge regions to go about their daily lives and helps to keep them healthy. We actively work in partnership with local communities, helping them to thrive. And we focus our efforts on being a custodian of our assets and the local environment to make sure we can keep delivering the things that matter most to our customers now and for future generations.

We run an efficient business which has always been in the private sector and which delivers sustainable, long-term returns for our investors. This is how we are making water count. Our purpose is underpinned by our core beliefs, which are that:

- preparing for the future is essential;
- minimising waste in every area of our business operations is critical;
- using water wisely is important;
- we are always looking for new ways to do things better and quicker;
- listening to customers is crucial;
- our focus is on local issues; and
- working with partners creates better communities.

Our primary operational targets are broadly those proposed to Ofwat (our economic regulator) in the Business Planning process for 2015 to 2020, and approved as part of our Final Determination for this period. These targets are known as Outcome Delivery Incentives (ODIs) and are grouped under a series of five "Outcomes" designed to benefit our customers and stakeholders. These represent our commitment to deliver what our customers said was important to them in the last price review. Information on our performance against our targets is contained within our Strategic Report on page 10 onwards.

Our ODIs are underpinned by many other operating targets which are set annually as part of our financial and operating budget setting process. All targets are set to ensure we maintain our ability to meet customer needs today and in the future. They are based on the Ofwat Final Determination, and are fine-tuned through constant customer engagement. As would be expected, in addition to the customer focus we are required to outperform our ODI targets whilst also delivering shareholder returns, ensuring capital investment takes place and operating as an efficient business across all price controls (currently Wholesale and Retail Household). We also have some non-regulated aspects to our business which are managed under a similar framework.

Each year our Executive Team proposes targets based on detailed knowledge of our customer needs and our operational requirements; our Board, led by the independent non-executive members uses its expertise and insight to challenge the targets we propose. Detailed discussion follows based on customer views, forecasts, outcomes to date and future expectations in order to agree the way forward. Variances from customer expectations, annual targets and the Ofwat Final Determination are strongly challenged throughout the year by the Board, with plans required to get back on track if there are shortfalls.

We believe it is important to be transparent with customers and stakeholders, and we work hard to regularly share more information about our performance. In addition to the information in this report, we also report operational performance using a customer-friendly dashboard (www.south-staffs-water.co.uk/about-us/our-performance-dashboard). We also make further disclosures around remuneration page 60, governance page 40, tax page 28 and our ownership structure page 47 as we know these are important matters for customers.

During the year our Board was actively involved in the process for preparing, approving and assuring our business plan for 2020 to 2025, which was initially submitted to Ofwat in September 2018. This was the culmination of several years of hard work from a number of teams across the business. This ambitious plan is the result of extensive engagement and includes our largest-ever investment programme to ensure we deliver the things our customers have said are important to them. Titled 'Making water count', our business plan followed consultation and engagement with more than 35,000 customers. It also built on the high levels of trust we already have with them, enjoying levels of support of 84%.

Looking ahead, we are facing a number of challenges over the next year or so – not least the turbulent political climate, the impact of Brexit, environmental pressures resulting from climate change and changes in customers' expectations. We will continue to consider all our operations in the round – building more flexibility and resilience into our systems and processes across the business to ensure we can adapt and respond to these changing circumstances quickly and efficiently. We resubmitted our business plan on 1 April. Ofwat will make its final decisions on all the companies' business plans in December this year. We will report on the outcome of this in next year's annual report.

Statement of Directors' responsibilities for regulatory information

Further to the requirements of company law, the Directors are required to prepare accounting statements, which comply with the requirements of Condition I of the Instrument of Appointment of the company as a water and sewerage undertaker under the Water Industry Act 1991 and RAGs issued by Ofwat.

This additionally requires the Directors to:

- confirm that, in their opinion, the company has sufficient financial resources and facilities, management resources and methods of planning and internal control for the next 12 months;
- confirm that, in their opinion, the company has sufficient rights and assets, which would enable a special administrator to manage the affairs, business and property of the company;
- confirm that, in their opinion, the company has contracts with any associated company with the necessary provisions and requirements concerning the standard of service to be supplied to ensure compliance with the company's obligations as a water and sewerage undertaker;
- report to Ofwat changes in the company's activities, which may be material in relation to the company's ability to finance its regulated activities;
- undertake transactions entered into by the appointed business, with or for the benefit of associated companies or other businesses or activities of the appointed business, at arm's length; and
- keep proper accounting records, which comply with Condition F.

These responsibilities are additional to those already set out in the statutory financial statements.

Sufficiency of financial resources certificate

The Directors declare that in their opinion:

a) The company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, the regulated activities (including the investment programme) necessary to fulfil the company's obligations under its Instrument of Appointment.
b) The company will, for at least the next 12 months, have available to it management resources which are sufficient to enable it to carry out its activities and fulfil its obligations.
c) All contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the appointee, to ensure that it is able to meet all its obligations as a water undertaker.
d) The company will, for at least the next 12 months, have available for it systems of internal control which are sufficient to enable it to carry out its functions.

In making this declaration, the Directors have taken into account:

a) The company's budget for 2019/20 and the investment programme.
b) The final determination for 2015/20 and the company's plan in relation to it.
c) The investment grade credit rating in the BBB+ band.
d) The committed borrowing facilities available to the company.
e) The depth of the management team and the succession planning in place.
f) The contracts in place with associated companies.
g) The company's internal control process which identifies, evaluates and manages risks faced by the company.

Phil Newland
15 July 2019

Risk and compliance statement

Background and requirements of the statement

South Staffs Water has a number of statutory and regulatory obligations as a water undertaker. These obligations are predominantly set down in the Water Industry Act 1991 and our Instrument of Appointment (the 'licence'). The purpose of the risk and compliance statement is to demonstrate that we fully comply with these obligations.

Ofwat's guidance requires the company to confirm that it has:

- a full understanding of, and is meeting, all its relevant statutory, licence and regulatory obligations;
- taken steps to understand and meet customer expectations;
- satisfied itself that it has sufficient processes and internal systems of control to fully meet its obligations; and
- appropriate systems and processes in place to allow it to identify, manage, mitigate and review its risks.

Each of these is considered in the statement below along with how the company has satisfied itself that it can confirm the obligations have been met.

Statutory licence and regulatory obligations

The company confirms that it has a full understanding of, and is meeting, all its relevant statutory, licence and regulatory obligations.

Each year, we consider our obligations as a water undertaker and that we understand and comply with them. This is done in a number of different ways.

- Assessing the impact of any licence changes or changes to the Water Industry Act made during the year and ensuring any new obligations are adopted.
- Reviewing and publishing relevant documents as required under our licence.
- The use of appropriate assurance, where required, either through internal audit or external technical audit.
- Requiring Board sign-off of all significant obligations – for example, customer charges and the APR.
- An annual review of compliance carried out by the Audit Committee.

During the year, a number of licence modifications have been proposed or introduced. Some have already taken effect, whereas others will take effect in the 2019/20 reporting year. Below we summarise these changes and any required actions we have taken to ensure we meet them.

Licence modification	How we are meeting the new obligation
Licence condition E1 prohibiting water companies from showing undue preference or discrimination to market participants in the new wholesale markets, the self-lay provider (SLP) market and the new appointments and variations (NAV) market.	In section 4 of our latest Condition R compliance code, we have set out how we are ensuring we comply. This is available on our website at: www.south-staffs-water.co.uk/media/2621/ssc-compliance-code-final.pdf.
Board leadership, transparency and governance principles	Although full reporting against these new objectives is not required until the 2019/20 reporting year, we have set out in this APR how we are already complying with these principles. See page 99.
Regulatory ring-fencing	This licence condition has not yet taken effect, but we support the modification which covers four key areas. • Maintaining investment grade credit ratings and cash lock up. • Providing ring-fencing certificates (see below). • Reporting of material issues. • Change of control and other matters.
Licence simplification	This licence condition sought to simplify the wording and remove conditions that were no longer relevant. There are no new obligations on companies from these changes.

At a meeting of Directors held on 27 June 2019, the Board confirmed that South Staffs Water:

- has adequate financial resources and facilities, management resources and systems of internal control (including those needed to manage risk) to enable it to carry out its regulated activities (including the investment programme necessary to fulfil its obligations under the Instrument of Appointment);
- has maintained an investment grade rating from both Moody's and S&P;
- can confirm there are sufficient rights and assets available to enable a special administrator to run the business;
- has ensured that executive Directors' remuneration packages are linked to the performance of the business, taking account of both financial and service performance;
- has ensured that each Director has confirmed that, in accordance with the Companies Act 2006, as far as they are aware, there is no relevant audit information of which South Staffs Water's auditors are unaware. The Board has taken all reasonable steps to make itself aware of any relevant audit information and to establish that South Staffs Water's auditors are aware of that information; and
- complies with Condition I of its licence. The Board can also confirm South Staffs Water's compliance with the objectives and principles of RAG 5.07, namely that transactions with associate companies are at arm's length and that cross-subsidy is not occurring.

Based on the work carried out during the year, we have not identified any exceptions and can confirm that the company has a full understanding of and is meeting all its relevant statutory, licence and regulatory obligations.

Customer expectations

The company confirms that it has taken steps to understand and meet customer expectations.

We have a number of outcomes that reflect what our customers have expressed as to what matters to them. These outcomes have performance commitments attached that customers can expect us to achieve. Each year, we publish our performance in a customer-facing report on our website at: www.south-staffs-water.co.uk/publications/annual-reports.

We believe it is important to be transparent with customers and stakeholders, and we work hard to regularly share more information about our performance. We report operational performance using a customer-friendly dashboard (www.south-staffs-water.co.uk/about-us/our-performance-dashboard). We also make further disclosures around remuneration, governance, tax and our ownership structure, as we know these are important matters for customers.

In addition to the ongoing programme of customer engagement dialogue, we have spoken to more than 35,000 customers in formal research as part of PR19, and it is their diverse views and priorities that are reflected in our business plan. Customers are challenging us to be more ambitious, but are also taking us into new areas. In general, customers are reminding us of our obligation to educate them about the value of water. Younger customers, in particular, are encouraging us to place greater emphasis on the impact of our operations on the environment.

Finally, in our role as the provider of an essential public service, we are embracing a renewed challenge to listen, and to support some of the most vulnerable in society. The aim through all this is to be an industry leader on cost and service, but also increasingly to innovate, and through this not only benefit customers but the sector as a whole.

We can therefore confirm that the company has taken steps to understand and meet customer expectations.

Processes and internal systems of control

The company confirms that it has satisfied itself that it has sufficient processes and internal systems of control to fully meet its obligations.

We have a number of processes and controls in place to ensure we deliver our statutory, licence and regulatory obligations.

There is an established internal control framework that is continually reviewed and updated. This process includes the identification, evaluation and management of the significant risks we face as set out in the strategic report.

Alongside this, we also have robust and transparent assurance processes in place as set out in our company monitoring framework and assurance plan, which are available on our website at: www.south-staffs-water.co.uk/media/2616/assurance-plan-april-2019-final.pdf.

There is an internal audit function, which provides support in maintaining good systems of internal control and assurance over the quality of our information. In addition, and as part of its terms of reference, the Audit Committee keeps under review the effectiveness of the internal audit arrangements, internal controls, and risk management policies and practices. This includes consideration of the statutory and regulatory obligations to ensure compliance.

Based on this, we are satisfied that the company has sufficient processes and internal systems of control to fully meet its obligations.

Risk review and mitigation

The company confirms that it has appropriate systems and processes in place to allow it to identify, manage, mitigate and review its risks.

We recognise that risks exist in all businesses and our approach to risk reflects our status as a regulated and licensed water undertaker providing an essential public service. We accept that not all risks can be mitigated entirely, but our aim is to ensure that risk management activities reduce the overall estimated impact of risks to a level that is considered to be acceptable and that does not impact on our long-term viability.

To facilitate the risk management process, every six months the Executive team reviews our key business risks as identified and documented by senior managers. They consider the risks of the whole business and the proposed mitigating controls and procedures, which are designed to reduce risks to an acceptable level. These risks are then presented to the Audit Committee for review, challenge and comment with any agreed actions passed on to the relevant senior manager, and any significant issues escalated to the Board.

The objective of this risk management process is to:

- ensure that the Executive team is able to identify and prioritise all key business risks;
- implement appropriate procedures and controls to mitigate risks to an acceptable level; and
- enable senior managers to highlight, document, prioritise and execute any identified actions.

The key risks, as identified using the process described, and details of what each risk means for us, the actions we are taking to mitigate the impacts and any change in risk are set out on pages 31 to 35.

Overall, we are satisfied that the company has appropriate systems and processes in place to allow it to identify, manage, mitigate and review its risks.

This statement was approved at a meeting of Directors, held on 27 June 2019, and duly signed on their behalf.

……………………………………

Phil Newland
Managing Director
South Staffordshire Water PLC

……………………………………

Sir James Perowne
Independent Chair
South Staffordshire Water PLC

Accounting disclosures

Board agendas for the year ended 31 March 2019

The Board met eight times during the year; the key areas discussed were as follows.

- The business plan for 2020 to 2025, focusing on:
  - customer engagement and customer views;
  - ODIs and performance commitments;
  - long-term planning and resilience;
  - the balance between stretch and deliverability; and
  - our cost adjustment claim.
- Approach and assurance.
- Ofwat's initial assessment of water companies' business plans and our resubmission in April this year.
- Leakage and water resource management, including our water resources management plans.
- Operational performance and issues.
- Customer issues, including vulnerability/ affordability and tariff setting.
- Financial performance, financeability, risk and cash management.
- The views of key stakeholders and regulators, including Ofwat, the DWI, CCWater and the Independent Customer Panel.
- Approvals of capital activities, budgets, proposals and reports.
- Health and safety.
- Legitimacy and other challenges facing the water sector.
- Board leadership, transparency and governance.
- Brexit planning.

Relationship between Directors' remuneration and standards of performance

The company has an obligation under Section 35A of the Water Industry Act 1991 to make a statement in relation to remuneration that is linked to standards of performance. Please refer to page 61 of the annual report and accounts (part 1 of this document) for full details of the relationship between Directors' remuneration and standards of performance.

Disclosure of information to auditors

The Directors confirm that as far as they are aware, there is no relevant audit information of which the company's auditor is unaware and that the Board has taken all reasonable steps to make itself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

Approach to taxation

Please refer to page 28 of the annual report and accounts (part 1 of this document) for full details of our approach to taxation.

Dividend policy

Dividends of £6.0m were paid during the year for the appointed business (2018: £15.4m). This included £2.5m net of tax (2018: £2.0m) paid to the company's holding company to enable it to pay intra-group loan interest to the company. Included in the prior year payment was a one-off element of £8.4m paid in relation to the proceeds from the sale of our non-household retail business.

Adjusting for the one-off payment and the intra-company interest, the appointed dividend was £3.5m (2018: £5.0m) representing 3% of regulated equity.

The 2019 dividend is less than that allowed in the final determination. Moving forward, the Directors will continue to take a responsible approach in determining the levels of dividends to be paid.

At 31 March 2019, the company's ratio of net debt/RCV was 65.5% (2018: 66.1%) of its RCV of £380.1m (2018: £364.3m) being the PR14 final determination RCV uplifted for inflation.

The RPI at March 2019 of 2.4% (2018: 3.3%), which is used to inflate RCV, whereas the majority of index-linked debt was inflated using RPI at July 2018 which was higher at 3.2% (July 2017: 3.6%); this would have had an adverse impact on the gearing ratio as index linked debt was uplifted by a higher RPI value. Going forward, the Directors will target a net debt/RCV rate of up to 66%, (on a covenant basis).

Condition K

In the opinion of the Directors, the company was in compliance with paragraph 3.1 of its Instrument of Appointment as at 31 March 2019.

Accounting policies

Accounting policy for price control segments

The regulatory accounts have been prepared in accordance with RAG 2 ('Guideline for the classification of costs across price controls') and follow the company's accounting separation methodology statement. This is available on the company's website at: www.south-staffs-water.co.uk/publications/annual-reports.

Data for accounting separation is predominately taken from the company's financial system, through downloads into spreadsheets. The financial information is captured at a location and activity level. Account codes are used to classify the expenditure to the correct cost lines within the relevant tables in section 2 and section 4 of this APR. Costs and assets are then attributed directly to business units in line with the RAGs.

For general and support expenditure, a number of cost drivers have been identified for allocation of costs into the relevant business units. These include:

- headcount;
- number of vehicles;
- floor space; and
- asset values.

Revenue recognition

In the regulatory accounts, income is based on the value of bills and accrued income for measured customers raised in the year in line with the RAGs. This is different to the statutory accounting policy on page 79.

For metered consumption not yet billed, an accrual is estimated. Where a property is unoccupied and fully furnished, charges are still applicable. Charges are also applicable where a property is renovated.

Charges may be waived in special circumstances – for example, hospitalisation, probate and incarceration. Where a property is believed to be occupied, but the occupier details are not known, the income is not recognised until the occupant details are obtained. The company uses Land Registry searches and void inspector visits to ascertain the identity of any occupier.

The company does not bill unmetered void properties speculatively to 'the occupier'. Properties are visited by void inspectors to confirm that a property is unoccupied. For void metered properties, where consumption has been measured and the identity of the customer is not known following a void inspection, the property will be billed for the full charges in the name of 'the occupier'. Charges raised are realised as revenue in the same way as other metered income.

The first bill for a new connection is based on an actual meter reading. Where a customer has been connected during the year but has not had a meter reading, an estimate of the income is accrued based on the average household consumption.

Charges on income include charging orders and attachment of earnings. Cash received is applied against the outstanding debt, with income being recognised from the billing date.

The company operates an 'income maximisation' project that is used to identify properties not held on its billing system. Any properties billed under this approach are not recognised as turnover until the running costs of the project have been covered.

Income recognised during the year is based on the value of bills raised. For metered consumption not yet billed, an accrual is estimated based on historical average daily consumption for each customer. The measured income accrual at March 2019 was £11.8m compared to £11.1m in the previous year. Following comparison to the income actually billed for these customers in the year there are no significant differences to report.

Capitalisation policy

Capital expenditure results in the acquisition of an asset for continuing use within the business with a view to earning income or making profits from its use, either directly or indirectly.

Operating expenditure is incurred either for the purpose of the day-to-day running of the business or to maintain the existing capacity of fixed assets.

Costs are allocated between operating and capital expenditure in accordance with the company's accounting policies and applicable accounting standards. The de minimis level for capitalisation is £1,000 for minor assets and £5,000 for buildings.

Bad debt policy

Before passing an account for write-off, all debts will be pursued through every available recovery method and will usually include attempts by the Sheriffs Office or debt collection agencies. Only where it is impossible, impractical or inefficient to collect debt, will a recommendation for write-off be made.

There will be a variety of circumstances when it will be necessary to write off irrecoverable debts; these are summarised below.

Absconded

- Where returned mail is received on accounts, no forwarding details are available and a final account is created,
  and where all recovery options have been exhausted.
- Where a debt has been passed to a 'trace and collect agency' and that agency is unable to trace the customer and therefore is unable to collect the outstanding debt.
- Where the total debt is less than £50, it is uneconomic to pass for trace and collection and therefore the outstanding debt is unable to be collected.
- Where a customer has debt greater than six years old and no billing activity or correspondence has been received in this period (statute barred).

Bankruptcy

- A household customer where official and final notification has been received from the courts or a check has been made with the online insolvency website service.

Deceased

- Where the balance outstanding is less than £25, the amount is written off immediately.
- Where the balance outstanding is greater than £25, the estate is approached. Where written confirmation has been received in writing that the estate has insufficient funds, the balance is written off.
- In circumstances where a joint tenancy liability exists, the remaining party is pursued for the whole amount of the arrears.
- Where attempts to contact the executors (or next of kin) have failed to produce a response, balances under £100 are written off after a period of six months.

Liquidation

- A commercial customer where final notification has been received from an Official Receiver, Insolvency Practitioner or Liquidator that the company has been liquidated.
- Debts where a company has ceased to trade, leaving no assets.

Uneconomic to collect

- Final debt more than four years old will be written off where evidence exists that it has become non-collectable. A minimum of three attempts to contact a customer by telephone and/or letter in the prior 12 months has proved to be ineffective and there has been no payment or contact in the preceding 12 months.

- The debtor’s age, health or other social factors make it inappropriate to pursue the debt.
- Sums of less than £25 will be written off as they are deemed to be uneconomic to collect.

Transactions between the appointed company and associated companies

The company is under a duty to trade at arm's length and to ensure there is no cross-subsidy with respect to transactions with associated companies or between price control units. The company's licence conditions require that all such transactions must be disclosed. In line with RAG 3.11, no single transaction exceeding £100,000 has been aggregated. Full details are set out on pages 126 and 127.

Loans by or to the appointed company

As at 31 March 2019 the company had a £15.0m, loan to Aquainvest Ventures Limited with interest payable at 5.3%; in the year the company received £0.795m in interest. The company also had a loan of £25.0m, to Hydriades Limited with interest payable at 7%; in the year the company received £1.750m in interest.

On 28 May 2019, the £15.0m loan to Aquainvest Ventures Limited was repaid in full.

Dividends paid to associated companies

As a wholly owned subsidiary, the appointed company paid dividends of £6.0m in the year to its holding company, South Staffordshire Plc. This included £2.5m (net of tax) to enable it to pay intra-group loan interest to the company. The remaining £3.5m is from the appointed business, representing 3.0% of regulated equity.

Guarantees or other forms of security by the appointed company

The company confirms that there are no guarantees or other forms of security with any associated companies.

Transfers of any asset or liability by or to the appointed company

During the year, the company transferred no assets or liabilities to an associated company and did not receive any from an associate.

Transfers of any corporation tax group losses by or to the appointed company

The company anticipates that it will not claim or surrender any group loss relief for the year ended 31 March 2019 (2018: £nil).

Other transactions

The company can confirm that there has been no omission to exercise a right as a result of which the value of the net assets of the appointee is decreased and that there has been no waiver of any consideration, remuneration or other payment by the appointee.

Supply of services by or to the appointed company

All supplies of services by associated companies comply with the objectives and principles of RAG 5.07. Transactions with associated companies are at arm's length, either through competitive tender or at cost, and cross-subsidy is not occurring.

Competitive tenders

Whenever a tender process is undertaken and could potentially involve an associated business, the following procedures are applied.

- The procurement team must be involved from an early stage to ensure that a proper tender process is carried out. Where required, this must follow EU procurement rules.
- The tender process must be fully documented. This is to ensure that it is auditable and that the details can be reported in the APR.
- Appropriate approval of the award of contract must be given, usually through a meeting of the Executive team or the Board of Directors. Any Director of the water company who is also a Director of an associated company tendering is not involved in the procurement process and must declare an interest, take no part in the discussions and have no vote in the matters discussed.
- Once the award of contract to an associated business is approved, all transactions must be in line with the contract. Any variations to the contract must be approved separately.
- All transactions under a contract with an associated company must be signed off by the appropriate manager to confirm that it is in line with the contract terms.
- On all key supplier relationships where we use the parties in the Appointed business, the Company requires that there is at least one other framework supplier in order to ensure ongoing competitive procurement.

'At cost' transactions

If work is carried out by an associated company where no competitive tender has been undertaken, then those transactions must be at cost as set out in RAG 5.07. The following guidelines are taken into account.

- All 'at cost' contracts are approved by the Executive team or the Board of Directors every 12 months. The approval should outline why the contract should continue at cost (for example, performance of the associate during the year or strategic reasons).
- All transactions under the 'at cost' contract must be signed off by the appropriate project manager.
- The cost allocation of the associated company must be fully auditable to show that it is 'at cost'. Sample audits are undertaken by the Internal Audit function.

Transactions between price controls

Since the 2014 price review, there are now separate binding price controls in place for wholesale, and retail household services. Companies need to ensure that there is no cross-subsidy between price control units.

The company has followed the RAGs to ensure that costs are correctly allocated between price controls. The tables in the price review and segmental reporting section of this APR and the accompanying cost allocation methodology statement have been reviewed externally by Jacobs to ensure that the company is compliant with the RAGs.

In addition, there are additional requirements set out in Condition R of the company's licence in relation to arm's length trading with related licensees operating in the retail business market. This information has to be updated and published each year on the company's website. The latest version can be found at: www.south-staffs-water.co.uk/media/2621/ssc-compliance-code-final.pdf.

The following transactions occurred during the 12 months to 31 March 2019

Services supplied to the appointee by associated companies

Associate	**Turnover of Associate £m**	**Service**	**Value £m**	**Terms of Supply**
Onsite	67.398	Mainlaying and repair of water mains	20.336	Competitive tendering
		Mains Rehabilitation	3.362	Competitive tendering
		Minor Civils	1.045	Competitive tendering
		Metering	1.591	Competitive tendering
		Reservoir Refurbishment	0.790	Competitive tendering
		Drainage Surveys	0.014	Cost
Integrated Water Services Limited	26.548	Water Treatment	0.036	Cost
		Mechanical and Electrical Services	0.566	Cost
		Capital Works	7.067	Competitive tendering
SSI Services UK Limited	2.960	Motor vehicle repair and maintenance	0.527	Cost
Hydrosave (UK) Limited	21.734	Leakage detection	0.053	Competitive tendering
Echo Managed Services Limited	29.988	Customer Services	6.579	Cost
		Billing Software	0.508	Cost
South Staffordshire Plc	-	Management services	2.948	Cost
		HR and Health & Safety	0.019	Cost
		Payroll Services	0.137	Cost
		IT Networks, Operations, Development and Telephony	1.009	Cost
		Finance, Treasury, Internal Audit and Accounts Payable	0.658	Cost
		Total services supplied to the appointee by associated companies	**47.245**	

Services supplied by the appointee to associated companies

Associate	Turnover of Associate £m	Service	Value £m	Terms of Supply
Echo Managed Services Limited	29.988	Sewerage collections support	0.214	Cost
Echo Managed Services Limited	29.988	Site Services	0.158	Cost
Echo Managed Services Limited	29.988	Recharges for the use of appointed assets	0.092	Cost
SSI Services UK Limited	2.960	Recharges for the use of appointed assets	0.003	Cost
South Staffordshire Plc	-	Communications and media support	0.041	Cost
Echo Managed Services Limited	29.988	Operational training	0.005	Cost
Hydrosave	-	Operational training	0.001	Cost
Integrated Water Services Limited	26.548	Operational training	0.013	Cost
Onsite	67.398	Operational training	0.009	Cost
South Staffordshire Plc	-	Operational training	-	Cost
		Total services supplied by the appointee to associated companies	**0.537**	

Services supplied by the appointee to non appointed business

Associate	Turnover of Associate £m	Service	Value £m	Terms of Supply
South Staffs Water Non appointed	5.666	Recharges for the use of appointed assets	0.002	Cost
South Staffs Water Non appointed	5.666	Management fees	0.108	Cost
		Total services supplied by the appointee to non appointee	**0.110**	

Data assurance summary

As a monopoly provider of an essential public service, we recognise the importance of high-quality assurance and governance to ensure our customers and other stakeholders can have trust and confidence in the information we publish and the services we provide across our South Staffs and Cambridge regions on a daily basis.

In 2015, Ofwat published its company monitoring framework, setting out its expectations for how water companies should demonstrate strong assurance and governance, and how Ofwat, as the sector regulator, would monitor this.

We have since worked with our major stakeholders to understand any areas of risk within our assurance processes, and to develop a holistic assurance framework that we use to assess our assurance requirements. Since 2015 we have consulted with our stakeholders each year to identify those risks and to put in place a plan to address them. Our latest assurance plan, covering this APR and other important submissions during the financial year, can be found on our website at: www.south-staffs-water.co.uk/about-us/our-strategies-and-plans/our-assurance-framework.

Our auditors

We have two primary audit requirements for the annual performance reporting information.

- Financial data relating to our accounting reporting and financial performance.
- Technical data relating to our water service performance.

We use a financial auditor, Deloitte LLP, for the statutory and regulatory financial accounting audits. Deloitte has an extensive understanding of the statutory and regulatory accounting requirements.

We use a technical auditor, Jacobs UK Limited, for the water service performance, which includes performance commitments and other technical data related to water supply reporting. We appointed Jacobs in 2017 after a competitive tender process, as we recognised that its broad experience of technical audit and its extensive knowledge of the current regulatory environment would work well with our continued data quality improvements.

Assurance of this APR

We summarise below our overall principles of assurance for each of the four sections in this APR.

Sections 1 and 2 – regulatory financial reporting, price review and other segmental reporting

Data reported in sections 1 and 2 is produced consistent with the RAGs published in November 2017. Deloitte LLP, our statutory auditor, audits this section of the APR and its audit assessment is set out on page 138. For 2018/19 Ofwat requested that table 1f (financial flows), should be audited, although it was subsequently agreed between Ofwat and Deloitte that the audit requirement would be replaced with Agreed upon procedures. In addition, we have also used Jacobs to carry out further assurance that table 1f is consistent with Ofwat's guidance.

Section 3 – performance summary

This section sets out our performance against our outcomes and ODIs.

We have used Jacobs to audit our:

- financially incentivised ODIs;
- reward and penalty calculations;
- asset health sub-measures; and
- SIM performance.

A statement from Jacobs is set out on page 133.

Our non-financial ODIs and our Abstraction Incentive Mechanism (AIM) table have been audited by our independent internal audit function.

Section 4 – additional regulatory information

There is a mix of tables and data within this section. Where data in these tables is the same as that used in other areas of the APR, then these data items are covered by the audits in sections 1, 2 and 3. We have also used Jacobs to review our RORE calculation as this is a key metric used by Ofwat and other key stakeholders.

Improvements we have made to our APR

In our assurance plan, published in April 2019, we defined a number of targeted areas that required extra focus this year. The table below sets out those targeted areas that are relevant to this APR and explains how we have addressed them.

Targeted area	How we have improved
Making sure cost assessment data is robust	Ofwat collects operational information to determine cost allowances at price reviews. Much of this data is longstanding; however, definitions are sometimes altered over time. To ensure our cost assessment data is fully compliant with the latest definitions, we are implementing additional checks and external assurance. We have used Jacobs to carry out the assurance process on our APR tables.
APR	As in previous years, we have used Deloitte LLP to externally audit our financial reporting for the APR. We have also produced a summary of the APR with the aim of ensuring the key information is accessible to customers. This year, we have enhanced what we publish by identifying areas of innovation and best practice to help stakeholder understanding. We have also reported against the new Board leadership, transparency and governance principles on page 99, despite this not being required until 2019/20.
Reporting of key metrics in a consistent way	The water sector has worked collectively to create common reporting methodologies to improve the consistency of reporting on four core service measures, including leakage. We have committed to developing the data and systems used to report leakage so that they are fully compliant with the new leakage methodology by April 2020.
Making sure our publications are customer friendly	We have continued to think about the audiences for our published documents and, where possible, we have created customer-friendly summary documents for our main submissions. We have also continued to improve our website to make it accessible and informative for customers. As well as this, we have continued to increase our use of social media channels for customer information.

The Independent Customer Panel

Throughout the year we have provided quarterly updates to the Independent Customer Panel (what we call our Customer Challenge Group or CCG) on our performance and year end forecasts. We have also sought the Panel's views on the summary version of our APR, which is a significantly shortened version containing key information for customers and other stakeholders who do not need to read the full version of this document.

Other significant publications

Below, we set out the other significant documents we have published during 2018/19.

Report	Explanation
PR19 business plan submission and resubmission	In September 2019, we submitted 'Making water count', our business plan for the five years from 2020 to 2025 to Ofwat. In developing our plan, we engaged with more than 35,000 customers over two years to understand what they want us to deliver. Our plan details the stretching targets we have set ourselves to make significant improvement in the services we deliver to our customers. At the same time, we will give customers certainty and stability by keeping bills flat in nominal terms over each of the five years of the next planning period. Following Ofwat's initial assessment of our plan, the results of which were announced on 31 January 2019, we resubmitted our plan on 1 April 2019. We have improved our proposals, increased the level of explanation and, once again, challenged ourselves on cost efficiency. We look forward to receiving our draft determination from Ofwat on our resubmitted business plan in July 2019. Our business plan can be found on our website at: www.south-staffs-water.co.uk/media/2599/south-staffs-water-final-business-plan-2020-to-2025-for-submission-1-apr-2019.pdf
Summary performance report	As well as publishing our full APR each year containing the statutory and regulatory accounts with detailed narrative, we also publish a summary version for customers and non-technical stakeholders. This is part of our commitment to making information accessible to as wide an audience as possible.
Revised draft water resources management plans (rdWRMP) and statement of responses (SoR)	Our water resources management plans describe how we will continue to meet the demand for water in our South Staffs and Cambridge regions over the long term. Following a 12-week consultation period on our draft plans, we received responses from nine organisations, including: • the Environment Agency; • Defra; • Ofwat; and • CCWater. We have summarised their queries and comments and how we have addressed them in our SoR, which can be found on our website at: www.south-staffs-water.co.uk/media/2231/statement-of-response-to-dwrmp19.pdf. Alongside this, we published a revised draft of both water resources management plans with the suggested amendments from the feedback we received. The plan for our South Staffs region can be found at: www.south-staffs-water.co.uk/media/2230/revised-draft-wrmp-2019-south-staffs-water.pdf, while the plan for our Cambridge region can be found at: www.cambridge-water.co.uk/media/2155/revised-draft-wrmp-2019.pdf.

Report	Explanation
Environment Agency annual return 2018/19	Each year, we report our progress against our water resources management plans to Defra and the Environment Agency. This annual review includes commentary on progress, as well as data such as our actual 2018/19 water consumption. We followed the Environment Agency's reporting guidance to produce our annual review for 2018/19 and produced separate submissions for our South Staffs and Cambridge regions. As most of the data in our annual review is from the APR it has been through that level of assurance. We submitted our reviews for 2018/19 on 28 June 2019, in line with the deadline associated with these reviews.
DWI annual return 2018	Over the reporting year we have extensive ongoing engagement with the DWI across a range of day-to-day processes, regular data submissions and end-of-year data submissions. Our data submission in February 2019 covered the 2018 calendar year and provided data on customer contact rates to the DWI. This is used, alongside regulatory sample data provided throughout the year, to monitor and report on our compliance. The DWI's drinking water report for 2018 is due to be published in July 2019. The DWI is introducing a new water quality composite measure, the Compliance Risk Index (CRI), in 2021. We have begun shadow reporting on this measure to ensure we are compliant and are reporting consistently with the rest of the water sector.
Carbon Reduction Commitment (CRC) Energy Efficiency Scheme 2018/19	This is a UK Government scheme designed to improve energy efficiency and cut carbon dioxide emissions in private and public sector organisations that are high energy users. The Environment Agency administers the scheme for the UK and regulates the scheme in England. In each compliance year, we collate and report information about our energy supplies to buy and surrender the appropriate carbon emission allowances. We inform the Environment Agency about changes to the business that could affect our registration, and we also keep the appropriate records about our energy supplies and organisation in an evidence pack. To ensure accuracy and consistency, we engaged independent internal audit to check the data sources and calculation methodologies.
CCWater annual update 2018/19	We supply CCWater with final, audited, year end data at the same time as we publish our APR. The data we submit is the final year end update to the quarterly reporting information that we send throughout the year, but which does not get audited until June each year. The data we submit at the end of the year is robust as it is the same data that we publish in our APR.
Developer Services charges	Our Developer Services charges scheme for 2019/20 contains detailed information about charges for new developments and connections to our network from 1 April 2019. We held a meeting of our Developers' Forum in July 2018 to help us understand their views; we also received comments from Ofwat and CCWater on our 2018/19 charges scheme. We took this feedback on board and have made our current charges scheme more transparent and easier to understand. This included providing greater clarity on all our charge types and rates. Where possible, we have fixed more charges, which should make it easier for developers to estimate their overall cost of connections more accurately. Our latest charges scheme is available on our website at: www.south-staffs-water.co.uk/media/2470/developer-services-charges-2019-to-2020.pdf.

Report	Explanation
Customer charges schemes 2019/20	We published our customer charges schemes in February 2019 for our South Staffs and Cambridge regions. These documents set out our charges for water services and also those we collect on behalf of Severn Trent Water in our South Staffs region and Anglian Water in our Cambridge region for wastewater services. The schemes cover the period from 1 April 2019 to 31 March 2020. We ensured no customer group received a bill increase of more than 5%. In addition, our customer engagement demonstrated that customers were willing to contribute a £3 cross-subsidy for our Assure social tariff, compared with the £1.50 charged in the previous year. This will enable us to help more than 26,000 customers who are struggling to pay their water bills. The charges scheme for our South Staffs region is available at: www.south-staffs-water.co.uk/media/2475/customer-charges-scheme-2019-20_lo.pdf, while the scheme for our Cambridge region is available at: www.cambridge-water.co.uk/media/2404/customer-charges-scheme-2019-20-cam_lo.pdf.

Board governance

Our Board has had extensive involvement in the production, audit and publication of our APR, including the summary version intended for customers and non-technical stakeholders.

The Audit Committee has overseen the external and internal assurance that has been carried out on the APR, and all audit reports produced internally and externally have been made available to the Committee and to the full Board for review and challenge.

The Board has also satisfied itself that we have implemented the improvements to the APR that we committed to in our assurance plan, shown in the table on page 129 above.

With sight of all of the above audit information, the Board has signed off the APR submission as being an accurate set of information on our 2018/19 regulatory accounts and performance.

External assurance of financial outcome delivery incentives

2018-19 SSC APR assurance letter

JACOBS

Letter of Assurance

For the attention of the Audit Committee **2 July 2019**

2018-19 APR assurance

Scope

Ofwat requires companies to publish an Annual Performance Report (APR) each July. The APRs are an important element of Ofwat's framework for encouraging companies to be transparent about their performance and for collecting information it requires to perform its duties. They also allow stakeholders to hold companies to account when they do not deliver against their promises. It is therefore important that customers and other stakeholders can have trust and confidence in the information contained in companies' APRs.

As your technical assurance partner, your team asked us to take a risk-based approach to reviewing the following aspects of your 2018-19 APR reporting:

- **Performance commitments (PCs)** – the proposed performance figures for the PCs in your final determination (FD) that have financial rewards and penalties associated with them and your reputational per capita consumption (PCC) PC;
- **Common PCs** – your reporting across each of the eight common PCs Ofwat requires water only companies to shadow report in the APR, focusing on the compliance assessments you are required to make;
- **APR section 4 tables and lines** – a selection of the non-financial lines in APR section 4 tables 4P and 4Q, focusing mainly on sample checking across the lines you asked us to review;
- **Return on Regulated Equity (RoRE) and financial flows** – your notional RoRE figure and calculations and your interpretation of Ofwat's financial flows methodologies (now that reporting is part of the APR);
- **Long-term viability statement (LTVS)** – your LTVS for consistency with Ofwat guidance (including IN 19/07 that clarified Ofwat's LTVS requirements); and
- **Reconciling for past performance –** the value of any movements in the PR14 adjustments compared to your PR19 business plan submission to reflect 2018-19 performance and updated forecasts for 2019-20, as Ofwat asked companies to update their proposed reconciliation adjustments for the 2015-20 period through the 2018-19 APR (our work therefore built on the assurance we provided on your business plan in this area).

As per last year, our assurance work was focused on assessing the level of reporting risk associated with data items. This letter summaries our work across the areas above. It is supported by separate detailed reports. We note we provided you with a standalone assurance letter covering your unplanned outage common PC reporting ahead of Ofwat's early submission date of 15 May 2019.

Findings

Across the PC and APR section 4 data we reviewed we generally observed no material issues with the data being reported. There are only two PC, or PC components, we consider might carry a material reporting risk (see table below).

PC	Potential outstanding material reporting risk
2.3	**Serviceability (non-infra) – unplanned maintenance component (CAM)** Based on our work last year we consider the team has a good understanding of the process and data. However, we continue to consider the quality and completeness of the source data presents a material risk to the CAM unplanned maintenance figure. The team remains reliant on paper documentation and cannot reliably determine if it is capturing all unplanned maintenance paper records. We note that whilst material for the CAM region, the company's overall performance for this serviceability component is again significantly below the reference level and the impact on the 2018-19 overall serviceability assessment of stable is unlikely to be material. We note that in the SST region, which accounts for a higher proportion of work orders, you capture orders at source on Maximo using field-based systems.

PC	Potential outstanding material reporting risk
4.3	**Per capita consumption (SSC)** We reviewed your reputational only PCC PC as part of your leakage reporting. We identified a number of issues during our water balance audits that have the potential to make a material impact on this measure. We did not identify any additional issues specifically in relation to the process for calculating this measure. For the calculation of this PC though, we note the specific material issue with the base data is that the method for calculating unmetered PCC for Cambridge is not robust and introduces significant reporting risk (eg: the team's assessment is based on applying changes seen in the metered PCC value to unmetered PCC without being able to demonstrate changes in the two are sufficiently linked and without taking account of the movement of customers from unmetered to metered). We note this does not materially impact on your reporting against your leakage PC for 2018-19. (The way in which the MLE for CAM distributes uncertainty across the water balance components means your leakage figure is very insensitive to changes in PCC).

We note that for leakage, we identified areas where we considered that although your team's approaches are consistent with prior years (and the basis on which the targets were set), they are no longer aligned to best practice. For some elements of the water balance, the original justification for assumptions is also unclear and processes could be more tightly controlled; and for your CAM region the team has made some changes to its reporting process. We consider it is difficult to evaluate the net impact of these issues, but note that you are on, or close to, your performance target in both your SST and CAM regions. We have agreed to discuss plans for improvement; this will form part of your plan to align your approach to the common PC leakage definition and methodologies.

For the common PCs, we note Ofwat has said it expects all companies to be ready to report in line with the standard definitions for 2019-20. It also expects companies to provide a clear commitment that they are putting in place all necessary plans to be able to do this. We consider your reporting, as seen during our audits, for five of the measures currently carries a material level of reporting risk. Our assessment is driven by a mix of your teams' own assessment of their gaps in compliance with Ofwat's guidance for this report year and the fact that it was not clear from our audits with them that they have all necessary plans in place to meet Ofwat's expectations next year. We understand you have updated your approach to some common PCs ahead of submission and are considering updating your approach to others.

We also note that although we observed teams had improved their reporting processes in some areas, the existence of formal reporting documentation is still not widespread and processes were materially unchanged in some areas. As such, although teams appear to have a good understanding of their existing processes, we consider there is scope to materially reduce your reporting risk by reviewing and improving your supporting documentation and processes – particularly where you rely heavily on individual subject matter experts to carry out unchecked complex processes that are not always aligned to the latest best practice (e.g. leakage and PCC). We would recommend doing this in advance of 2020-25 reporting as we have observed that a more detailed examination of reporting documentation, processes and data can lead to identifying additional opportunities to lower reporting risk.

We note that based on our review of your team's RoRE model, we consider that the calculations, assumptions and inputs to the headline model are consistent with the methodology provided by Ofwat. For financial flows, we observed the team's methodology for completing APR table 1F is consistent with Ofwat guidance; and that the inputs to the financial flows model are consistent with the Ofwat guidance and tie to relevant source data. Your team raised queries with Ofwat on two areas of the guidance that it considered were open to a degree of interpretation; and has reflected Ofwat's responses in its proposed figures. Your team has confirmed that it will provide commentary on its approach for these items.

For your LTVS, your team appear to have applied appropriate rigour when making your assessment of long-term viability and the information provided to stakeholders appears suitably transparent and robust. Your statement also provides an explanation of how your team assessed the prospects over the appropriate period. We note though that Ofwat's clarified expectations, as set out in IN 19/07, set out a large, but not exhaustive, number of considerations to cover in a company LTVS. Although not all considerations will be equally relevant for each company, you agreed you would be more explicit in how you have examined some areas Ofwat expects you to have considered.

2018-19 SSC APR assurance letter

JACOBS

During our review of the movements in your reconciliation of past performance figures (compared to your PR19 business plan submission), we observed your team appeared to have fully considered the impact of the latest information on your proposed adjustments. We understand you will provide commentary that supports the changes set out in your APR19 update. We also note the team continued to demonstrate the commitment to, and ownership of, this process that we observed during our PR19 work in this area.

Conclusions

For the areas you asked us to review our conclusions are as follows:

- APR section 4 table data – we identified no material issues with the data being reported;
- PCs – we identified a limited number of PCs we consider might carry a material reporting risk;
- Common PCs – we consider your reporting for five of the measures currently carries a material level of reporting risk; and
- RoRE, financial flows, LTVS and reconciling for past performance – we identified no material issues with the approaches but note there are opportunities for you to clarify your approach by including commentary with your submission.

This letter summarises the results of our APR assurance. We are providing you with separate reports that set out our scope, findings and general observations in more detail.

Alexandra Martin
Divisional Director

Management Response to Jacobs' Letter of Assurance

Jacobs has carried out a detailed and extensive review across six key areas of our APR as requested. We have engaged closely with this review and made a number of changes as a result of the insight provided, and continue to address some of the longer term advice and observations. The key purpose of this review has been to provide assurance to our Board as to the quality and accuracy of the reporting within our APR; this assurance has been successfully delivered. Jacobs raise a number of points that we feel are worthy of management comment:

Unplanned maintenance (CAM)

Although we agree that this metric does not materially affect overall stable serviceability, we recognise the risk of using paper based records. We are looking to capture this data in future through our works management system as part of our 'enhancing ways of working' project.

PCC (CAM)

We acknowledge that there are some limitations with the methodology we currently use. During AMP6 we have been mindful of making methodological changes which would alter the basis of the calculation on which our AMP6 targets were based. For the shadow reporting and future AMP7 performance commitments we have plans in place to develop consumption monitors to improve our Cambridge unmeasured PCC data for 2020/21 onwards, in line with the latest convergence methodology and best practice. Our new monitors will involve the use of fast logging which will also improve our data for bottom up leakage and night use allowances.

Reporting of common PCs

We have action plans in place to ensure that we are compliant with the standard definitions for 2019-20. This includes improvements to data capture, documented methodologies, the development of new data models and external support where necessary.

Internal independent assurance of reputational outcome delivery incentives

South Staffs and Cambridge Water 2018/19

As the South Staffordshire Group Internal Audit Manager (with over twenty-five years' experience of working within the Water Industry), Internal Audit was requested to perform an independent review of the reporting of reputational ODIs below:

- Biodiversity
- Carbon Emission savings
- Support for Customers in Debt
- Community Engagement
- Customer Satisfaction
- Value for Money and Affordability
- Abstraction Incentive Mechanism

The audit work carried out sought to review the methodology supporting the calculations to ensure accuracy, consistency and validity of the numbers provided. Internal Audit has confirmed that that the figures reported have been validated and checked to supporting information.

Glyn Palmer BA (Hons) FCA

Group Internal Audit Manager

July 2019

Independent Auditor's report

Independent Auditors' report to the Water Services Regulation Authority (the WSRA) and the Directors of South Staffordshire Water Plc

Report on the audit of the Regulatory Accounting Statements

Opinion

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

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

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

In our opinion, South Staffordshire Water Plc's Regulatory Accounting Statements within the Annual Performance Report have been prepared, in all material aspects, in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.08, RAG 2.07, RAG 3.11, RAG 4.08 and RAG 5.07) and the accounting policies (including the Company's published [accounting methodology statement(s), as defined in RAG 3.11, appendix 2]), set out on pages 121 to 123.

Basis for opinion

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

Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the Regulatory Accounting Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit, including the Financial Reporting Council's (FRC's) Ethical Standard, 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 – special purpose basis of preparation

We draw attention to the fact that the Regulatory Accounting Statements have been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the Company's published [accounting methodology statement(s), as defined in RAG 3.11, appendix 2]) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment. In addition, we are not required to assess whether the methods of cost allocation set out in the Methodology Statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA.

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

The Regulatory Accounting Statements on pages 142 to 163 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from UK GAAP. A summary of the effect of these departures from Generally Accepted Accounting Practice in the Company's statutory financial statements is included in the tables within section 1.

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

Our opinion is not modified in respect of this matter.

Conclusions relating to going concern

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

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

Other information

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

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

We have nothing to report based on these responsibilities.

Responsibilities of the Directors for the Regulatory Accounting Statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 113, the directors are responsible for the preparation of the Regulatory Accounting Statements in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published [accounting methodology statement(s), as defined in RAG 3.10, appendix 2]).

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

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

Auditor's responsibilities for the Audit of the Regulatory Accounting Statements

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

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

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

Report on other legal and regulatory requirements

Opinion on other matters prescribed by Condition F

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

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

Use of this report

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

Our opinion on the Regulatory Accounting Statements is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2019 on which we reported on 15 July 2019, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Deloitte LLP

Deloitte LLP

Statutory Auditors

Leeds, United Kingdom

15 July 2019

Section 1 – regulatory accounts primary statements

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

	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities
	£m	£m	£m	£m	£m
Revenue	128.781	0.656	5.666	(5.010)	123.771
Operating costs	(98.846)	(7.281)	(3.416)	(3.865)	(102.711)
Other operating income	1.137	(0.474)	0.561	(1.035)	0.102
Operating profit	31.072	(7.099)	2.811	(9.910)	21.162
Other income	-	7.755	0.144	7.611	7.611
Interest income	2.545	-	-	-	2.545
Interest expense	(14.604)	-	-	-	(14.604)
Other interest expense	(0.178)	-	-	-	(0.178)
Profit before tax and fair value movements	18.835	0.656	2.955	(2.299)	16.536
Fair value gains/(losses) on financial instruments	-	-	-	-	-
Profit before tax	18.835	0.656	2.955	(2.299)	16.536
UK corporation tax	(2.898)	-	(0.562)	0.562	(2.336)
Deferred tax	(0.448)	-	-	-	(0.448)
Profit for the year	15.489	0.656	2.393	(1.737)	13.752
Dividends	(8.424)	-	(2.393)	2.393	(6.031)
Tax analysis					
Current year	3.321	-	0.562	(0.562)	2.759
Adjustments in respect of prior years	(0.423)	-	-	-	(0.423)
UK Corporation tax	2.898	-	0.562	(0.562)	2.336

Analysis of non-appointed revenue	**Non-appointed**
Imported sludge	-
Tankered waste	-
Other non-appointed revenue	5.666
Revenue	5.666

Activities outside of the appointed business include:

- Aqua Direct spring water business;
- commission from sewerage collection;
- property searches;
- sailing and fisheries;
- restaurant facilities;
- rental income from non-appointed properties; and
- energy generation.

Non-appointed operational costs include the cost of providing these services, including a share of depreciation to the non-appointed business for the use of assets owned by the wholesale business.

1a) Income statement – continued

In line with the RAGs, the following adjustments between the statutory financial statements and regulatory reporting have been completed.

	Revenue £m	**Operating costs £m**	**Other operating income £m**	**Other income £m**	**Profit for the year £m**
Revenue not recognised under FRS102	0.656	-	-	-	0.656
Rental income	-	-	(0.474)	0.474	-
Amortisation of capital contributions	-	(2.701)	-	2.701	-
IRE contributions	-	(4.580)	-	4.580	-
Net adjustments	0.656	(7.281)	(0.474)	7.755	0.656

Reconciliation of appointed current taxation to standard tax rate

This reconciliation of the appointed current tax charge results from applying the standard tax rate to the profit before tax as shown in table 1a.

	2019 £m		Current Tax £m
PBT			
Appointed	15.880		(2.336)
Non appointed	2.955		(0.562)
Total	**18.835**		**(2.898)**
Appointed profit on ordinary activities	**15.880**		
Appointed profit before tax at standard UK corporation tax rate of 19%	3.017		
Expenses not deductible for tax purposes		0.145	
Capital allowances less than depreciation		(0.614)	
Other timing differences		0.211	
Adjustments in respect of prior years		(0.423)	
	(0.681)		
Appointed current tax charge	**2.336**		
Appointed total current tax charge allowed in price limits	**2.128**		
Variance			
Impact of difference between tax rate used in price limits (20%) and actual tax rate (19%)		(0.106)	
Differences in profit before tax		0.041	
Taxable interest income for which no tax allowance given in price limit		0.484	
Expenses not deductible for tax purposes for which no tax allowance given in price limit		0.333	
Capital allowances in advance of depreciation		(0.252)	
Other timing differences		0.131	
	0.631		
Current year	**2.759**		
Adjustments in respect of prior years	(0.423)		
Appointed current tax charge	**2.336**		

The current tax charge in respect of the year at £2.7m was higher than that allowed in price limits by £0.6m and was offset by adjustments from prior years of £0.4m. These arise primarily as a result of the company revising its estimate of the tax impact of the transition to FRS 102. The change of basis of accounting for certain historical items, on transition, and the related revision to estimates, have given rise to a current tax credit and an equivalent offsetting deferred tax charge during the year.

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

	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities
	£m	£m	£m	£m	£m
Profit for the year	15.489	0.656	2.393	(1.737)	13.752
Actuarial gains/(losses) on post employment plans	-	-	-	-	-
Other comprehensive income	(0.254)	-	-	-	(0.254)
Total comprehensive income for the year	15.235	0.656	2.393	(1.737)	13.498

Other comprehensive income relates to the movement in the hedging reserve net of deferred tax.

1c) Statement of financial position – as at 31 March 2019

	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities
	£m	£m	£m	£m	£m
Non-current assets					
Fixed assets	531.869	-	1.907	(1.907)	529.962
Intangible assets	-	-	-	-	-
Investments - loans to group companies	-	25.000	-	25.000	25.000
Investments - other	-	-	-	-	-
Financial instruments	-	-	-	-	-
Retirement benefit assets	-	-	-	-	-
Total non-current assets	531.869	25.000	1.907	23.093	554.962
Current assets					
Inventories	2.366	-	0.038	(0.038)	2.328
Trade & other receivables	75.824	(17.693)	1.994	(19.687)	56.137
Financial instruments	-	-	-	-	-
Cash & cash equivalents	0.764	-	-	-	0.764
Total current assets	78.954	(17.693)	2.032	(19.725)	59.229
Current liabilities					
Trade & other payables	(50.982)	(7.307)	4.409	(11.716)	(62.698)
Capex creditor	(5.341)	-	(0.216)	0.216	(5.125)
Borrowings	-	-	-	-	-
Financial instruments	-	-	-	-	-
Current tax liabilities	(1.745)	-	-	-	(1.745)
Provisions	-	-	-	-	-
Total current liabilities	(58.068)	(7.307)	4.193	(11.500)	(69.568)
Net current assets/(liabilities)	20.886	(25.000)	6.225	(31.225)	(10.339)
Non-Current liabilities					
Trade & other payables	(14.437)	-	(0.386)	0.386	(14.051)
Borrowings	(269.114)	-	-	-	(269.114)
Financial instruments	(2.153)	-	-	-	(2.153)
Retirement benefit obligations	-	-	-	-	-
Provisions	-	-	-	-	-
Deferred income - G&C's	(152.310)	-	(0.007)	0.007	(152.303)
Deferred income - adopted assets	-	-	-	-	-
Preference share capital	-	-	-	-	-
Deferred tax	(39.732)	-	-	-	(39.732)
Total non-current liabilities	(477.746)	-	(0.393)	0.393	(477.353)
Net assets	75.009	-	7.739	(7.739)	67.270
Equity					
Called up share capital	2.123	-	-	-	2.123
Retained earnings & other reserves	72.886	-	7.739	(7.739)	65.147
Total Equity	75.009	-	7.739	(7.739)	67.270

Activities outside of the appointed business include:

- Aqua Direct spring water business;
- commission from sewerage collection;
- property searches;
- sailing and fisheries;
- rental income from non-appointed properties; and
- energy generation.

1c) Statement of financial position – continued

The statement of financial position reflects the balance sheet as at 31 March 2019. Both statutory financial statements and regulatory reporting is based on FRS 102, with the following adjustments to reflect the RAGs.

	Investments - loans to group companies £m	**Trade & other receivables £m**	**Trade & other payables £m**	**Net assets £m**
Long term group debtor	25.000	(25.000)	-	-
Inter company alignments	-	7.307	(7.307)	-
Net adjustments	25.000	(17.693)	(7.307)	-

1d) Statement of cash flows – for the 12 months ended 31 March 2019

	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities
	£m	£m	£m	£m	£m
Statement of cashflows					
Operating profit	31.072	(7.099)	2.811	(9.910)	21.162
Other income	-	7.755	0.144	7.611	7.611
Depreciation	23.654	-	0.137	(0.137)	23.517
Amortisation - G&C's	(2.701)	-	-	-	(2.701)
Changes in working capital	(0.428)	(0.656)	0.472	(1.128)	(1.556)
Pension contributions	-	-	-	-	-
Movement in provisions	-	-	-	-	-
Profit on sale of fixed assets	(0.663)	-	(0.561)	0.561	(0.102)
Cash generated from operations	50.934	(0.000)	3.003	(3.003)	47.931
Net interest paid	(7.093)	-	-	-	(7.093)
Tax paid	(2.069)	-	(0.562)	0.562	(1.507)
Net cash generated from operating activities	41.772	(0.000)	2.441	(2.441)	39.331
Investing activities					
Capital expenditure	(44.251)	-	(0.502)	0.502	(43.749)
Grants & contributions	8.515	-	-	-	8.515
Disposal of fixed assets	0.567	-	0.456	(0.456)	0.111
Other	-	-	-	-	-
Net cash used in investing activities	(35.169)	-	(0.046)	0.046	(35.123)
Net cash generated before financing activities	6.603	(0.000)	2.395	(2.395)	4.208
Cashflows from financing activities					
Equity dividends paid	(8.424)	-	(2.393)	2.393	(6.031)
Net loans received	0.393	-	-	-	0.393
Cash inflow from equity financing	-	-	-	-	-
Net cash generated from financing activities	(8.031)	-	(2.393)	2.393	(5.638)
Increase/(decrease) in net cash	(1.428)	(0.000)	0.002	(0.002)	(1.430)

Capital expenditure relates to the cash paid out in the year in relation to fixed asset additions. The difference in what was paid for in the appointed business £43,749,000 and additions reported in the fixed assets note 2d £43,884,000 is due to an increase in year of creditors relating to capital purchases of £135,000.

1d) Statement of cash flows – continued

	Operating profit £m	Other income £m	Changes in working capital £m	Increase / (decrease) in net cash £m
Revenue not recognised under FRS102	0.656	-	(0.656)	-
Rental income	(0.474)	0.474	-	-
Amortisation of capital contributions	(2.701)	2.701	-	-
IRE contributions	(4.580)	4.580	-	-
Net adjustments	(7.099)	7.755	(0.656)	-

1e) Net debt analysis – as at 31 March 2019

	Interest rate risk profile			
	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Borrowings (excluding preference shares)	31.619	7.740	229.755	269.114
Preference share capital	-	-	-	-
Total borrowings	31.619	7.740	229.755	269.114
Cash				(0.764)
Short term deposits				0.000
Net debt				268.350
Gearing				70.60%
Adjusted gearing				65.47%
Full year equivalent nominal interest cost	0.897	0.106	13.525	14.528
Full year equivalent cash interest payment	0.897	0.106	7.012	8.015
Indicative interest rates				
Indicative weighted average nominal interest rate	2.84%	1.37%	6.44%	5.97%
Indicative weighted average cash interest rate	2.84%	1.37%	3.34%	3.30%
Weighted average years to maturity	2.78	4.60	27.77	24.17

Net debt comprises the book value of debt excluding accrued interest as defined by the RAGs. In addition to the coupons payable, interest costs include the impact of hedging.

The adjusted gearing of 65.5% is based on the company's covenant net debt of £248.8m, which differs to the book net debt by £19.5m. Covenant debt is the key metric used by the Board, investors, lenders and rating agencies in assessing gearing.

A full reconciliation between book net debt and covenant net debt is provided below.

The difference between book net debt in table 1e of £268.35m and that stated in the table below at £268.13m is in relation to accrued interest of £0.22m, which is not recognised as part of net debt in accordance with the RAGs. The regulatory gearing ratio is at 70.54% (70.60% using statutory book debt below and 65.5% using covenant debt).

The difference between covenant and book net debt includes £11.6m, which relates to the unamortised premium and costs on issuance of the company's debt. The remaining £7.7m relates to the difference in the long-term inflation assumption to maturity used for the book value of index-linked debt compared to the lower actual inflation rate used for covenant reporting.

The table below explains the book net debt and net debt reported for borrowing covenants.

	31 March 2019	
	£'000	**Gearing %**
Book net debt - statutory accounts	(268.350)	70.60%
Exclude accrued interest	0.215	(0.06%)
Book net debt (as reported above)	(268.134)	70.54%
Exclude book premium on issue of index linked debt	13.447	(3.54%)
Difference between long-term RPI assumption and actual RPI inflation	7.673	(2.02%)
Exclude unamortised issue costs	(1.819)	0.48%
Net debt reported for borrowing covenants	(248.834)	65.47%

1f) Financial flows – for the 12 months ended 31 March 2019

			12 Months ended 31 March 2019					
				%			£m	
	Units	DP	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	%	2	5.82%	4.49%	5.82%	7.056	5.446	5.446
Actual performance adjustment 2010-2015	%	2	2.52%	1.94%	2.52%	3.055	2.358	2.358
Adjusted return on regulatory equity	%	2	8.34%	6.44%	8.34%	10.111	7.804	7.804
Regulatory equity base	£m	3	121.235	121.235	93.569			
Financing								
Gearing	%	2	0.00%	1.31%	1.70%	-	1.590	1.590
Variance in corporation tax	%	2	0.00%	0.02%	0.02%	-	0.020	0.020
Group relief	%	2	0.00%	0.00%	0.00%	-	-	-
Cost of debt	%	2	0.00%	0.53%	0.68%	-	0.637	0.637
Hedging instruments	%	2	0.00%	(0.34%)	(0.44%)	-	(0.408)	(0.408)
Financing total	%	2	8.34%	7.95%	10.31%	10.111	9.643	9.643
Operational Performance								
Totex out / (under) performance	%	2	0.00%	(0.50%)	(0.65%)	-	(0.609)	(0.609)
ODI out / (under) performance	%	2	0.00%	0.19%	0.25%	-	0.231	0.231
Retail out / (under) performance	%	2	0.00%	2.58%	3.34%	-	3.122	3.122
Other exceptional items	%	2	0.00%	0.00%	0.00%	-	-	-
Operational performance total	%	2	0.00%	2.26%	2.93%	-	2.744	2.744
Total earnings	%	2	8.34%	10.22%	13.24%	10.111	12.387	12.387

RCV growth from RPI inflation	%	2	3.06%	3.06%	3.06%	3.710	3.710	2.863
Total shareholder return	%	2	11.40%	13.28%	16.30%	13.821	16.096	15.250
Net dividend	%	2	4.00%	2.83%	3.66%	4.849	3.429	3.429
Retained value	%	2	7.40%	10.45%	12.63%	8.971	12.667	11.821

Dividends reconciliation								
Gross dividend	%	2	4.00%	4.30%	5.57%	4.849	5.209	5.209
Interest receivable on intercompany loans	%	2	0.00%	1.47%	1.90%	-	1.780	1.780
Net dividend	%	2	4.00%	2.83%	3.66%	4.849	3.429	3.429

1f) Financial flows – average for AMP6

			Average 2015-19					
			%			£m		
	Units	DP	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	%	2	5.90%	4.78%	5.90%	7.00	5.67	5.67
Actual performance adjustment 2010-2015	%	2	2.42%	1.96%	2.42%	2.87	2.33	2.33
Adjusted return on regulatory equity	%	2	8.32%	6.74%	8.32%	9.87	8.00	8.00
Regulatory equity base	£m	3	118.645	118.645	96.114			
Financing								
Gearing	%	2	0.00%	1.23%	1.52%	-	1.46	1.46
Variance in corporation tax	%	2	0.00%	1.16%	1.43%	-	1.37	1.37
Group relief	%	2	0.00%	0.00%	0.00%	-	-	-
Cost of debt	%	2	0.00%	(0.63%)	(0.93%)	-	(0.75)	(0.89)
Hedging instruments	%	2	0.00%	(0.33%)	(0.40%)	-	(0.39)	(0.39)
Financing total	%	2	8.32%	8.17%	9.94%	9.87	9.70	9.56
Operational Performance								
Totex out / (under) performance	%	2	0.00%	(0.24%)	(0.30%)	-	(0.289)	(0.289)
ODI out / (under) performance	%	2	0.00%	0.28%	0.35%	-	0.335	0.335
Retail out / (under) performance	%	2	0.00%	2.32%	2.87%	-	2.757	2.757
Other exceptional items	%	2	0.00%	1.28%	1.58%	-	1.514	1.514
Operational performance total	%	2	0.00%	3.64%	4.49%	-	4.317	4.317
Total earnings	%	2	8.32%	11.81%	14.44%	9.871	14.016	13.874

RCV growth from RPI inflation	%	2	2.50%	2.50%	2.50%	2.966	2.966	2.403
Total shareholder return	%	2	10.82%	14.31%	16.94%	12.837	16.982	16.277
Net dividend	%	2	4.00%	5.28%	6.52%	4.746	6.270	6.270
Retained value	%	2	6.82%	9.03%	10.41%	8.092	10.712	10.007

Dividends reconciliation								
Gross dividend	%	2	4.00%	6.85%	8.45%	4.746	8.124	8.124
Interest receivable on intercompany loans	%	2	0.00%	1.56%	1.93%	-	1.854	1.854
Net dividend	%	2	4.00%	5.28%	6.52%	4.746	6.270	6.270

Addendum to table 1f

The following lines have been updated since the version published on the 15 July 2019:

Table / Line reference	Original number	Revised number	Explanation
Cost of debt – year (actual return/actual equity)	£2.428m	£0.637m	Excludes interest on intercompany loans
Cost of debt – average (actual return/notional equity)	£0.894m	-£0.748m	Excludes interest on intercompany loans
Cost of debt – average (actual return/actual equity)	£0.965m	-£0.890m	Excludes interest on intercompany loans

Commentary to financial flows

The financial flows table above is based on book debt rather than covenant debt to be consistent with Ofwat's guidance.

We exited the non-household retail market on 1 April 2017, and so in line with Ofwat's guidance the final determination RORE has been reduced by 0.15% to 5.82% in each subsequent year.

In the Ofwat prescribed table format the cost of debt of £0.637m for 2018/19 under actual returns and notional regulated equity is set to be equal to that under actual returns and actual regulated equity. Ofwat has confirmed that this is incorrect and should be an input cell. The actual cost of debt should be £0.609m. This would reduce the shareholder return for 2018/19 from 10.45% to 10.42%. The average for AMP6 is unaffected.

The four-year actual average shareholder return based on actual regulatory equity and using book debt is 16.94%, 6.12% above the notional return in the final determination. This is driven by:

- returns from higher gearing using the average book debt of 71.1% compared to the notional gearing of 62.5%, this is 1.52%. Using covenant debt this is an under performance of 0.44%;
- higher returns from a lower tax charge of 1.43%. This is predominantly as a result of a change in the tax impact of the transition to FRS 102. The change of basis of accounting for certain historical items gave rise to a current tax credit and a deferred tax charge;
- operational outperformance, resulting in a benefit of 4.49% driven by significant cost reductions in the household retail business compared to that allowed in the final determination; and
- the benefit of the sale of the non-household retail business in 2017/18 of 1.58%.

Dividend yield is 2.5% above the final determination, with 1.58% of this outperformance the result of the sale of the non-household retail business, which generated a dividend of £8.4m in 2017/18. Excluding this one-off dividend results in an outperformance of 0.91%.

The remaining 3.59% of outperformance on shareholder returns has been retained within the business.

Calculating the financial flows using the more appropriate measure for gearing of covenant debt gives an actual shareholder return of 14.9% instead of 16.9%.

Section 2 – price review and segmental reporting

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

	Retail		Wholesale			
	Household	**Non-household**	**Water Resources**	**Water Network +**	**Water Total**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**
Revenue - price control	16.567	-	-	105.002	105.002	121.569
Revenue - non price control	-	-	-	2.202	2.202	2.202
Operating expenditure	(12.029)	-	(7.322)	(59.843)	(67.165)	(79.194)
Depreciation - tangible fixed assets	(0.916)	-	(0.366)	(22.235)	(22.601)	(23.517)
Amortisation - intangible fixed assets	-	-	-	-	-	-
Other operating income	-	-	-	0.102	0.102	0.102
Operating profit before recharges	3.622	-			17.540	21.162
Recharges in respect of 'principal use' assets						
Recharges from other segments	0.038	-	-	-	-	0.038
Recharges to other segments	-	-	-	(0.038)	(0.038)	(0.038)
Operating profit	3.660	-			17.502	21.162

2b) Wholesale totex analysis – for the 12 months ended 31 March 2019

	Water Resources £m	Water Network + £m	Total £m
Operating expenditure			
Power	2.615	12.537	15.152
Income treated as negative expenditure	-	-	-
Abstraction charges/discharge consents	2.838	0.112	2.950
Bulk supply/bulk discharge	0.010	0.030	0.040
Other operating expenditure - renewals expensed in year (Infrastructure)	-	13.894	13.894
Other operating expenditure - renewals expensed in year (Non-Infrastructure)	-	0.493	0.493
Other operating expenditure - excluding renewals	1.680	25.450	27.130
Local authority and Cumulo rates	0.171	5.207	5.378
Total operating expenditure excluding third party services	7.314	57.723	65.037
Third party services	0.008	2.120	2.128
Total operating expenditure	7.322	59.843	67.165
Capital Expenditure			
Maintaining the long term capability of the assets - infra	-	-	-
Maintaining the long term capability of the assets - non- infra	2.490	18.804	21.294
Other capital expenditure - infra	0.487	9.881	10.368
Other capital expenditure - non-infra	0.994	8.665	9.659
Infrastructure network reinforcement	-	1.416	1.416
Total gross capital expenditure excluding third party services	3.971	38.766	42.737
Third party services	-	-	-
Total gross capital expenditure	3.971	38.766	42.737
Grants and contributions			
Grants and contributions	-	13.095	13.095
Totex	11.293	85.514	96.807
Cash Expenditure			
Pension deficit recovery payments	-	-	-
Other cash items	-	-	-
Total			
Totex including cash items	11.293	85.514	96.807

Wholesale pension deficit recovery payments of £1.080m are included in the totex lines within operating and capital expenditure. Third party operating expenditure includes the costs of providing bulk supplies and other rechargeable works.

2c) Retail operating costs analysis – for the 12 months ended 31 March 2019

	Household	Non-household	Total
	£m	£m	£m
Operating expenditure			
Customer services	4.805	-	4.805
Debt management	0.540	-	0.540
Doubtful debts	2.878	-	2.878
Meter reading	0.855	-	0.855
Services to developers	-	-	-
Other operating expenditure	2.951	-	2.951
Total operating expenditure excluding third party services	12.029	-	12.029
Third party services operating expenditure	-	-	-
Total operating expenditure	12.029	-	12.029
Depreciation - tangible fixed assets	0.916	-	0.916
Amortisation - intangible fixed assets	-	-	-
Total operating costs	12.945	-	12.945
Debt written off	5.137	-	5.137

Total retail operating costs (before depreciation charges) of £12.0m were £2.7m lower than that allowed in price limits for the year.

Savings continue to be driven by:

- historic changes in metering operations;
- the transfer of non-voice back office functions off shore;
- the merging of the Cambridge customer contact centre operations with those in the South Staffs region; and
- more use of digital and self-serve communications channels.

2d) Historic costs analysis of fixed assets (wholesale and retail) – for the 12 months ended 31 March 2019

	Wholesale		Retail		
	Water Resources	Water Network +	Household	Non-household	Total
	£m	£m	£m	£m	£m
Cost					
At 1 April 2018	14.373	893.200	11.103	-	918.676
Disposals	-	(0.479)	-	-	(0.479)
Additions	3.971	38.766	1.147	-	43.884
Adjustments	-	(0.008)	-	-	(0.008)
Assets adopted at nil cost	-	-	-	-	-
At 31 March 2019	18.344	931.479	12.250	-	962.073
Depreciation					
At 1 April 2018	(2.818)	(397.323)	(8.922)	-	(409.064)
Disposals	-	0.470	-	-	0.470
Adjustments	-	-	-	-	-
Charge for the year	(0.366)	(22.235)	(0.916)	-	(23.517)
At 31 March 2019	(3.184)	(419.088)	(9.838)	-	(432.111)
Net book amount at 31 March 2019	15.160	512.390	2.412	-	529.962
Net book amount at 1 April 2018	11.555	495.877	2.181	-	509.612
Depreciation charge for year					
Principal services	(0.366)	(22.235)	(0.916)	-	(23.517)
Third party services	-	-	-	-	-
Total	(0.366)	(22.235)	(0.916)	-	(23.517)

2e) Analysis of capital contributions and land sales (wholesale)

	Fully recognised in income statement £m	Capitalised and amortised (in income statement) £m	Fully netted off capex £m	Total £m
Grants and contributions - water				
Connection charges (s45)	-	2.470	-	2.470
Infrastructure charge receipts (s146)	-	1.914	-	1.914
Requisitioned mains (s43, s55 & s56)	-	1.351	-	1.351
Other contributions (price control)	-	-	-	-
Diversions (s185)	4.580	-	-	4.580
Other contributions (non-price control)	-	2.780	-	2.780
Total	4.580	8.515	-	13.095
Value of adopted assets	-	-	-	-

	Water £m
Movements in capitalised grants and contributions	
Brought forward	146.496
Capitalised in year	8.515
Amortisation (in income statement)	(2.701)
Carried forward	152.310

Land sales	
Proceeds from disposals of protected land	-

Contributions for main diversions are now shown as other income within table 1a with the cost shown in table 2b at the gross position before contributions in line with the RAGs.

2f) Revenues by customer type (household)

	Wholesale charges revenue	Retail revenue	Total revenue	Number of customers	Average household retail revenue per customer
	£m	**£m**	**£m**	**(000s)**	**£**
Unmeasured water only customer	46.147	8.943	55.090	374.117	23.90
Unmeasured wastewater only customer	-	-	-	-	-
Unmeasured water and wastewater customer	-	-	-	-	-
Measured water only customer	35.029	7.624	42.653	304.464	25.04
Measured wastewater only customer	-	-	-	-	-
Measured water and wastewater customer	-	-	-	-	-
Total	81.176	16.567	97.743	678.581	24.41

Household retail revenues are £0.048m higher than that assumed in the final determination. This is largely because of higher demand from metered customers in the year.

2g) Revenues by customer type (non-household)

As at 1 April 2017 we exited the non-household retail market and in accordance with the reporting requirements, can confirm that our wholesale revenue relating to non-household was £23.826m for the year.

2i) Revenue analysis and wholesale control reconciliation

	Household	Non-household	Total
	£m	£m	£m
Wholesale charge - water			
Unmeasured	46.147	1.004	47.151
Measured	35.029	22.822	57.851
Third party revenue	-	-	-
Total	81.176	23.826	105.002
Retail revenue			
Unmeasured	8.943	-	8.943
Measured	7.624	-	7.624
Other third party revenue	-	-	-
Retail total	16.567	-	16.567
Third party revenue - non-price control			
Bulk Supplies - water			0.368
Bulk Supplies - wastewater			-
Other third party revenue			0.890
Principal services - non-price control			
Other appointed revenue			0.944
Total appointed revenue			123.771

	Water
	£m
Wholesale revenue governed by price control	105.002
Grants & contributions	5.735
Total revenue governed by wholesale price control	110.737
Amount assumed in wholesale determination	106.265
Adjustment for in-period ODI revenue	-
Adjustment for WRFIM	0.886
Total assumed revenue	107.151
Difference	3.586

Wholesale revenues were £3.586m higher than that assumed in the wholesale price control. After adjusting for the Wholesale Revenue Forecasting Incentive Mechanism (WRFIM) under-recovery from 2016/17 of £0.9m, revenue from water customers was broadly in line with the final determination. Contributions predominantly from developer charges was £3.580m higher, reflecting a higher number of new property connections in the year and higher costs incurred by the company for a significant number of non-standard connections on brownfield sites and infill of smaller developments. The wholesale control assumed that all connections were large housing developments in greenfield sites.

The company has had no net benefit from higher capital contributions from developers, which were as a result of higher costs incurred.

We submitted a claim as part of our business plan submission proposing that there should be no adjustment through WRFIM for this additional revenue.

2j) Infrastructure network reinforcement costs

	Network reinforcement capex £m	On site/site specific capex (memo only) £m
Wholesale water network+ (treated water distribution)		
Distribution and trunk mains	1.416	-
Pumping and storage facilities	-	-
Other	-	-
Total	1.416	-

2k) Infrastructure charges reconciliation

	Infrastructure charges reconciliation £m
Impact of infrastructure charge discounts	
Infrastructure charges	1.914
Discounts applied to infrastructure charges	-
Gross infrastructure charges	1.914
Comparison of revenue and costs	
Variance brought forward	-
Revenue	1.914
Costs	(1.416)
Variance carried forward	0.498

Infrastructure charges received in the year were £0.5m higher than the costs of infrastructure network reinforcement. This is as a result of the timing of new developments and is expected to reverse in future years.

Section 3 – performance summary

3a) Outcome performance

Performance commitment	Unit	Unit description	Decimal places	2017-18 performance level - actual (for information)	2018-19 performance level - actual	2018-19 PCL met?	2018-19 outperformance payment or underperformance payment - in-period ODIs (indicator)	2018-19 outperformance payment or underperformance payment - in-period ODIs (£m, to 4 dp)	2018-19 outperformance payment or underperformance payment - ODIs payable at the end of AMP6 (indicator)	2018-19 outperformance payment or underperformance payment - ODIs payable at the end of AMP6 (£m, to 4 dp)	31 March 2020 forecast - total AMP6 outperformance payment or underperformance payment (indicator)	31 March 2020 forecast - total AMP6 outperformance payment or underperformance payment (£m, to 4 dp)
								£m		£m		£m
1.1: Mean zonal compliance (MZC, combined company)	%	Mean zonal compliance (%)	3	99.943	99.915	No	0	0.0000	Underperformance payment	(0.1620)	Underperformance payment	(0.3623)
1.2: Acceptability of water to customers (combined company)	nr	No. of contacts per 1,000 population	2	1.42	1.51	No	0	0.0000	Underperformance payment	(0.4452)	Underperformance payment	(0.9438)
2.1: Interruptions to supply (combined company)	time	Minutes / property / year	1	8.5	7.2	Yes	0	0.0000	Outperformance payment	0.8381	Outperformance payment	3.7681
2.2: Serviceability infrastructure (combined company)	category	Asset health indicator	na	Stable	Stable	Yes	0	0.0000	-	0.0000	-	0.0000
2.3: Serviceability non-infrastructure	category	Asset health indicator	na	Stable	Stable	Yes	0	0.0000	-	0.0000	-	0.0000

(combined company)												
4.1: Leakage (South Staffordshire operating region)	nr	Megalitres per day (Ml/d)	1	72.4	70.5	Yes	0	0.0000	-	0.0000	-	0.0000
4.2: Leakage (Cambridge operating region)	nr	Megalitres per day (Ml/d)	1	14.4	13.2	Yes	0	0.0000	Outperformance payment deadband	0.0000	Underperformance payment	(0.2166)
4.3: Water efficiency (household per capita consumption (PCC) reported annually, combined company)	nr	Litres per head per day (l/h/d)	2	133.09	136.41	No		0.0000	-	0.0000	-	0.0000
4.4: Biodiversity (cumulative total hectares of land under management per year, combined company)	nr	Cumulative total hectares of land	0	119	138	Yes		0.0000	-	0.0000	-	0.0000
4.5: Carbon emissions from power consumption (tonnes, combined company)	nr	tCO2e (tonnes CO2e) in real savings	0	550	635	No		0.0000	-	0.0000	-	0.0000
5.1: Independent customer surveys of value for money and affordability (combined company)	%	% customers satisfied with vfm & affordability	0	94	95	Yes		0.0000	-	0.0000	-	0.0000

5.2: Support for customers in debt (combined company)	nr	No. of customers engaged with on debt	0	29,036	30,838	Yes		0.0000	-	0.0000	-	0.0000
3.1: Service incentive mechanism (SIM, combined company)	score	Service incentive mechanism (SIM) score	1	87.0	86.4	No	0	0.0000	-	0.0000	-	0.0000
3.2: Customer satisfaction surveys (combined company)	%	% customer satisfaction	0	97	98	Yes		0.0000	-	0.0000	-	0.0000
3.3: Community engagement (combined company)	nr	No. of employee days per year	0	425	749	Yes		0.0000	-	0.0000	-	0.0000

We discuss outcomes, ODIs, performance commitments and financial incentives in more detail on page 10 to 22 of the strategic report. We also summarise our performance in a customer-facing version of this APR.

The forecast AMP6 reward of £2.246m is based on the net rewards and penalties accrued in respect of 2015/16, 2016/17 and 2017/18 added to by a continued reward expectation in interruptions to supply.

3b) Sub-measure performance

PC / sub-measure	Unit	Decimal places	2017-18 performance level - actual	2018-19 performance level - actual	2018-19 PCL met?
2.2: Serviceability infrastructure (combined company)	category	na	Stable	Stable	Yes
Mains bursts	nr	0	1,300	1,244	Yes
Supply interruptions > 12 hours	nr	0	637	2,389	No
Properties with persistent low pressure	nr	0	1	1	No
Discolouration contacts per 1,000 customers	nr	2	0.70	0.82	Yes
TIM index non-compliance	score	2	0.13	0.06	No
2.3: Serviceability non-infrastructure (combined company)	category	na	Stable	Stable	Yes
WTW coliform non-compliance	%	2	0.05	0.02	Yes
Service reservoir coliform non-compliance	%	2	0.00	0.00	Yes
WTW turbidity non-compliance	nr	0	0	0	Yes
DWI enforcement actions	nr	0	0	0	Yes
Unplanned maintenance work orders	nr	0	2,662	2,802	Yes

Our assessment of stable serviceability for both infrastructure and non-infrastructure has followed the detailed methodology we set out in 'Asset Health ODI Methodology November 2015', which is available on our website at: www.south-staffs-water.co.uk/about-us/our-strategies-and-plans/our-assurance-framework.

Our calculation, and the resulting categorisation, has been externally assured by Jacobs.

For infrastructure, our headline indicator is bursts and our performance in this area has been better than the reference level of performance for the past three years. Even though we experienced an increased number of bursts as a result of the freeze/thaw event in 2017/18, our performance has improved.

The significant increase in interruptions in supply of more than 12 hours was the result of a burst on a 12" main in Smethwick in our South Staffs region in January this year. This incident affected 2,189 properties. The burst was on a cast iron delivery main of the Smethwick Booster. Because of the surrounding geography, a significant part of the zone could not be fed from another source.

Therefore, the indicator is above the reference level of performance for 2018/19, but as a standalone event does not signify an overall worsening of serviceability in combination with other metrics in the basket.

We have also exceeded our control limit for the turbidity, iron and manganese (TIM) index, which was due to a small number of failed water quality samples. This is also reflected in our Mean Zonal Compliance (MZC) performance commitment.

For non-infrastructure, we met our control limits for water quality compliance and we had no enforcement action due to microbiological parameters. Our final indicator – unplanned maintenance – is also within the reference level of performance.

3c) Abstraction Incentive Mechanism (AIM) – for the 12 months ended 31 March 2019

Abstraction site	Decimal places	2018-19 AIM performance [Ml]	2018-19 normalised AIM performance [nr]	Cumulative AIM performance 2016-17 onwards [Ml]	Cumulative normalised AIM performance 2016-17 onwards [nr]	Contextual information relating to AIM performance
Hagley	1	-	-	-	-	-
Linton	1	(41.0)	(0.4)	(55.4)	(1.0)	-
Rivey B	1	(4.1)	(0.0)	(61.4)	(1.0)	-

AIM was introduced in April 2016 and encourages water companies to reduce the environmental impact of abstracting water at environmentally sensitive sites during certain periods of low surface water flows.

We have three sites under AIM and during the year none of them exceeded the baseline for the periods when flows are below the relevant threshold. Hagley has not been in use during the year and so had no performance against the baseline to record.

3d) Service Incentive Mechanism (SIM) – for the 12 months ended 31 March 2019

	Units	DPs	Score
Qualitative performance			
1st survey score	nr	2	4.50
2nd survey score	nr	2	4.36
3rd survey score	nr	2	4.40
4th survey score	nr	2	4.39
Qualitative SIM score (out of 75)	nr	2	64.13
Quantitative performance			
Total contact score	nr	2	54.40
Quantitative SIM score (out of 25)	nr	2	22.28
SIM score			
Total annual SIM score (out of 100)	nr	2	86.40

SIM measures the levels of service that customers experience, by measuring performance across a number of contact channels, including telephone and written contacts, and also through a quarterly customer survey. SIM performance is financially incentivised; however, the level of financial incentive each company receives is determined relative to other water companies at the next price review in 2019.

Section 4 – additional regulatory information

4a) Non-financial information

	Unmeasured	Measured
Retail household		
Number of void households	13.898	7.449
Per capita consumption (excluding supply pipe leakage) l/h/d	141.53	129.48

	Water
Volume (Ml/d)	
Bulk supply export	38.720
Bulk supply import	0.114
Distribution input	396.640

4b) Wholesale totex analysis

	Current year £m	Cumulative 2015-20 £m
Actual totex		
Actual totex	96.807	357.858
Items excluded from the menu		
Third party costs	2.128	6.860
Pension deficit recovery payments	1.080	6.057
Other 'Rule book' adjustments	0.000	0.000
Total items excluded from the menu	3.208	12.917
Transition expenditure		
Transition expenditure	0.000	0.000
Adjusted Actual totex		
Adjusted Actual totex	93.599	344.941
Adjusted Actual totex base year prices	80.835	311.364
Allowed totex		
Allowed totex based on final menu choice – base year prices	77.947	310.045

The company's totex of £80.8m (2012/13 prices) was £2.9m (3.7%) higher than allowed in price limits for 2018/19.

Actual wholesale operating costs per the regulatory accounts in 2018/19 are £0.4m higher than the fast money from the final determination.

In the final determination, Ofwat adjusted the split of expenditure between fast money and slow money to smooth bills. In 2018/19, this resulted in the transfer of £2.0m from fast money to slow money. IRE (which is included in both operating expenditure in the regulatory accounts and fast money in the final determination) was £2.7m lower than the final determination in 2018/19 following a decision to move some expenditure from infrastructure renewals to capital expenditure over the AMP period while maintaining the total level of expenditure across these two areas. As a result, wholesale capital expenditure was £2.3m over the final determination, reversing the underspend in prior periods of the AMP, with the cumulative overspend to be managed to a flat position in line with the final determination by the end of the AMP. The remaining £1.2m overspend in operating costs was as a result of atypical costs incurred from the hot, dry summer of 2018, which increased production costs.

The cumulative position for the four years to 2018/19 shows totex £1.3m (0.4%) above the final determination, with operating costs including IRE being £10.9m lower than the final determination.

Ofwat adjusted the Pay As You Go (PAYG) rate in the final determination to smooth bills in the period to 2020. The impact was to have a final determination PAYG rate of 73.9% in 2015/16 compared with the average in the final determination of 68.2%, which was in line with the expected allocation between capital and operating expenditure. This smoothing accelerated £4.6m of fast money into the final determination for the 2015/16 year from slow money and adjusted subsequent years as an offset. The cumulative position for the four years to 2018/19 is an acceleration of £2.3m. IRE was £10.8m lower than the final determination, offset by an overspend on capital expenditure of £12.1m. The remaining £2.3m overspend in operating costs was predominantly related to the additional costs of associated with the prolonged hot summer during 2018 and ongoing upward pressure on power costs driven by higher pass-through charge rates partly offset by savings on laboratory analysis costs and rates.

The overspend of £1.3m of capital investment and IRE is expected to reverse in 2019/20.

4c) Forecast impact of performance on regulatory capital value

	£m
Cumulative totex over/(underspend) so far in the price control period	1.537
Customer share of cumulative totex (over)/underspend	(2.230)
RCV element of customer share of cumulative totex over/(underspend)	0.333
Adjustment for ODI rewards or penalties	0.000
RCV determined at Final Determination at 31 March	380.092
Projected 'shadow' RCV	380.425

The cumulative totex overspend is as per that set out in table 4b. All the lines are presented in March 2019 prices.

The customer share of cumulative totex overspend has been calculated using the formula (menu baseline totex – actual menu totex) x (1 – cost sharing rate). The RCV element has been calculated in line with the PR14 reconciliation rulebook calculations.

4d) Wholesale totex analysis (water)

	Water Resources		Water Network +				
	Abstraction licences £m	Raw water abstraction £m	Raw water transport £m	Raw water storage £m	Water treatment £m	Treated water distribution £m	Total £m
Operating expenditure							
Power	-	2.615	1.195	-	0.917	10.425	15.152
Income treated as negative expenditure	-	-	-	-	-	-	-
Abstraction charges/discharge consents	2.838	-	-	-	0.112	-	2.950
Bulk supply	-	0.010	-	-	0.030	-	0.040
Other operating expenditure - renewals expensed in year (Infrastructure)	-	-	-	-	-	13.894	13.894
Other operating expenditure - renewals expensed in year (Non-Infrastructure)	-	-	-	-	-	0.493	0.493
Other operating expenditure - excluding renewals	-	1.680	0.275	0.003	6.448	18.724	27.130
Local authority and Cumulo rates	-	0.171	0.200	-	0.422	4.585	5.378
Total operating expenditure excluding third party services	2.838	4.476	1.670	0.003	7.929	48.121	65.037
Third party services	-	0.008	0.003	-	0.689	1.428	2.128
Total operating expenditure	2.838	4.484	1.673	0.003	8.618	49.549	67.165
Capital Expenditure							
Maintaining the long term capability of the assets - infra	-	-	-	-	-	-	-
Maintaining the long term capability of the assets - non- infra	-	2.490	-	-	2.965	15.839	21.294
Other capital expenditure - infra	-	0.487	-	-	-	9.881	10.368
Other capital expenditure - non-infra	-	0.994	-	-	4.415	4.250	9.659
Infrastructure network reinforcement	-	-	-	-	-	1.416	1.416
Total gross capital expenditure excluding third party services	-	3.971	-	-	7.380	31.386	42.737
Third party services	-	-	-	-	-	-	-
Total gross capital expenditure	-	3.971	-	-	7.380	31.386	42.737
Grants and contributions							
Grants and contributions	-	-	-	-	2.700	10.395	13.095
Totex	2.838	8.455	1.673	0.003	13.298	70.540	96.807

Cash Expenditure							
Pension deficit recovery payments	-	-	-	-	-	-	-
Other cash items	-	-	-	-	-	-	-
Totex including cash items	2.838	8.455	1.673	0.003	13.298	70.540	96.807
Unit cost information (operating expenditure)							
Licenced volume available (Ml)	240,962.050						
Volume abstracted (Ml)		177,521.400					
Volume transported (Ml)			83,666.656				
Average volume stored (Ml)				2,665.308			
Distribution input volume (Ml)					144,773.600		
Distribution input volume (Ml)						144,773.600	
Unit cost (£/Ml)	11.778	25.259	19.996	1.126	59.527	342.252	
Population (000s)	1,712.812	1,712.812	1,712.812	1,712.812	1,712.812	1,712.812	
Unit cost (£/pop)	1.657	2.618	0.977	0.002	5.031	28.928	

4f) Operating cost analysis (household retail)

	Household unmeasured £m	Household measured £m	Total £m
Operating expenditure			
Customer services	2.198	2.607	4.805
Debt management	0.482	0.058	0.540
Doubtful debts	1.984	0.894	2.878
Meter reading	-	0.855	0.855
Other operating expenditure	1.627	1.324	2.951
Total operating expenditure excluding third party services	6.291	5.738	12.029
Third party services operating expenditure	-	-	-
Total operating expenditure	6.291	5.738	12.029
Depreciation - tangible fixed assets (on assets existing at 31 March 2015)	0.308	0.248	0.556
Depreciation - tangible fixed assets (on assets acquired since 1 April 2015)	0.198	0.162	0.360
Amortisation - intangible fixed assets (on assets existing at 31 March 2015)	-	-	-
Amortisation - intangible fixed assets (on assets acquired since 1 April 2015)	-	-	-
Total operating costs	6.797	6.148	12.945
Capital expenditure	0.633	0.514	1.147
Demand-side efficiency and customer-side leaks analysis - Household			
Demand-side water efficiency - gross expenditure			0.025
Demand-side water efficiency - expenditure funded by wholesale			0.010
Demand-side water efficiency - net retail expenditure			0.015
Customer-side leak repairs - gross expenditure			0.880
Customer-side leak repairs - expenditure funded by wholesale			0.880
Customer-side leak repairs - net retail expenditure			-

4g) Wholesale current financial performance

	£m
Revenue	107.204
Operating expenditure	(67.165)
Capital maintenance charges	(25.474)
Other operating income	0.102
Current cost operating profit	14.667
Other income	-
Interest income	2.545
Interest expense	(14.604)
Other interest expense	(0.178)
Current cost profit before tax and fair value movements	2.430
Fair value gains/(losses) on financial instruments	-
Current cost profit before tax	2.430

4h) Financial metrics

	Units	Metric Using Covenant Net Debt	Metric Using Book Net Debt	AMP to date Book Net Debt
Financial indicators				
Net debt	£m	248.834	268.350	
Regulated equity	£m	131.258	111.742	
Regulated gearing	%	65.47%	70.60%	
Post tax return on regulated equity	%	11.14%	13.17%	
RORE (return on regulated equity)	%	8.70%	9.17%	9.54%
Dividend yield	%	2.66%	3.12%	
Retail profit margin - Household	%		3.71%	
Retail profit margin - Non household	%		0.00%	
Credit rating	Text		Baa2 (stable)	
Return on RCV	%		7.06%	
Dividend cover	dec		3.945	
Funds from operations (FFO)	£m		40.887	
Interest cover (cash)	dec		5.2400	
Adjusted interest cover (cash)	dec		2.6600	
FFO/Debt	dec		0.152	
Effective tax rate	%		16.69%	
RCF	£m		34.856	
RCF/capex	dec		0.797	
Revenue and earnings				
Revenue (actual)	£m		121.569	
EBITDA (actual)	£m		42.375	
Movement in RORE				
Base return	%	5.96%	5.96%	5.97%
Totex out / (under) performance	%	-0.40%	-0.40%	-0.20%
Retail cost out / (under) performance	%	2.07%	2.07%	1.85%
ODI out / (under) performance	%	0.15%	0.15%	0.22%
Financing out / (under) performance	%	1.07%	1.53%	0.49%
Other factors	%	-0.14%	-0.14%	1.21%
Regulatory return for the year	%	8.70%	9.17%	9.54%
Borrowings				
Proportion of borrowings which are fixed rate	%	12.67%	11.75%	
Proportion of borrowings which are floating rate	%	3.10%	2.88%	
Proportion of borrowings which are index linked	%	84.23%	85.37%	
Proportion of borrowings due within 1 year or less	%	0.00%	0.00%	
Proportion of borrowings due in more than 1 year but no more than 2 years	%	0.00%	0.00%	
Proportion of borrowings due in more than 2 years but no more than 5 years	%	15.16%	14.06%	
Proportion of borrowings due in more than 5 years but no more than 20 years	%	0.00%	0.00%	
Proportion of borrowings due in more than 20 years	%	84.84%	85.94%	

Addendum to table 4h

The following metrics have been updated since the version published on the 15 July 2019:

Table / Line reference	Original number	Revised number	Explanation
RORE - year	9.32%	9.17%	Adjustment for lower net income from cessation of NHH retail activity
RORE – AMP to date	8.34%	9.54%	Adjustment for lower net income from cessation of NHH retail activity (-0.06%), proceeds from disposal of NHH retail business (1.26%).
Dividend Yield	3.55%	3.12%	Adjustment for intercompany interest to deduct gross of £2.5m rather than net of £2.0m
Dividend Cover	3.46	3.94	Adjustment for intercompany interest to deduct gross of £2.5m rather than net of £2.0m
Movement in RORE other factors - year	0.01%	-0.14%	Adjustment for lower net income from cessation of NHH retail activity
Movement in RORE other factors – AMP to date	0.01%	1.21%	Adjustment for lower net income from cessation of NHH retail activity (-0.06%), proceeds from disposal of NHH retail business (1.26%).

Ofwat's reporting requires the dividend yield and dividend cover metrics to be calculated after deducting £2.5m (net of tax) of dividends paid to the company's holding company to enable payment of intra-group loan interest to the company. The table also shows the following metrics calculated using covenant debt, which is the key metric for the company's:

- borrowing;
- regulated gearing;
- post-tax return on regulated equity;
- RORE; and
- dividend yield.

Calculating RORE using the more appropriate measure for gearing of covenant debt, excluding interest received on inter-company loans that are not part of net debt and excluding the impact of the sale of the non-household retail business gives a return of 6.29% instead of 8.34%, which is 0.32% above the notional return.

Calculating the RORE on book debt

The calculation of RORE follows the guidance issued by Ofwat in its letter of 12 April 2017 and subsequent clarifications. We have engaged Jacobs to review and audit our RORE calculation methodology. Jacobs's conclusion is that our approach is consistent with Ofwat's guidance.

The reported figure of 9.54% is the simple arithmetic mean of RORE figures in 2015/16 (5.76%), 2016/17 (7.97%), 2017/18 (15.18%) and 2018/19 (9.17%). This is higher than that allowed in the final determination of 5.98%. The main driver for this is outperformance is the impact of the sale of the non –household retail business and outperformance on retail costs and ODIs offset by the difference between the interest rate assumed by Ofwat and the actual higher interest rate on the company's borrowings (which is predominantly made up of long-term RPI index-linked debt).

As a result of the sale of the non-household retail business on 1 April 2017, net income in the final determination for 2017/18 and 2018/19 would have been £0.183m and £0.177m lower, respectively. This reduces the final determination RORE by 0.15% in each year and the four-year average by 0.06%.

The proceeds from the sale of the non-household retail business has increased RORE in 2017/18 by 5.03% and the four average RORE by 1.26%.

12-13 prices

	15-16 Final Determination	Totex (Note 1)	Retail (Note 2)	RCV run off (Note 3)	ODI (Note 4)	Interest (Note 5)	NHH exit	Actual
	£m	£m	£m	£m	£m	£m	£m	£m
Out / (under) performance	-	(0.825)	2.450	0.026	0.541	(2.508)	-	
Less tax (20%)	-	0.165	(0.490)	(0.005)	(0.108)	0.502	-	
Appointed business: profit	6.923	(0.660)	1.960	0.021	0.433	(2.007)	-	6.671
Appointed business: regulated equity	115.775							115.775
Appointed business: RORE (actual)	5.76%							5.76%

12-13 prices

	16-17 Final Determination	Totex (Note 1)	Retail (Note 2)	RCV run off (Note 3)	ODI (Note 4)	Interest (Note 5)	NHH exit	Actual
	£m	£m	£m	£m	£m	£m	£m	£m
Out / (under) performance	-	(0.141)	2.767	0.006	0.808	(0.491)	-	-
Less tax (20%)	-	0.028	(0.553)	(0.001)	(0.162)	0.098	-	-
Appointed business: profit	7.065	(0.113)	2.214	0.004	0.647	(0.393)	-	9.423
Appointed business: regulated equity	118.205							118.205
Appointed business: RORE (actual)	5.98%							7.97%

	12-13 prices							
	17-18 Final Determination	**Totex** (Note 1)	**Retail** (Note 2)	**RCV run off** (Note 3)	**ODI** (Note 4)	**Interest** (Note 5)	**NHH exit**	**Actual**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Out / (under) performance	-	0.419	2.688	(0.016)	(0.241)	3.574	7.250	-
Less tax (19%)	-	(0.080)	(0.511)	0.003	0.046	(0.679)	(1.378)	-
Appointed business: profit	7.183	0.339	2.177	(0.013)	(0.195)	2.895	5.873	18.259
Appointed business: regulated equity	120.316							120.316
Appointed business: RORE (actual)	5.97%							15.18%

	12-13 prices							
	18-19 Final Determination	**Totex** (Note 1)	**Retail** (Note 2)	**RCV run off** (Note 3)	**ODI** (Note 4)	**Interest** (Note 5)	**NHH exit**	**Actual**
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Out / (under) performance	-	(0.609)	3.122	0.024	0.231	2.302	(0.219)	-
Less tax (19%)	-	0.116	(0.593)	(0.005)	(0.044)	(0.437)	0.042	-
Appointed business: profit	7.287	(0.493)	2.529	0.020	0.187	1.864	(0.177)	11.216
Appointed business: regulated equity	122.200							122.200
Appointed business: RORE (actual)	5.96%							9.17%

Notes to RORE calculations

	2015-16	2016-17	2017-18	2018-19
	£m	**£m**	**£m**	**£m**
1. Totex out performance				
Totex out / (under) performance (12/13 price)	(1.671)	(0.287)	0.848	(1.234)
Cost sharing rate	49.35%	49.35%	49.35%	49.35%
Out / (under) performance	(0.825)	(0.141)	0.419	(0.609)
Totex underperformance relates to operating costs excluding IRE as outlined in Table 4B				
2. Retail outperformance				
Per FD (allowed retail service expenditure including depreciation on assets post April 2015)	15.894	16.123	14.681	15.511
Actual retail costs (including depreciation on assets post April 2015)	13.444	13.356	11.993	12.389
Out / (under) performance	2.450	2.767	2.688	3.122
Retail out performance is outlined in table 2C				
3. Impact on RCV run off of totex out performance				
Totex out / (under) performance (12/13 price)	(1.671)	(0.287)	0.848	(1.234)
PAYG rate per FD	73.94%	68.33%	67.80%	65.70%
RCV out / (under) performance	(0.436)	(0.091)	0.273	(0.423)
Run off rate (per FD)	6.00%	6.10%	6.00%	5.70%
Impact on RCV run off	0.026	0.006	(0.016)	0.024
4. ODI reward				
Reward as set out in Table 3A	0.541	0.808	(0.241)	0.231
5. Interest (calculation as set out in Ofwat RD letter 12 April 2017)				
Net nominal interest paid	11.695	12.019	11.531	12.059
March opening net debt (book value)	233.179	233.708	242.976	260.541
March closing net debt (book value)	233.708	242.976	260.541	268.350
Average net debt (book value)	233.444	238.342	251.759	264.446
Nominal interest rate paid	5.01%	5.04%	4.58%	4.56%
Year average RPI	1.08%	2.14%	3.74%	3.06%
Deflate to real interest rate	3.89%	2.84%	0.81%	1.46%
Cost of debt at PR14	2.59%	2.59%	2.59%	2.59%
Difference	(1.30%)	(0.25%)	1.78%	1.13%
Notional level of debt	192.959	197.008	200.527	203.667
Financial out / (under) performance	(2.508)	(0.491)	3.574	2.302

Notes to the book debt RORE calculation

The performance on interest is as a result of a single industry cost of debt at PR14 of 2.60% compared to the average real interest rate on the company's borrowings of 3.89% (2015/16), 2.84% (2016/17) and 0.81% (2017/18) and 1.46% (2018/19).

Most of the company's debt is long-term RPI index-linked debt, the majority of which was issued in 2005. Since then, interest rates have fallen significantly. Therefore, the company has not been able to benefit from these lower interest rates in comparison to larger water companies in the sector, which, because of their size, issue new debt on a more regular basis.

4i) Financial derivatives

	Nominal value by maturity (net)			Total value					Interest rate (weighted average)	
	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Nominal value (net) £m	Mark to Market £m	Total accretion at 31 March 2018 £m	Units	DPs	Payable	Receivable
Derivative type										
Interest rate swap (sterling)										
Floating to fixed rate	-	-	30.000	30.000	(2.153)	(2.153)	%	2	2.14%	0.41%
Floating from fixed rate	-	-	-	-	-	-	%	2	0.00%	0.00%
Floating to index linked	-	-	-	-	-	-	%	2	0.00%	0.00%
Floating from index linked	-	-	-	-	-	-	%	2	0.00%	0.00%
Fixed to index-linked	-	-	-	-	-	-	%	2	0.00%	0.00%
Fixed from index-linked	-	-	-	-	-	-	%	2	0.00%	0.00%
Total	-	-	30.000	30.000	(2.153)	(2.153)	0	0		
Foreign Exchange										
Cross currency swap USD	-	-	-	-	-	-	%	2	0.00%	0.00%
Cross currency swap EUR	-	-	-	-	-	-	%	2	0.00%	0.00%
Cross currency swap YEN	-	-	-	-	-	-	%	2	0.00%	0.00%
Cross currency swap Other	-	-	-	-	-	-	%	2	0.00%	0.00%

Total	-	-	-	-	-	-	0	0		
Currency interest rate										
Currency interest rate swaps USD	-	-	-	-	-	-	%	2	0.00%	0.00%
Currency interest rate swaps EUR	-	-	-	-	-	-	%	2	0.00%	0.00%
Currency interest rate swaps YEN	-	-	-	-	-	-	%	2	0.00%	0.00%
Currency interest rate swaps Other	-	-	-	-	-	-	%	2	0.00%	0.00%
Total	-	-	-	-	-	-	0	0		
Forward currency contracts										
Forward currency contracts USD	-	-	-	-	-	-	%	2	0.00%	0.00%
Forward currency contracts EUR	-	-	-	-	-	-	%	2	0.00%	0.00%
Forward currency contracts YEN	-	-	-	-	-	-	%	2	0.00%	0.00%
Forward currency contracts Other	-	-	-	-	-	-	%	2	0.00%	0.00%
Total	-	-	-	-	-	-	%	2		
Other financial derivatives										
Other financial derivatives	-	-	-	-	-	-	0	0	0.00%	0.00%
Total										
Total financial derivatives	-	-	-	-	-	-				

Nominal values (net) above represent the nominal value of the interest rate swap of £30.0m, which hedges the interest rate payments on £30.0m of bank loans. This does not equal the value reflected in total financial instruments in table 1c of £2.153m as the balance sheet value of the swap is recorded at mark to market value as described above.

The fixed payable element of the interest rate swap is 2.135% and the receivable floating rate element is three-month LIBOR, shown above as the average for the 12 months to 31 March 2019 of 0.410%.

The receivable floating rate element of the swap exactly offsets the payable floating rate element (three-month LIBOR interest payment) of the related £30.000m bank loan. The effect of this is that the interest payable on the loan, when combined with the cash flows on the swap, is fixed to 2.135% a year plus the agreed fixed bank margin percentage per annum.

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