south east water

2018/19

Group Annual Report and Financial Statements

Annual Performance Report

Pure know

Our business

We supply top quality drinking water to 2.2 million customers in the south east of England. Through a network of 14,780 kms of pipe, we deliver 526 million litres of water every day. The skill and expertise of our employees ensures our customers' water meets the highest of standards.

Our vision

Our vision is to be the water company people want to be supplied by and want to work for. Everything we do is underpinned by technical excellence.

Pure know h₂ow

- **526 million litres of water a day** – that's how much water we supply to around 2.2 million people
- **83 water treatment works** – that's how we ensure our water is of the highest quality
- **500,000 water quality tests each year** – that's how we ensure your water meets the highest standards
- **14,780 kms of water mains** – that's how we bring fresh drinking water direct to your tap
- **950 employees** – that's how we make sure your water supply runs 24 hours a day, 365 days a year

How we invest in your water

Where each £1 of your bill is spent.

Water extraction **8%**	Water treatment **21%**	Getting the water to you **42%**
Customer service **8%**	Interest & Tax **14%**	Dividends **7%**

Financial highlights

Revenue	Operating profit	Capital expenditure	Cash generated from operating activities
£238.3m	**£86.4m**	**£104.7m**	**£125.0m**
Increase of 7.6 per cent on last year	Increase of 15.2 per cent on last year	Up from £96.0 million last year	Increase of 1.5 per cent on last year

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Planet focused

We consider ourselves to be guardians of the environment. We believe in sharing our passion for protecting and conserving the water environment we all rely on.

Innovating

We have trained more than 20 champions across the business who are helping us continue to build a culture of innovation.

Directors

Nick Salmon (Independent Chairman)

John Barnes (Independent Non-Executive Director)
Christopher Girling (Independent Non-Executive Director)
Célia Pronto (Independent Non-Executive Director)
Stephen Jordan (Non-Executive Director)
Marissa Szczepaniak (Non-Executive Director)

Paul Butler (Managing Director)
Andrew Farmer (Finance Director)
David Hinton (Asset and Regulation Director)

Nicolas Truillet (Company Secretary)

Company's bankers

HSBC Bank plc, 60 Queen Victoria Street, London EC4N 4TR

Company's auditor

Deloitte LLP Statutory Auditor
London, United Kingdom

Registered office

Rocfort Road, Snodland, Kent ME6 5AH

Registered No. 02679874
Country of domicile and incorporation: England and Wales

Chairman's introduction

On behalf of the Directors of South East Water, I am pleased to present our annual report and the audited financial statements for the year ended 31 March 2019. This was the fourth year of the current five year regulatory period. It has been a pivotal year in building our long-term plans placing people (customers, the community we serve and our employees) and our environmental impact at the centre of our strategy to responsibly deliver exemplary customer satisfaction.

Our team has worked hard throughout the year to achieve the stretching objectives set in the 2015 to 2020 business plan, providing great service to all our household customers and to water retailers who rely on our wholesale water services. In addition, we have been developing our plans for the future in the form of the 60 year water resources management plan and publishing a very ambitious business plan for the next five year regulatory period.

Customer satisfaction responsibly delivered – our ambitious business plan

On 3 September 2018 we published our business plan for the five year period commencing April 2020, as did all of the other water and wastewater companies in England and Wales, following which Ofwat published its Initial Assessment of Plan (IAP) for each company in January 2019.

We were very pleased that Ofwat recognised the ambition in our plan and how we had challenged ourselves to deliver significant improvements over current performance levels at efficient cost. In particular, Ofwat commended us for showing ambition and innovation in the areas of improving customer service, support for vulnerable customers and the environment. We were one of only three companies to meet Ofwat's stretching requirements with a high quality package of outcome delivery incentives (ODIs) based on customer views.

However, Ofwat's overall assessment was that in certain areas our plan required further evidence and/or justification for some of the decisions made. We have responded comprehensively to all of the issues and actions raised by Ofwat and published our full response to the IAP on our website on 1 April 2019. We have provided more evidence in those areas where Ofwat did not find our initial evidence compelling and made a limited number of changes. For example, we have:

- **given greater protection to customers with a re-design of how any outperformance payments should be shared with them**
- **provided additional evidence in critical areas, such as per capita consumption (PCC) and leakage, to justify our approach in a water stressed region**

The plan has been built through an extensive engagement process involving nearly 13,000 customers, other stakeholders and businesses through 120 separate elements of research.

This research used both traditional methods and more innovative approaches and has enabled us to build a business plan that goes further to deliver a more personalised service for customers.

The plan, if agreed, will see the investment of a further £472 million to improve water infrastructure over the five year period. We consider this to be the most ambitious five year plan we have ever proposed. With a 36-strong suite of performance commitments, and innovative incentives - the plan challenges us to deliver performance levels well beyond anything we have delivered before.

Our plan also recognises our wider responsibilities as the provider of an essential service. To reflect this responsibility we have created 10 specific responsible business measures for key areas that customers and stakeholders have identified that we should focus on. The business plan also includes six very stretching new performance commitments relating to vulnerable customers and six new environmental performance commitments.

“We are particularly proud to be a part of Interreg, a four year programme which aims to address the impacts of climate change

Nick Salmon
Chairman

We firmly believe our ambitious business plan will deliver the service customers rightly expect in a responsible way, while maintaining the average annual bill at £204 before inflation for the next five years.

Throughout the year we worked closely with our independent Customer Challenge Group, led by chair Zoe McLeod, who provided challenge throughout which helped us build a business plan truly driven by customer priorities. I would like to thank Zoe and her team for their contribution and look forward to continuing the relationship as we develop a new Customer Engagement Panel which will support our efforts to continue to embed customer engagement in the way we conduct our business.

Engaging for long-term water resilience and sustainability

During 2018 we held a 12 week public consultation on our draft water resources management plan which formed part of our business plan submission. This plan takes a long term view, over 60 years, of how we aim to ensure that there are adequate supplies of water both throughout normal conditions and during periods of drought, taking account of forecast population growth and the potential effects of climate change. We need to achieve this while balancing the needs of the natural environment on a sustainable basis. We engaged with hundreds of customers and stakeholders during this time and the web page for the consultation received more than 1,900 visits.

In August 2018 we published a revised water resources management plan which took on board the key challenges raised in the consultation, and in particular customer and stakeholder support for the reduction of customers' water use and overall leakage. In line with the guidelines we have made an estimate of the cost of our preferred plan. Over the 60 year planning period we estimate that the current cost of our plan will be £986.2 million in net present value (NPV) terms and will increase the supply of water by 266.5 Ml/d (52 per cent) to secure the long-term resilience of water resources in our area. The revised plan is with the Secretary of State for approval and we hope to publish a final plan later this year.

Our award winning catchment management partnership has continued as part of our large programme of environmental work under the Water Industry National Environment Programme (WINEP). The team has had some notable successes during the year, including picking up a Water Industry Achievement Award for water resilience and successfully removing more than a tonne of agricultural chemicals from 23 farms across three catchments as part of a pesticide amnesty.

We are particularly proud to be a part of Interreg, a four year programme which aims to address the impacts of climate change and enhance the availability of raw water in Europe. The cross-border project is called PROWATER, which stands for 'protecting and restoring raw water sources through actions at the landscape scale' and will contribute to climate adaptation by restoring water storage in the environment through catchment management. Examples of this are forest conservation, natural water retention and restoration of compacted soils. These are all examples of Ecosystem-based Adaptation (EbA) measures.

Targeting five-out-of-five customer service

We have continued with our "five-out-of-five" customer commitment across the business including:

- increased digital communications such as 'My Account' with more than 60,000 customers signed up during 2018/19 taking total numbers to 162,000, and 138,000 customers using our 'in your area' map showing supply updates
- improving our customer account management tool giving our advisors a clearer view of customer information and ability to offer better advice for customers on payment plans
- training 20 innovation champions across the business to embed a culture that supports new ideas and continual improvement
- engaging with more than 5,800 people via our community events, open days and school programme

Volunteering days

We have been carrying out volunteering activities to improve woodland areas to encourage more biodiversity in our region

> **Contributing to climate adaptation by restoring water storage in the environment**

This year we became the first water company to receive BSI (British Standards Institution) accreditation to BS 18477, the standard which demonstrates that an organisation provides a comprehensive service for identifying and responding to vulnerable customers.

This was the last year of Ofwat operating its service incentive mechanism (SIM) survey. This compares customer service and satisfaction across the industry. It will be replaced by a customer experience measure (C-MeX) which is currently in development. For this final year we were pleased to see our SIM score for 2018/19 end the year at 85.4 out of 100 (85.6 in 2017/18). This is commendable as it was achieved against a backdrop of embedding the significant change in our billing processes through the introduction of "One Bill".

"One Bill" is our project with Southern Water to simplify 465,000 customer bills, enabling one bill to be issued for water and wastewater services. This project was in response to customers' requests for simpler bills for water and wastewater. This has been an important improvement for customers as many have said they wanted to be able to manage their water and wastewater bill through one account, just as our customers who have Thames Water as their wastewater service provider have done for many years.

Science and engineering excellence to deliver quality water

An exciting development this year has been the commencement of a year-long innovation programme to trial a smart water network. Around 2,000 properties in our Hartley district have been provided with the latest technology that could enable a further step change in leakage detection and repair times. What makes this trial different is we are the first water company in the UK to be using the 5G network as a key component to collect higher volumes of data, and then analysing this data to provide a centralised view of the digital network.

This in turn will enable us to become far more proactive when discovering and prioritising leak repairs, alongside opening up our engagement with customers in a much more innovative and interactive way. We are expecting the trial to inform subsequent wider programmes of work across the company.

We are continually looking for the latest innovations to drive leakage levels down further. In Kent we are pioneering a new satellite technology to identify leaks that are difficult to find with traditional methods. This technology, which is used to identify water on other planets, creates images which cover approximately 5,700 kms. An algorithm then detects treated water, by looking for a particular chemical signature present in drinking water. This data is presented in a leakage graphic report overlaid on a map with streets and water pipes.

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Our technicians in the area have an app on their phones which shows the location of suspected leaks, which they can then check and verify. This trial is in its early stages but the initial results look promising both in terms of leaks found and productivity.

The leakage figures we report include leaks on customers' pipes as well as our own, and we have also been trialling customer-side leak identification and repair innovations. We are currently partnering with Centrica Hive (a smart home technology provider) in an industry first to test new devices to alert customers to issues on their own plumbing.

I am pleased to report that the leakage team has beaten our target of 89.1 million litres a day (Ml/d), achieving 86.9 Ml/d during the year – a good step towards our commitment of reducing leakage by a further 15 per cent by 2025.

Beating the target was a significant achievement given that the team started the year with additional leaks resulting from the severe cold weather and sudden thaw caused by the Siberian 'Beast from the East' in March 2018, and having recovered from this position, then had to mitigate a similar impact from a prolonged summer heatwave. Through round the clock working, and the diversion of other technical resources to the leakage effort we managed to repair an additional 1,717 leaks, compared to an average year.

The long heatwave of summer 2018 required us to produce up to an additional 100 million litres of treated water a day, 19 per cent more than a normal summer day.

Despite the increased demand for water throughout the heatwave, we were able to maintain supplies to customers without the need for temporary water restrictions. This was helped by customers themselves responding responsibly to our communication campaigns to save water usage during the hot, dry spell and we thank everyone for doing their bit to save water. Rainfall through the winter 2018/19 has enabled our reservoirs and groundwater sources to replenish and means as we move into summer 2019 our water resources are in a good position.

We saw an increase in burst water mains during the year, 2,826 compared with 2,747 in 2017/18, as the hot weather of the summer led to ground movements and the increased demand for water put pressure on the network. The number of bursts were a challenge for our operational teams. We ended the year with overall interruption to supply performance at 14.2 minutes per property (against our target of 12 minutes for the year). We undertake a wide range of activities to minimise the number of burst mains including dynamic pressure management, calm network operations and a targeted mains replacement policy.

During the year we invested £104.7 million in new and existing assets as part of the £437 million investment planned for the period from 2015 to 2020. The expenditure in the year saw us install 33 kms of new mains pipelines and renew a further 30 kms of old pipelines across the region, finish our customer metering programme and improve our water treatment works. Schemes such as these are supporting our efforts to improve services for our customers and help safeguard the environment. We are committed to continuing this level of investment in 2020 to 2025 business plan.

Our largest single investment commenced this year at the Keleher Water Treatment Works at Bray in Berkshire. The £21 million project is increasing the capacity of the treatment works, which celebrated its 25th anniversary this year, from the current 45 million litres per day to 68 million litres per day. The work got underway during the summer with a site clearance programme which was completed ahead of schedule. Work will continue throughout 2019 and is on track to complete in early 2020.

We strive to keep improving the quality of the water we supply. We have maintained high overall water quality with 99.98 per cent of samples passing standards set by the Drinking Water Inspectorate in the calendar year from January to December 2018. I am pleased to report we have also made progress on reducing the number of contacts received from customers about discoloured water. In 2018/19 we received 0.59 contacts (per 1,000 population) compared to 0.82 the previous year. This improvement was the result of our successful Seaquest dosing and mains flushing programme which removes the harmless naturally occurring deposits which build up over time within mains which can cause discolouration incidents.

A very important water demand management project over the last eight years has been the compulsory Customer Metering Programme, which aimed to have 90 per cent of properties metered by 2020. The project has achieved the 90 per cent target in March 2019. I would like to commend the team, including our partner Clancy Docwra, which has delivered this metering programme. The project, which was shortlisted this year for a Water Industry Achievement Award, has been a success with demand for water reducing by 18 per cent in the homes that we have compulsorily metered.

Non-household customers

During the earlier part of the financial year the decision was taken to exit the non-household retail market and focus solely on the provision of services to retailers in this new market. I am pleased to report that the transfer of our non-household customers to the new retailers has been successful. (Further details are set out below and in the Managing Director's report on page 20).

Brexit

The proposed exit of the UK from the European Economic Area has been included in our risk analysis. Throughout the year we have been making contingency plans for this evolving issue. We have been working with our suppliers and other partners in the industry to ensure the consequences of the various exit scenarios have minimal impact on our services. Further details are set out in the Managing Director's report.

Financial results

The results published in this report describe our performance for the year and incorporate the performance of South East Water Limited and South East Water (Finance) Limited.

This year we have had a strong financial performance having generated a group operating profit of £86.4 million for the year to 31 March 2019, compared with £75.0 million for the prior year. Our turnover was £238.3 million for the year compared to £221.5 million in the prior year. This additional revenue is primarily due to the allowed price increase in the year of £9.2 million and the additional turnover taken to the income statement following the adoption of IFRS 15 of £7.5 million.

Group net operational costs, including charges for doubtful debt, have increased in the year to £164.8 million compared to £155.3 million in the prior year, an increase of £9.5 million. Included in this increase are additional costs of £2.3 million reflecting the impact of the adoption of IFRS 15 (see note 5), £1.4 million additional depreciation on fixed assets and £1.5 million of additional energy and bulk water supply costs.

Profit before tax has increased by £12.6 million from £23.8 million to £36.4 million. Net finance costs have reduced in the year by £1.2 million to £50.0 million. This is due to an increase in finance income of £1.3 million being offset by an increase in finance costs of £0.1 million. Details of the movement in finance income and finance costs are provided in the strategic report.

Profit for the year has increased from £16.2 million to £38.7 million, which is driven by the improved operational performance detailed above together with the profit on disposal of the company's non-household business of £9.2 million. The reduction in tax during the year is largely due to the treatment of deferred tax on the group's revaluation reserve being revised in the prior year.

We have developed a Sustainability Finance Framework, under which the company can issue Sustainability Bonds and Sustainability Loans. We believe this is a European water utility company first. The framework will finance a range of activities, not only environmental projects but also ones which will benefit society such as improving drinking water quality. The framework was supported by ING, which acted as sole Green Structuring Advisor and independently reviewed by VigeoEiris.

This Sustainability Finance Framework highlights how our activities are supporting five of the United Nation Sustainable Development Goals, including climate action and sustainable cities and communities. It is an important step in our continuous development as a responsible business.

We have secured the funding to replace the £311 million of our debt which matures on 30 September 2019. We have secured £120 million of debt from banks, which matures in 2025, and £175 million from US insurance companies and pension funds in the form of a Private Placement. The Private Placement is in two tranches with £75 million maturing in 2031 and £100 million maturing in 2042. In addition we have secured a £54 million equity injection from our shareholders which allows our gearing to reduce and is consistent with the commitment they provided in our business plan. The funds for each tranche are committed and will be drawn down in September. We look forward to working with our new investors to continue to develop our sustainable business strategy.

Our people, working together towards future success

We know that great people, who see purpose in their work, are the key to the success of our business. That is why ensuring South East Water is "the water company people want to work for" is an integral part of our vision. We are delighted that this year we were shortlisted in the Utility Week Environment Award and that in May 2018 we won the Resilience Initiative of the Year at the Water Industry Achievement Awards. Our people should be rightly proud of the job they do and the important role they play in our society.

Our "Thrive 365!" health, safety and wellbeing strategy, consists of two strands, safe people and safe working, and is about more than just preventing accidents; it is about enhancing the overall wellbeing of our people.

This year we have been developing our mental health strategy to combat poor mental health and the first stage has been to recruit and train 16 mental health first aiders. The course, conducted by the charity Mind, was thought provoking and those who took part said they left with a determination to ensure that everyone has access to the support they need at the times that they need it.

In March we published our gender pay gap report which shows an average hourly rate pay gap of 23 per cent, while a small drop from the previous year it is still above the national average. We ensure that on a like for like role there is no gender pay gap, but our gap is the result of having more men in higher paid roles. To continue to reduce the gap we therefore need to increase the number of women we appoint and develop into higher paid roles. Accordingly we have concentrated this year on a review of our recruitment processes, to ensure that we benefit from the widest possible talent pool, alongside a review of our job evaluation system, to ensure that there is a clearer progression path for all our colleagues. We are also continuing with the initiatives we put into place last year, such as our women at work group, to help women progress their careers in the company and STEM ambassadors, to encourage recruitment into technical roles.

Engaging with our employees is important so we can continue to improve as an employer of choice. We were pleased that our 2018 engagement survey achieved a response rate of 88 per cent, and that 90 per cent of the employees who responded are proud to work for South East Water. We also undertook to achieve re-accreditation of the Investors in People (IIP) award during the year. The IIP framework has recently been updated and therefore we are pleased to confirm we have achieved the silver award, a great result against much more stretching standards, that is only achieved by six per cent of IIP accredited companies. Thank you to the 100 colleagues who participated in the interview and review process that focused on nine indicators and 27 themes developed to reflect the features of leading businesses and organisations which outperform industry norms.

To support continued development of our employees we introduced a new employee performance management framework called iReview in 2017 and developed it further this year. We are delighted that this second year saw 100 per cent completion putting employees in the driving seat of their personal development. Building on the ambitions of our employees is vital and we are pleased to confirm last year more than 19,000 hours of official training and development were recorded.

Building a sustainable future

During the year we have been building our environmental, social and governance (ESG) framework and we aim to be recognised as a leading responsible business. As highlighted earlier the business plan incorporated a responsible business strategy with 10 new responsible business commitments to reflect the actions and behaviours customers expect a responsible business to display.

Activities we've been developing include increasing our schools programme of engagement, developing more partnerships by working with charities and universities, ensuring fair reward and recognition for all employees and working with WaterUK and the Refill organisation to encourage the use of tap water as a sustainable alternative to bottled water. Full details of our work and example case studies can be seen in our performance, people and planet report.

To ensure we are prepared to continue to lead in this area, embed the commitments within the business and never stand-still, we have set up a Responsible Business board committee. The main purpose of the committee is to assist the board in defining the company's strategy relating to ESG matters and in reviewing related practices and initiatives to ensure they remain effective and up-to-date.

On behalf of the Board I would like to thank all our employees, the management team and our business partners for all they achieved during 2018/19. Yet again this year the South East Water community has demonstrated dedication and passion for providing customers with a sustainable water supply today and into the future. Our plans prepared during 2018/19 are the most ambitious we have seen and will support a long-term vision and legacy for the region. I look forward to the year ahead as we work together to prepare for the start of a new five year period and complete the commitments we made through to 2020.

Nick Salmon
Chairman
15 July 2019

> **“During the year we have been building our environment, social and governance (ESG) framework and we aim to be a recognised leading responsible business**

Motivating our people

Our colleagues and the partners and supply chain we work with are vital to the future of our business.

Strategic report

Managing Director's introduction

I am pleased to present our annual report and the audited financial statements for the year ended 31 March 2019.

The strategic report summarises our activities over the fourth year of the 2015 to 2020 regulatory period. It has been an important year as we published our plans for the future in the form of our revised water resources management plan and submitted our five-year business plan for 2020 to 2025 to Ofwat.

Operationally, the teams contended with extreme weather conditions due to the summer heatwave shortly after recovering from the impacts on our network from the so-called "Beast from the East" in March 2018.

We continue to focus on delivering a five-out-of-five service, endeavouring to increase customer satisfaction and I am pleased to report we have made significant progress in these areas during the year.

In this report we have summarised the main points in respect of our performance, competition in the water industry, and our future plans based on our five business commitments.

Our business commitments were developed as part of our 2015 to 2020 strategy and support the delivery of our vision, to be the water company people want to be supplied by and want to work for.

These commitments impact our customers, our partners and our employees. They help us focus on how we run our business today, how we plan for the long-term and how we ensure that our customers remain at the heart of everything we do.

Every customer counts

Our results on written complaints remain upper quartile for the industry and we are continuing work to reduce this number for 2019/20.

The level of written complaints received from our customers increased from 1,476 (2017/18) to 1,823 this year. While we are disappointed to see an increase, this is against work to embed wastewater billing for 465,000 customers and operational recovery from the freeze/thaw in March 2018.

We have put customer satisfaction at the heart of our business through an innovative approach to the outcome delivery incentives (ODIs) which are at the core of our business plan.

We have widened our focus to take account of all customers, rather than solely those who have reason to contact us. Customers are selected at random to take part in a telephone survey. This survey is continuous and runs throughout the year giving the business real time feedback on performance. With a maximum score of five, customers are giving their opinions on a range of measures based on their priorities:

- appearance, taste and odour of water
- interruptions to supply
- hosepipe bans
- leakage
- direct interaction
- water pressure

This helps us to better understand what influences customer satisfaction and allows us to continuously react to their views. Across the company at every level there is a determined focus to achieve five-out-of-five and a commitment that ensures "every customer counts".

We care deeply about our vulnerable customers and those who have difficulty paying their bills, and have developed a social tariff and a dedicated customer care team to support those who require additional help. The team has this year worked collaboratively with our vulnerability stakeholders and our Customer Challenge Group to create a new vulnerability strategy which has formed part of our business planning process.

Find out more at corporate.southeastwater.co.uk/news-info/publications/our-draft-vulnerability-strategy-2019

A reflection of this customer focus has been the achievement of BSI 18477 which demonstrates our support for vulnerable customers, an area in which we are showing leadership being the first water company to have been accredited in this way. The standard provides a framework to help us build on the great work of our Customer Care team as we work to identify those customers who could benefit from our support in the future.

Our overall annual result in the Ofwat Service Incentive Mechanism (SIM) scores for all water companies in 2018/19 was 85.4 out of 100, against a target of reaching a score greater than 80 out of 100 by 2019/20. In 2017/18 our score of 85.6 was above industry average of 84, we therefore expect our score this year will continue to be above average. The comparison results will be published on discoverwater.co.uk.

Since 2010 SIM has provided a comparable measure of consumers' experience and how satisfied they are with the overall handling of an actual recent contact with their water supplier. Combined data gathered during each five-year investment period is then used to support Ofwat's decisions on financial incentives.

However, from 2020 a new customer survey mechanism called C-MeX is to replace SIM. Unlike its predecessor, C-MeX will link financial incentives to the performance level of the best performing companies in all sectors, taking account of water companies' performance relative to other companies and sectors.

We continue to focus on providing great customer service at every opportunity as we adapt to the new mechanism.

Some of the key activities developed by our Retail and Business Information Systems teams include:

Follow Me - This functionality gives our agents the tools to increase their case ownership practices, allowing them to monitor accounts for bills, payments and contacts, ensuring we deliver as promised.

PAYG (Pay As You Go) - Payment plans are still one of the main reasons that our customers make contact and we have streamlined this process so that we can use the same language and views across all our channels, including the customer relationship management system (CRM), our bills and the website.

Health Check - We have also developed new 'account health check' screens within the CRM which allow the advisor to update the details and gives them advice on how to help improve the account.

Interaction with our customers is of prime importance. Investing in the latest digital communications channels and in the technology that underpins the smooth running of our business allows us to offer customers online services. Our website has received more than six million visitors which has seen more than 60,000 additional customers sign up this year for the "My Account" services, and an increase in unique visitors of seven per cent for the "in your area" updates.

Our website also continues to be developed as a prime communications channel offering the spoken word as an alternative to written text and a comprehensive language translation service of benefit to our customers where English is not their first language more than 20,000 customers have used this service during the year.

We are making more use of social media channels to communicate our key messages, increasingly employing video to create impactful and informative levels of engagement. This year we have increased our online engagement introducing an Instagram account in March as well as using our existing channels more effectively.

Everyone counts

All that we have achieved in the last 12 months would not have been possible without the dedication and commitment to our vision and values of the people who work for South East Water – both our employees and the employees of our partners and businesses we work with.

Our silver award, received in 2016 from Investors in People, and renewed this year after a further evidence-based accreditation process, is the result of hard work and innovation across the business and demonstrates the further progress we have made including improvements in:

- learning and development opportunities
- improved and more diverse rewards package for employees
- knowledge sharing across the business
- improved communications generally, not just top down but also between departments

Health, safety and wellbeing is fundamental to both our vision and our everyone counts business commitment, which is why we launched our Thrive 365 strategy in 2015 to ensure that this important area continues to have a strong focus.

The strategy has a particular emphasis on willingness to intervene and the importance of personal ownership, particularly important in high risk environments often most associated with our engineering work.

However, this year we had three reportable injuries following slips or trips in what are often perceived as low risk environments such as our offices and car parks. We are taking every opportunity to remind everyone of safe practice and ensure no matter where you work at South East Water, people go home safely at the end of the day.

It is important that we continue to motivate and develop our employees.

Our 2018 employee engagement survey achieved a response rate of 88 per cent, a slight increase over the 2016 survey result. Areas of most improvement were communication across the business, giving feedback to managers, feeling positive about the level of health and safety training provided and believing managers are leading by example.

To support the continued development of our employees we introduced a new employee performance management framework called iReview in 2017 and we have developed it further this year. This is a system created to support the business objective of employee self-assessment.

Developed in collaboration with managers and employees through focus groups, iReview replaced the system of appraisals and 1-2-1s and has been designed to provide a more continuous approach of regular feedback from managers and recognition of achievements. Employees are able to assess their own performance against objectives as well as the new behavioural framework, tied to our values.

This approach puts employees in control of their development and we are delighted that in the second year we achieved 100 per cent completion. One of the improvements we've made is to allow employees to link their personal objectives to departmental objectives in iReview. These in turn link to overall corporate objectives.

Our talent and organisational development team has helped deliver 19,585 hours of training to colleagues.

The company has a number of initiatives to reduce the gender pay gap at South East Water and to increase diversity. We are taking a number of steps to increase the diversity of candidates within management roles, including:

- ensuring that our recruitment advertising is accessible to all
- talking to local schools and other educational establishment to promote STEM (Science, Technical, Engineering and Maths) careers within South East Water, with a particular emphasis on women
- advertising all roles internally
- encouraging female employees to consider working within technical areas of the business

We are developing our in-house mentoring service. Mentoring is a good way of developing those who want to advance by arranging discussions with senior managers or specialists. While our mentoring service is not specifically aimed at women, we believe that it is a measure that will assist progression into senior roles.

At South East Water our Women at Work group exists as a discussion group for employees to share experience and knowledge. The group includes members from the senior management team.

We also have a Women Returners Programme which seeks to connect women returning to work after a career break with companies seeking to fill management positions. Many women returners find it difficult to find new positions that are commensurate with their skills and experience.

We are now a Disability Confident Committed Employer. We have signed up to this government initiative designed to help companies recruit and retain disabled employees and people with health conditions for their skills and talent. Where a disabled candidate meets the criteria for a role they should automatically be invited to attend an interview.

Our intranet (Gurgle) has continued to be an important channel for sharing news and views across the business. During the year there have been more than 100,000 page visits and 899 blogs published by colleagues to share news about themselves and their work.

In particular it has been important to share key messages such as cyber security advice and GDPR legislation that came into force in May 2018.

Congratulations also go to all the teams and projects that received industry recognition through shortlisting in a number of awards during the year. Our biodiversity improvement project that has reintroduced the rare wartbiter cricket to our land at Deep Dean picked up a CIEEM Best Practice Award in 2018. While our catchment management programme was shortlisted for a Utility Week Award and picked up Water Resilience Initiative of the Year at the Water Industry Achievement Awards.

Every action counts

We continue to invest in our infrastructure network so that we can provide our customers with high quality water. In this, the fourth year of the five year investment period, we delivered £104.7 million of capital investment.

For our project engineers the dry summer weather provided excellent conditions as they progressed the company's largest ever single investment at the Keleher Water Treatment Works at Bray in Berkshire.

Conditions meant the first phase of work to significantly increase the plant's capacity to abstract and treat water from the River Thames, which got underway at the end of May 2018 was completed ahead of schedule.

The £21 million project means the water treatment capacity at Keleher will increase from the current 45 million litres a day to 68 million litres a day. Work on the scheme is due to be completed in early 2020.

Our customer metering programme has successfully installed more than 300,000 meters between 2011 and 2019. More than 90 per cent of customer properties are now metered and we've seen demand for water reduce by an average of 18 per cent in those homes.

Our teams have worked hard through the year to reduce the length of interruption to supply that customers' experience. The changeable weather through the year led to an increase in burst water mains that we have worked hard to manage. Unfortunately we ended the year just missing our interruption target of 12 minutes per property, with a final total of 14.2 minutes. A number of lessons have been learned during our action planning following the freeze/thaw event and we are implementing these to help us reduce this number further.

To strengthen our network of 14,780 kms of water mains network we have laid and renewed 63 kms of new mains during the year and undertaken engineering schemes at many of our water treatment works, pumping stations and reservoirs to maintain, renovate and upgrade equipment and infrastructure.

Every drop counts

The changing weather patterns and extreme conditions were a dominating factor in the first six months. In April we were still dealing with the aftermath of the extreme winter weather event known as the Beast from the East which severely affected customer supplies and which continued into the spring.

The severity of the freeze/thaw event was caused by the unprecedented demand arising from leaks on customers' pipes and the ability of our assets to cope with this additional demand. Subsequent to the freeze/thaw event, we have assessed our resilience to such extreme events and our full "lessons learned" report is available on our website.

Find out more at
corporate.southeastwater.co.uk/news-info/publications/beast-from-the-east-incident-response-south-east-water-action-plan

Ofwat completed its own review into the impact of the freeze/thaw across the whole country and the lessons to be learned. They detailed where our plans worked well and where improvements could be made. We published our action plan in response to this on 28 September 2018 which included 61 actions that we agreed to. We have now completed 49 of these actions and an independent assurance by Jacobs in March 2019 concluded the plan was substantially complete and that none of the outstanding or ongoing actions represent a material risk to our preparedness or resilience in the event of a major incident.

Within a few short weeks the weather had warmed up and by early summer we were starting to experience higher than normal demand for water leading to the stepping up of our water efficiency messaging and a campaign encouraging customers to use water wisely during the heatwave, a recurring theme for the whole of the summer in which the whole country experienced hotter than normal conditions for weeks on end.

“To further support our leakage reduction strategy we have secured an industry first as part of a digital water meter trial which could revolutionise the way the water industry detects and prevents leaks

Our production teams geared up to produce an extra 100 million litres of drinking water a day at the peak with employees working round the clock to produce the extra water needed.

Although the amount of water available in reservoirs and aquifers were at normal levels for the time of year, and remained so throughout the hot weather, we asked customers to save water in order to help us meet demand for extra supplies at peak times of the day when it was challenging to meet the challenging peak time demand.

We also joined forces with other water companies in the south east of the country to run an advertising campaign in local media and radio, focused on water-saving measures and the need for prudence when contemplating the use of such things as paddling pools and garden sprinklers. While demand was higher than normal throughout the summer, the effects of our metering programme and customer communications helped to keep the demands at manageable levels and we thank everyone who took important necessary steps to save water.

Alongside this, as part of our water efficiency campaign we have given out more than 32,000 water efficiency devices and visited 49 schools to promote our message to use water wisely. We continue to work with an environmental innovation company, So Sussex, which hosts outdoor events for families and children who can interact with our educational water game to learn about water in a fun way.

Our annual estimated level of leakage was 86.9 Ml/d against the target of 89.1 Ml/d which was a good performance considering the aftermath of the Beast from the East and this year’s summer heatwave. Credit to the team who have worked hard to ensure we meet our target, something we know is particularly important to customers and stakeholders.

To further support our leakage reduction strategy we have secured an industry first as part of a digital water meter trial which could revolutionise the way the water industry detects and prevents leaks.

We are the first utility in England to have a full NBIoT (Narrowband Internet of Things) commercial agreement in place with Vodafone UK.

This partnership will allow the transmission of data for analysis from digital water meters at 2,000 homes in a trial area, as well as information from other network sensors.

In addition, a collaboration with ATi and Syrinix is the first time data from both our pressure and water quality monitors have been combined into one data set for analysis. If successful, it has the potential to alert us to the smallest leaks on both our and our customers' pipes soon after they occur, and could even enable us to predict and prevent pipeline failure before it happens.

While we have met our leakage target for more than 10 years, we are not complacent and are committed to using the latest, most innovative technology to drive leakage down further.

Our future counts

To ensure the sustainability of the business we must ensure our financial performance continues to be satisfactory. Our revenue was £238.3 million (2018: £221.5 million). Our profit before tax for the year was £36.4 million (2018: £23.8 million). Further details of our financial performance are set out on page 47.

On 1 May 2018 we exited the non-household retail market and transferred our non-household customer base to Invicta Water Limited, one of our group companies. On 1 July 2018, Invicta Water Limited was acquired by Castle Water (Holdings) Limited. The transfer of this business out of the group was a significant event in the year and we are pleased that the process has gone smoothly. As part of this process we have re-deployed employees elsewhere in the business.

Between February and May 2018 we consulted on our latest draft water resources management plan, by speaking to hundreds of customers and stakeholders across our supply area to gather their thoughts and opinions on our proposal which looks 60 years into the future.

After reviewing the representations alongside new data which has been made available to us, we made a number of changes to our plan, including reducing the amount of leakage by 15 per cent by 2025, halving the amount of leakage from our current position to 44 million litres a day by 2050 and adopting a more ambitious target for water efficiency which, in the long term, could save an extra 150 million litres a day by 2080.

In September we submitted our business plan to Ofwat for the forthcoming five-year regulatory period. The ambitious plan would see us invest a further £472 million to improve the local water infrastructure between 2020 and 2025.

While Ofwat praised our plan overall, we were requested to provide further evidence or justification and we responded comprehensively to the issues and actions raised by Ofwat. Ofwat will publish their draft determination in July and final determination in December.

We see our role as being guardians of the environment and work hard to protect the natural water resources we rely on. In the current five-year investment period we are investing £16.7 million in our National Environment Programme to complete 42 schemes that will bring real benefits to our natural habitats.

This year as part of our business plan we prepared our responsible business strategy which sees 10 additional commitments that our customers, employees and stakeholders felt were important we achieve. We have developed a responsible business committee with members of the board to oversee the progress of the strategy.

> **We see our role as being guardians of the environment and work hard to protect the natural water resources we rely on**

Thank you

I would like to thank all South East Water employees, suppliers and our board for their ongoing commitment and support. As we head into the final year of our investment period, with customer satisfaction at the heart of our business promise, I am proud to say we have a team at South East Water that is passionate about ensuring we deliver on the commitments we made to all our customers in our five year plan and continue to develop as a responsible business. I hope that you will find this report both interesting and informative. Further information is available in our performance, people and planet report.

Paul Butler
Managing Director
15 July 2019

Read our latest performance, people and planet report at corporate.southeastwater.co.uk/about-us/our-performance

Our business

Our vision and strategy

Our vision for the future is to be the water company people want to be supplied by and want to work for. It puts both customers and our people at the heart of what we do.

Our commitments – achieving our vision

To support the delivery of our vision, our 2015 to 2020 plan has five commitments which help us focus on how we run our business today and how we plan for the long term, with our employees ensuring that our customers are the priority in everything we do.

- **Every customer counts** – Our customers' priorities lie at the heart of everything we do
- **Everyone counts** – We inspire and motivate our people and partners
- **Every action counts** – Our operational performance is safe, effective and efficient
- **Every drop counts** – Our infrastructure delivers a reliable service to our customers
- **Our future counts** – We plan effectively for the long term

Our core values

Core values support our vision and commitments, and reflect what South East Water is all about.

Through workshops and interviews with employees talking about what it's like to work here, what our people stand for and what characterises the way we deliver our service, we created and defined our own set of core values:

Trust – Dependable, safe and sound, as a team always delivering on our commitments. Guardians of the environment

Passion – Dedicated to delivering a safe, reliable service, always caring for our customers and each other

Agility – Responsive, flexible and adapting quickly to change

Creativity – Fresh thinking, improving, never standing still

Excellence – Striving at all times to be the best and deliver the best

Our business strategy

Planning for water is a long-term business, which is why it is important we set out the opportunities and challenges we face in the future.

There are some considerable challenges for companies such as ours, which operate in a region which has been designated as being in serious water stress. The biggest of these is the need to meet the demand for water, from customers of today and the customers of tomorrow.

It is vital we look a long way ahead to anticipate the changes and challenges that could impact our work in the future. The challenges we face include:

- rising numbers of homes and people
- meeting customer demand for water
- climate change
- maintaining supplies
- customers' changing expectations

We put customers centre stage of our business strategy, while ensuring we take account of all our other legal and financial obligations, which has meant we have a clear direction of travel; one which we believe is better signposted as a result of our innovative and holistic approach to measuring our future performance through outcomes.

To develop our 2015 to 2020 plan we consulted with more than 8,000 people with an interest in our business, from customers and employees, through to community leaders and investors, to ensure we had developed a strategy that met their expectations.

Their feedback helped us to develop our five year business plan and to develop our corporate plan. This has led to the development of the five commitments, each of which leads to our customer outcomes which we measure to assess our current performance.

Read more online at southeastwater.co.uk/businessplan2015

We have been building on this customer engagement to create our new 2020 to 2025 business plan which is our most ambitious plan yet.

2020 to 2025 business plan – customer satisfaction responsibly delivered

We believe customer satisfaction is the best yardstick for everything we do, which is why it is the core theme of our 2020 to 2025 business plan. We published the plan in September 2018 and, following initial feedback from Ofwat we now await their draft determination. We believe our plan is the right one for our customers, now and in the future.

We are driven by the same values of trust as our customers. We are a business made up of dedicated water people who want to make a difference – to customers, communities, the environment and society – so that everyone and everything thrives as a result of what we collectively do.

We are immensely proud of being a local water company with a passion for sharing our 'pure know $h_2$ow' – and we have used our customers' desire to know more about their water supply service to develop our 'resilient customer' concept.

The result is a plan which:

- remains **built around customer satisfaction**, but which has improved from measuring average satisfaction across seven service elements to measuring satisfaction by attitudinal segments so we meet the expectations of all our customers – whatever their needs or circumstances
- strengthens the link between satisfaction and resilience by making customers part of the solution by giving them targeted information, and as such, greater control over their water use. We have used recent supply challenges in 2018 – such as the freeze/thaw and heatwave events – to develop this further through our **resilient customer concept**
- has a **focused innovation strategy** which targets our customers' and stakeholders' priorities; and where we can make the most difference to lead the industry, not least using our toolboxes to deliver greater customer satisfaction
- has **10 new responsible business commitments** to reflect the actions and behaviours that customers expect a responsible business to display; and, in conjunction with great service, have the potential to create a step-change in trust of the water sector
- challenges us to **deliver performance levels well beyond anything we have delivered before** and new ones too, such as our performance commitments relating to vulnerable customers, the environment and customer satisfaction
- when all the components are intrinsically linked as a package, **only four per cent of our customers did not find it acceptable**

The plan commits to all this at the same price as now, the challenge of doing more for less should not be underestimated. We have included 36 new performance commitments in our plan. To deliver those while keeping water bills stable has required us to make aggressive assumptions on our ability to reduce total expenditure, via bold efficiency and productivity improvements.

Our ambition to do more for less is what this plan is built upon and is what drives us to set a new tone of trust and transparency in the water sector. We will do this by evolving our use of satisfaction and introducing responsible business commitments.

How our plan addresses great customer service, resilience, affordable bills and innovation

GREAT CUSTOMER SERVICE

- Evolving customer satisfaction to six attitudinal segments
- Dedicated strategy to keep our services affordable, accessible and protective
- Priority Services Register support for 60,000 customers
- Six new vulnerability measures

RESILIENCE

- Resilient customer
- Leakage reduced by 14 per cent
- Per capita consumption reduced by 9 per cent
- Greater resilience to severe droughts
- Six environmental measures

AFFORDABLE BILLS

- Average household bill maintained at £204
- Financial assistance extended to further 43,500 eligible customers
- Cost of capital lowest ever at 2.4 per cent
- Efficiency savings of £45 million

INNOVATION

- Targeted innovation strategy
- Behaviour change, partnership and innovation toolboxes
- 10 new responsible business commitments
- Focus on environmental engagement

How our plan builds on our current performance

This plan builds on our performance for the current five year investment period which has to date delivered:

2015 TO 2020 CHECKLIST

- ✔ an **improvement** in customer satisfaction scores for:
  - the appearance of drinking water
  - the taste and odour of drinking water
  - leakage
  - water pressure
  - water restrictions
  - customers' direct interaction with us
- ✔ a **maintained** customer satisfaction score for water supply interruptions, despite significant operational challenges during this period
- ✔ a **strong improvement** in our Service Incentive Mechanism score and complaints at their lowest levels
- ✔ **safe, high-quality** drinking water that meets stringent standards and maintains customers' trust – underpinned by a continuous reduction in the number of customer contacts about discolouration and stable performance on taste and odour issues
- ✔ a **top-performing** industry position for our leakage performance
- ✔ **stable assets** and a secure supply of water with no water use restrictions – despite the 2018 heatwave driving sustained high demand
- ✔ our wide ranging **environmental** and **statutory** obligations including our award-winning catchment management programme
- ✔ a **steady performance** on all our financial obligations

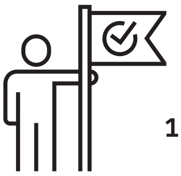
What makes this plan different from our last?

This plan is different to our last because of understanding our customers better and keeping them satisfied with our service.

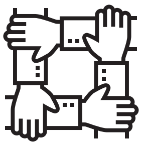
We were the only water company to introduce a suite of innovative customer satisfaction commitments for our 2015 to 2020 business plan.

We did that because we believe customer satisfaction is the best yardstick for everything we do. It underpins customers' trust in us; and is the very essence of what a responsible business should be.

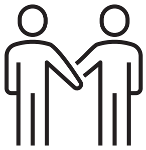
Customer satisfaction, responsibly delivered, remains the core theme of this plan but achieves much more because:



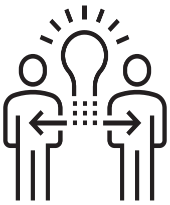
1 Customer satisfaction drives... **greater trust** among customers



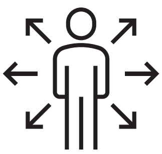
2 Customer satisfaction drives... **greater resilience**



3 Customer satisfaction drives... **smarter engagement**



4 Customer satisfaction drives... **innovation in the right areas**



5 Customer satisfaction drives... **us to be a responsible business**

OUR TOOLBOXES

We have developed toolboxes to deliver on our promises which ensure that customers, stakeholders and society play a greater part in the delivery of our services and become part of the solution to old and new challenges.

The **behavioural change toolbox** for customers – using successfully-tested behavioural science techniques as well as more traditional campaigns and literature to tap into attitudes so that customers help us achieve shared goals.

The **partnership toolbox** for our stakeholders – who have a strong desire to increase their participation in water issues and activities.

The **innovation toolbox** for the supply chain to work with our business – so that we can adopt or adapt existing technologies while actively seeking out new ones.

Customer Challenge Group

The Customer Challenge Group endeavours to put South East Water customers at the heart of future plans.

The independent group – which comprises water regulators, customer representatives and key stakeholders – scrutinises and challenges our strategic direction, including this current business plan.

Ofwat requested that our Customer Challenge Group write a report which sets out how well we've engaged with our customers, and whether their views have been adequately reflected in the plan.

You can read the report and find out more about the Customer Challenge Group at www.customerchallenge.co.uk

Your water, your say

Our 2020 to 2025 business plan is based on feedback from thousands of our customers and stakeholders. We want to continue these conversations as we prepare to deliver this plan in collaboration with others, so if you have any feedback please contact us.

Read our latest plan at corporate.southeastwater.co.uk/about-us/our-plans/our-business-plan-2020-2025

Water resources for the future

Every five years we update our water resources management plan (WRMP) which looks at how we will keep taps running while striking that delicate balance between protecting the environment and keeping bills affordable.

Since we published our previous plan in 2014 we have:

- reduced the amount of water lost through leaks, exceeding our target
- metered 90 per cent of our customers
- reached more than 22,000 people as part of our award-winning targeted behaviour change campaign

Previously these plans looked 25 years into the future, but because the south east faces a number of unique challenges, as detailed on page 28, we've taken the decision to look forward 60 years to 2080.

By doing this we can make sure the work we do now lays the best foundation for future generations.

Over the next 60 years the population in our supply area is set to increase by 53 per cent to 3.34 million. To ensure all existing and new customers continue to receive a reliable tap water supply we need to increase the amount of water available by an extra 294.2 million litres a day by 2080.

Our latest plan includes proposals for making what water we already have go further – by reducing leaks on our pipes further and developing water efficiency programmes.

Although this will help, these measures alone won't be enough to meet the predicted shortfall in water.

Our larger scale proposals for 2020 to 2045 include:

- building a new water treatment works at the former Aylesford Newsprint site, Kent by 2023
- upgrading existing water treatment works at Ford, Kent by 2027
- developing a water re-use scheme at Peacehaven, East Sussex by 2028
- building a new reservoir next to our existing Arlington Reservoir, East Sussex by 2032
- creating a new reservoir in Broad Oak, Kent by 2033
- developing a water re-use scheme at Aylesford, Kent by 2038
- developing a regional water transfer scheme from SES Water

Long term considerations between 2045 and 2080 include:

- desalination at Eastbourne, Reculver and the River Medway
- water re-use on the River Stour, East Kent
- a new reservoir in West Sussex
- a new raw water abstraction and treatment works from the River Thames near Maidenhead, Berkshire
- regional water transfers from Portsmouth and Thames Water
- a new groundwater resource near Farnborough, Hampshire

By planning so far in advance we can find the most sustainable long-term options to meet the demands of both our existing and our anticipated new customers. Our planning supports the 'twin track' approach to ensure that we adopt the best options to manage both customer demand for water and the development of the most sustainable sources of supply.

We asked for customers' views while we developed our plans and thank everyone who took part in the consultation process. In particular we are grateful to the members of our Environment Focus Group who have challenged our approach and helped ensure we develop an acceptable, resilient and innovative plan.

Following the public consultation which concluded on 21 May 2018 we prepared a revised plan that takes on board much of the feedback we have received about the draft plan. The revised plan was published in August 2018 and we hope to publish a final plan later this year.

Read more online at
corporate.southeastwater.co.uk/about-us/our-plans/water-resources-management-plan-2019

Our objectives

We use outcome delivery incentives (ODIs) to measure our progress towards achieving our goals and priorities. We have published a summary of our performance against these ODIs on page 216 as part of our annual performance report. We have also published our Performance, People and Planet report 2018/19 which provides much more detail on each of the ODIs, the challenges we face and our future plans to ensure we continue to improve, and further develop our focus on customer and stakeholder outcomes.

We engaged with customers to help us set our future priorities and prepare our outcomes for the next business plan that covers the period 2020 to 2025 (see page 29). The priorities we have developed aim to exceed customers' expectations for us to ensure health and wellbeing through a quality, reliable water service, and improving the environment to secure a resilient service for the future. They also include commitments to ensure we are supporting all our customers, including those who are vulnerable. We will confirm our objectives following Ofwat's draft determination of the plan which will be published in July 2019.

Our business model

We deliver water to our customers. We do this by applying our pure know h_2ow to the process of collecting, storing, abstracting, treating and transporting water using the infrastructure (reservoirs, treatment works, pipes and pumps) that we build and maintain.

We rely on the environment to provide us with the water resources to meet customer demand. Throughout our history we have put the quality of our water resource and protection of the environment that our water comes from at the heart of what we do. With increasing stresses on our environment, our history provides us with the platform for continuing to create value and meeting stakeholder expectations in the short and long term.

All our activities are regulated by Ofwat which is our economic regulator and has a duty to protect the interests of consumers. We operate under an instrument of appointment issued under the Water Industry Act 1991. Every five years under the terms of our licence and as part of the industry price review we submit a business plan to Ofwat. Our business plan sets out the costs that we expect will be required to run the water network and the capital investment we expect will be required to maintain a high quality of service to our customers.

These business requirements are used to determine appropriate tariffs for our customers which are set out in our charges schemes. Our revenues and costs are regulated by Ofwat, as are our returns to investors. There are three price controls, being for the wholesale business, the retail household business and the non-household retail business.

Our business model has evolved with the opening of the non-household retail market on 1 April 2017 and the continued development of competition in the provision of water infrastructure and supply to new development sites by other water companies. We significantly reviewed the way we operate for market opening and functionally separated our non-household retail business (which has since been sold to another retail business) from South East Water's wholesale and household retail business. Therefore we are now concentrating on retail services for household customers and ensuring we provide an excellent wholesale service to all that use the water we produce and supply.

There are further changes on the horizon with new price controls for water resources and the operation of our network (Network Plus) replacing the single wholesale price control. This is designed to enable further innovation and potential competition for water resources. While we continue to provide the same services to our customers within a defined regulatory framework, we are also increasingly subject to competitive pressures and must adapt our strategy to this changing environment.

Creating value by being a responsible business

Our business creates value in a variety of ways:

- value for customers – maintaining and investing in our infrastructure to ensure current and future customer demand for water is met. Achieving customer outcomes
- value for the environment – protecting and enhancing the environment
- value for employees – providing training and fulfilling jobs
- value for our communities – enabling communities to develop and thrive thanks to a reliable water infrastructure
- value for investors – providing stable returns by anticipating and managing emerging risks and identifying new business opportunities

We believe that by focusing on creating and delivering value across these different dimensions we will be able to achieve our ambition of being a responsible business, one that creates value for, and is valued by, our stakeholders and society.

Taking the long view

We have a rich history of taking a long-term view: making decisions that balance meeting the needs of customers today with ensuring we can provide a quality service for our customers of the future. We design and build our infrastructure to meet expected changes in demand and environmental conditions.

We raise money for our investment programme from financial institutions like pension funds who take a long-term view and seek steady, reliable and reasonable returns on their investment.

The price that we charge our customers is regulated by Ofwat and set for a five-year period at a level that reflects the expected cost of running our business and funding our investment programme. Customer bills are inflation linked and thus provide some protection from the impact of increased operating costs, but we have to think about how best to manage the risks to the business of events not included in the prices set by Ofwat.

Increasingly, these risks may arise from environmental and societal factors beyond our control such as the extremely cold weather conditions we experienced in March 2018 that led to customer pipes bursting. The next five year price period runs from 2020 to 2025 and our business planning has been based on a good understanding of the medium to long term business and external environment.

Engaging with stakeholders

To help develop our business plan for 2020 to 2025 we developed a comprehensive engagement programme to ensure we capture all the differing views of our customers and other stakeholders about their priorities and expectations both now and in the future. This programme has seen us engage with 13,000 stakeholders to help us shape our plans.

We worked closely with our stakeholders, including customers and employees to build our responsible business strategy that identified emerging risks and opportunities relating to the long-term success of the business and environmental and societal needs.

Being part of the solution

We recognise that as a water company we cannot solve the many challenges that our communities face on our own. We are seeking to engage more deeply with different stakeholders to understand how value will be created over the longer term, what the role of South East Water is, who we should collaborate with, and what actions we need to take. We seek to be part of the solution to making our communities and our environment healthy and thriving.

“To help develop our business plan for 2020 to 2025 we developed a comprehensive engagement programme to ensure we capture all the differing views of our customers and other stakeholders

How we do business

1 Vision

Our vision, "to be the water company people want to be supplied by and want to work for", is the source of our inspiration and is the start of our journey

2 Values

Core values support our vision and commitments, they shape our culture and reflect what South East Water is all about

Trust – Dependable, safe and sound, as a team always delivering on our commitments. Guardians of the environment

Passion – Dedicated to delivering a safe, reliable service, always caring for our customers and each other

Agility – Responsive, flexible and adapting quickly to change

Creativity – Fresh thinking, improving, never standing still

Excellence – Striving at all times to be the best and deliver the best

Every customer counts
Our customers' priorities lie at the heart of everything we do

Everyone counts
We inspire and motivate our people and partners

Every action counts
Our operational performance is safe, effective and efficient

Every drop counts
Our infrastructure delivers a reliable service to our customers

Our future counts
We plan effectively for the long term

3 Commitments

We developed five commitments which ensure we will reach our vision

6 Customer satisfaction outcomes

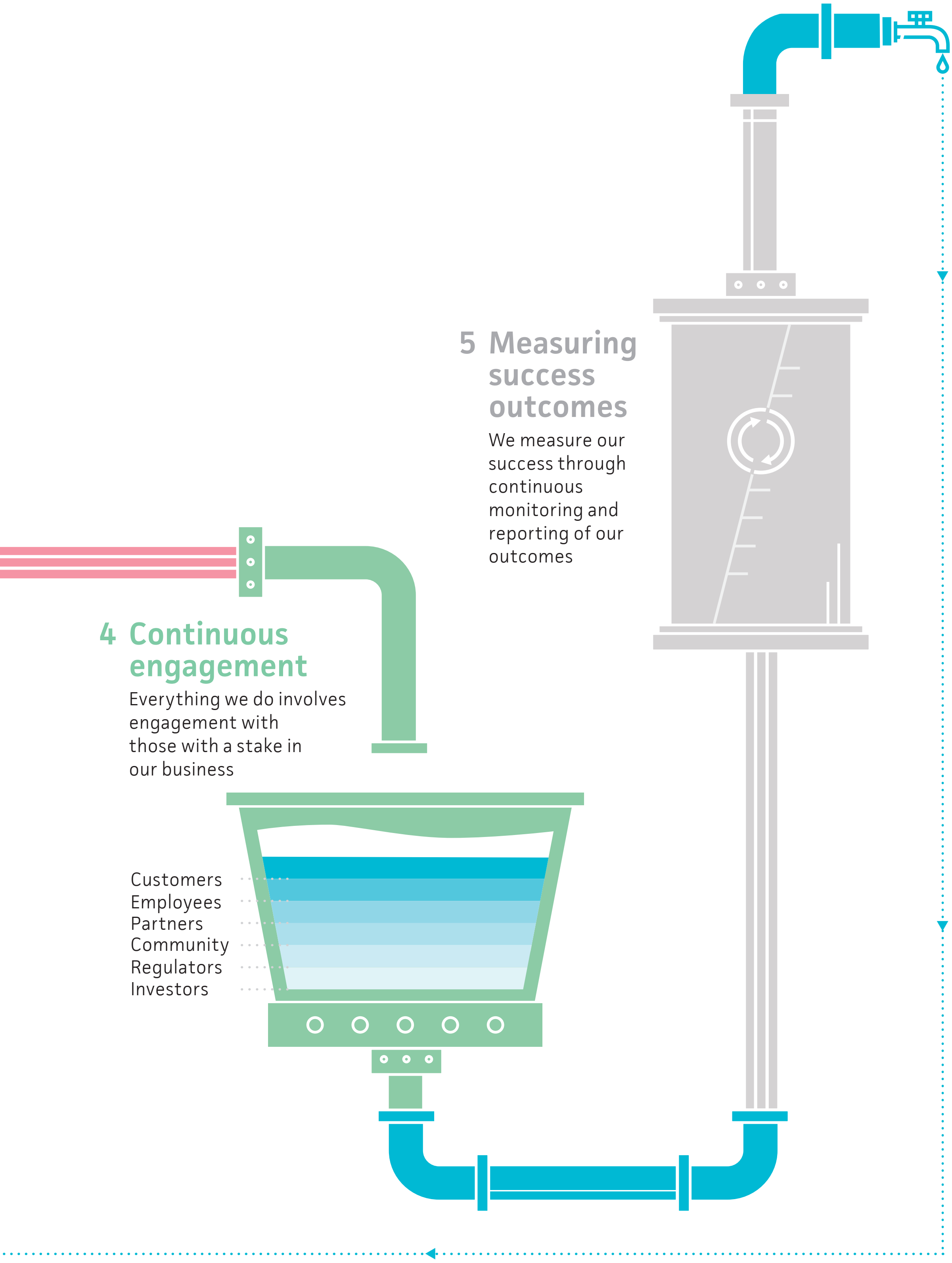
We aim to deliver a five-out-of-five service to deliver complete customer satisfaction

5 Measuring success outcomes

We measure our success through continuous monitoring and reporting of our outcomes

4 Continuous engagement

Everything we do involves engagement with those with a stake in our business



7 Business environment

There are many factors that feed into our process whether from the external environment (such as political and regulatory), environmental, social and technological, or internal factors of our people, assets and financing

Business environment

External environment

Political and regulatory

We operate within a strict regulatory environment and work closely with our regulators to strive to deliver a great service for our customers both now and in the future.

- The Water Services Regulation Authority (Ofwat) regulates our prices and levels of customer service
- The Drinking Water Inspectorate (DWI) monitors drinking water quality
- The Environment Agency (EA) covers environmental protection
- The Consumer Council for Water (CCWater) represents customers' interests
- Water Redress Scheme (WATRS) is an independent service designed to adjudicate disputes that have not been resolved through the water company's customer service teams or by referring the matter to the Consumer Council for Water
- Natural England (NE) is responsible for the protection of designated sites for nature conservation
- Department for Environment, Food and Rural Affairs (Defra) deals with all aspects of policy relating to the water industry and we operate under a licence granted by the Secretary of State
- Centre for the Protection of National Infrastructure (CPNI) is the government authority for protective security advice to the UK national infrastructure

The political and regulatory environment changes significantly over time and we ensure South East Water is able to respond to these changes and where appropriate influence future policy through our participation in consultations and as active members of the water industry trade body, Water UK. Our aim is to ensure any changes that affect the outcomes for our customers, shareholders and other stakeholders are positive.

South East Water has worked collaboratively with water companies from across the country to prepare for the potential implications of the UK's exit from the European Union, this included preparations during the year for the potential risks if no deal was in place. We are working with our supply chain and putting measures in place to minimise any impact. We have been liaising with government, regulators and, on a local level, with Local Resilience Forums, keeping them updated on our planning.

Environmental

Our business clearly relies on a secure supply of our natural resource – water. We must ensure that we protect both the quantity and quality of our key resource.

Rainfall in the South East of England is lower than other parts of the country and is officially designated as an area of serious water stress. Our water resources management plan (see page 32 for details) is key to the management of our precious resource.

As well as ensuring we have the supplies we need, now and into the future, we can also protect the quality of that water and reduce energy use through more efficient treatment processes.

We recognise that good effective environmental management must be at the heart of all of our water supply operations, which is why it is embedded into all aspects of our work. It is something that we do every day through the management of our assets, delivery of our product and investment in the community in which we serve, live and work.

Government and our industry are working together to understand future needs for water and we were active members of an industry-led project to look to improve the resilience of water in the UK. Details of this project were published in our Water Resources Long Term Planning Framework.

Our planning into the future includes considering the effects of climate change, working to protect the environment from pollution caused by others as well as our own activities and reducing our carbon footprint.

Our education programme continues to introduce pupils to the "wonderful world of water" and we visited 49 school classes during 2018/19 and gave out more than 32,000 water efficiency devices to customers across our region to help encourage a sustainable use of water.

Our careful stewardship of the 2,000 hectares of land we own ensures our groundwater sources produce a top quality product as the natural filtering through underground aquifers means minimal additional treatment is needed.

Where our water is sourced from surface water, such as rivers and reservoirs, we are working with local communities to improve the quality of the water within the catchment. Our water and farming partnership sees us work together with Natural England to support farmers with the management of the water catchment in their areas.

We realise, as significant landowners, we have tremendous responsibility in looking after our 33 sites which are within areas of Special Scientific Interest, including the national nature reserve at Lullington Heath in East Sussex, two nature reserves at Arlington Reservoir and Ardingly Reservoir in Sussex and numerous other areas of outstanding natural beauty.

How we do this is the result of many years of careful and sensitive management of a wide variety of flora and fauna flourishing on our sites and we often work in partnership with Natural England and various wildlife trusts.

We are investing £16.7 million in our national environmental programme between 2015 to 2020, which will see us complete 42 schemes that cover various aspects of our operations.

These include biodiversity, surface and groundwater catchment management, abstraction, the installation of flow meters and the implementation of new eel regulations which seek to protect an endangered species at risk from water treatment processes.

This year we have implemented 10 pilot biodiversity plans which are being monitored and active conservation is being delivered. The aim of our pilots has been to establish the current value of the sites and to proactively manage the sites to develop rare, priority chalk grassland habitat. To deliver this work our environmental team has delivered 79 invertebrate surveys, three botanical surveys, six dormice surveys and 24 reptile surveys.

We're proud to be a part of Interreg, a programme which aims to address the impacts of climate change and enhance the availability of raw water. This cross-border project is called PROWATER, (Protecting and restoring raw water sources through actions at the landscape scale).

The four-year project has a budget of more than €5.5 million. It is part funded by the European Regional Development Fund, which contributes €3.3 million, and part by project partners.

Find out more at corporate.southeastwater.co.uk/about-us/our-environment/interreg-partnership

Social

We have many people that care about our business, including our customers, our communities and our employees. Our performance, people and planet report for 2018/19 summarises how we are working to meet the different requirements of this diverse group.

An important development in our preparations for the business plan has been our focus on attitudinal customer segmentation. Historically, the water industry has tended to segment customers based on age, income or their metered or unmetered consumption of water.

Our engagement with customers shows us that this is too simplistic and therefore we have segmented our customers based on their attitudes to water. Successful retail businesses do this as a matter of course and we believe the results will enable us to develop better communications that meet the needs of these different groups for the future.

Thinking about future generations, the impact we have on them as a business and how we will ensure we are sustainable is important. We take our corporate social responsibility very seriously as we plan for the future. Clearly the drinking water we supply is fundamental to the health and quality of life of our customers. The quality of the drinking water we supply is monitored at every stage of the treatment process through to when it flows from our customers' taps.

We take samples every day, which are analysed in our state-of-the-art laboratory in Farnborough to ensure that the water is safe to drink and that we are fully compliant with water quality regulations. We must supply water that complies with these regulations, exceeding these standards where possible.

The quality of water for domestic purposes is also monitored by the independent Drinking Water Inspectorate.

Customer segment	MINDFUL OPTIMISTS	GLOBAL ADVOCATES	JUST ME AND MINE
Attributes	Less affluent, with community versus corporate focus	Affluent, financially secure and engaged in the big picture	Comfortable and whose main focus is on their immediate world
Per cent of customer base	23%	16%	12%

Customer segment	CAREFUL NEIGHBOURS	BUSY JUGGLERS	LIVING FOR TODAY
Attributes	Kind and thoughtful about their community, financially careful and waste conscious	Tech immersed, would be more outwardly focused if they had time	Low social conscience with spontaneous nature
Per cent of customer base	12%	15%	22%

Our communities also benefit from the provision of educational, recreational and amenity opportunities that come from being able to access our land and from the contributions we make through donations, organised charitable events and the support of our employees in their voluntary activities. In 2018/19 we provided support to the volunteers organising promotions of "Refill", an online app to encourage people to refill bottles with tap water rather than buying single-use plastic.

Our intention is to be a good neighbour and we take account of the views of our customers and the community in which we work to ensure we minimise our social and economic impacts, particularly when delivering our capital programme. We also recognise our obligation to observe high standards of corporate governance in the way we conduct our affairs.

The average household water bill from 1 April 2019 rose by 0.5 per cent to £211 (including inflation), which works out at 58 pence a day for the average family. For this we supply safe, high quality water for everyday needs such as drinking, washing and cooking which represents great value for money. We have also offered extra help for those struggling to pay their bill or who are in debt.

Our customer care team assist customers who are on a low income or in receipt of specific benefits. We understand that customers may have difficulty with paying their bills and our team has found the right assistance for more than 27,000 people by transferring them to our social tariff.

In addition, we assist customers with a wide range of support tariffs, payment schemes and financial assistance through our charitable trust, "Helping Hand". We work closely with Citizens Advice and other organisations to share good practice in debt management and our customer care team worked constantly with external partners to ensure that harder to reach customers did not miss out on support available to them.

We want to ensure the bills our customers receive for their water services are accurate and easy to understand. There is a postcode checker which allows customers to quickly check their charges on our website. An interactive online bill is also available to help people understand their bill better.

We know the value of our employees and the importance of making individuals feel engaged in running the business. We firmly believe that engaged employees go the extra mile to deliver a great service.

How we do this is by embracing the Investors in People ethos of continuous improvement and measuring performance against our corporate objectives. This framework enables us to channel resources more effectively and harness the talent of our people towards achieving our company goals. We are proud to be accredited to the Silver Investors in People standard which was retained following assessment during the year.

Developments in our journey so far include improved training opportunities, better internal communications and ensuring all employees and contractors receive the living wage – the sum above the minimum wage and we are accredited by the Living Wage Foundation.

Technological

We work closely with our employees and supply chain to research and develop technological advances that can help us improve the quality of our service.

An example of this in action is a computer system invented by our leakage team which has helped stop millions of litres of water being lost to leaks every year. Aquanet has become a vital research and analysis tool, identifying pipes which are leaking as little as 0.05 litres a second by using advanced mathematical algorithms to compare flow rates in thousands of water meters throughout the company's network of 14,780 kms of pipes.

It uses that data to find anomalies such as unusual increases in water flow which could suggest a leak and that enables distribution technicians to investigate, find and fix minor leaks before they have chance to turn into major bursts.

Aquanet is compatible with our other operations and asset management systems and constantly updates, adding more than one million rows of data a day to its database. We've found that up to 90 per cent of the anomalies Aquanet suggests are leaks are indeed leaks when investigated by our technicians on the ground.

Our aim is to use Aquanet to predict when pipes will fail looking at historical information, pipe history, condition reporting, pressure, demand and burst history.

We are also using the system to enhance our demand forecast, cross referencing demand with weather forecasts so we can accurately predict the amount of water required over a given period.

Embracing the latest digital technology is a vital business tool and we continue to invest heavily in our website to give customers a useful, comprehensive and instantaneous two-way communications channel simply by signing up for an online account.

This enables them to view bills, check their online balance, sign up for a direct debit, notify us when they move home, make a payment and submit a meter reading.

It also offers customers the ability to report an incident or a leak and check for the latest news on incidents, repairs or planned work in their area simply by entering their postcode on an interactive map.

They can also sign up for updates on engineering work or incidents via email or mobile. We have had more than 90,000 alerts sent to customers through the year and by the end of the financial year a further 61,000 customers had signed up for My Account.

The website, which works seamlessly on desktop, tablet and mobile, can also talk to customers in more than 60 different languages.

In addition, it employs dyslexia software, an interactive dictionary and an electronic magnifying glass, alongside the translation tool which can instantly convert English into foreign text and then read it aloud if required.

Our investment in this new software underlines our commitment to providing a five-out-of-five service to all of our customers, including those for whom English is not their first language, and for anyone with additional needs.

The software, a proprietary cloud-based web accessibility platform called Recite Me, works on all computer platforms including desktop, tablet and mobile. It claims translation accuracy of 96 per cent. During the year the system has been accessed more than 20,000 times.

Customers should go to southeastwater.co.uk and click the "Speak or Translate Me" button on the right of the home page to access the service.

Case study

Digital water meter trial

Industry first trials new technology to detect and prevent leaks

Ground-breaking technology is being tested by South East Water in a trial of smart water technology which could revolutionise the UK water industry.

Approximately 2,000 customer homes in the New Barn and Longfield areas of north Kent will be connected to a Smart Water Network in the trial which will run until the end of 2019.

The Smart Water Network (SWN) trial integrates existing infrastructure, introduces digital meters and increases network sensor density (noise loggers, pressure sensors and water quality sensors) through a live smart water platform – effectively creating a "digital twin" of the physical water network.

The data collected from our network is sent in near real-time over two types of wireless network to a central IT system which enables more effective analysis and processing of the information.

The main aim of the trial is to identify leaks and bursts more quickly and efficiently and understand the root cause of the burst, while also testing the reliability of the new equipment and networks being used. Having a greater understanding of what's happening in the hidden world of our underground water pipes far sooner than we have done in the past means decisions can be made quicker. In a later phase of the trial we hope to use the data to engage with our customers and help them to reduce their water use and ultimately increase overall customer satisfaction.

Head of Networks Jim MacIntyre said: "This trial is so much more than just installing lots of digital sensors and meters. What makes this trial different is we are the first water company in the UK to be testing different types of communication networks as a key component to collect higher volumes of data, and then analysing this data to provide a centralised view of the digital network.

"We will also have opportunities to become far more proactive when discovering and prioritising leak repairs, alongside opening up our engagement with customers in a much more innovative and interactive way than ever before."

We are expecting the trial to give us invaluable first hand learnings that can be used to inform wider programmes of work across the company.

Find out more at southeastwater.co.uk/digitalmeters

Getting connected
One of the first smart meters is installed

Internal factors (key resources)

People

We know that we can only achieve our ambitions for customers with a thriving and creative team of people to deliver our promises. That is why we ensured our vision was as much about the people we work with as it is about those we work for.

Protecting the interests of our employees and partners and ensuring that they are respected, fairly treated and highly motivated is a key objective through our "everyone counts" commitment.

The health, safety and wellbeing of our employees is vital to our business. During the year we have built on our Thrive 365! Strategy, which sets out how health, safety and wellbeing is at the heart of everything that we do and supports our ambition to be the water company that people want to work for.

Key achievements against this strategy include:

- a health and safety conference held on the subject of Leadership. It was attended by the majority of operational managers and featured a keynote speech by Alan Chambers MBE, polar explorer
- operational teams attended a 'Don't Walk By' workshop intended to provide them with the tools to make a safe intervention when they observe unsafe behaviour
- a recognition and reward scheme has commenced for positive safety interventions
- an improved chemical awareness training course has been developed, approved and scheduled with our chemical supplier

Activities underway to improve diversity across the organisation include:

- ensuring our recruitment advertising is accessible to all
- promoting STEM careers within schools in our local area, particularly using women role models
- developing a "Women at Work" group to share experiences and knowledge
- developing our in-house mentoring service
- working with the women returners programme to support women returning to work after a career break

Last year we launched a new employee performance management framework called iReview. This is a system created to support the business objective of employee self-assessment.

Developed in collaboration with managers and employees through focus groups, iReview has been designed to provide a more continuous approach of regular feedback from managers and recognition of achievements. Employees are able to assess their own performance against objectives as well as the new behavioural framework, tied to our values.

This approach puts employees in the driving seat of their development and we are delighted that we have achieved 100 per cent completion this second year.

In 2018/19 we completed, achieved and gained:

- Number of training hours: 19,585
- Number of apprentices: 11
- Number of apprentices recruited last year: 8 (in 2017/2018)
- Number of apprentices recruited this year: 6 (in 2018/2019)

Our performance, people and planet report details the work we are doing to continue to ensure we are the water company people want to work for.

Assets

Keeping 14,780 kms of pipe, 83 treatment works, 86 boreholes and 254 pumping stations running efficiently requires the right investment at the right time. It is these assets that ensure we deliver a successful 24-hour water supply service for our customers. We use the latest technology and modelling capabilities to constantly assess the health of our assets which must be stable enough to deliver expected levels of service for many years ahead.

In September 2018 we were reaccredited with PAS55, the British Standard produced by the Institute of Asset Management and recognised as a benchmark for how physical assets and infrastructure are best managed.

Making sure we provide value for money to our customers, while maintaining our water supply and distribution systems is a complex job, and renewing our PAS55 certificate shows that we are getting our approach to asset management right.

Gross capital investment in the year was £104.7 million (2018: £96.0 million).

We have worked with our strategic partner, Jacobs, to deliver our capital programme which has seen us invest £31.4 million on maintaining our above ground assets (treatment works, service reservoirs and pumping stations). These assets are in good shape and their performance has been assessed as being stable. We have invested a further £36.9 million on renewing and replacing our underground mains infrastructure (the pipes that transfer water to our customers).

We have spent approximately £29.6 million as part of our strategic objective to improve our supply and demand management. This includes achieving our goal of having at least 90 per cent of our household customers on metered supply by 2020. With more than 30,000 new water meters installed this year, 90 per cent of our customers are now on a metered supply.

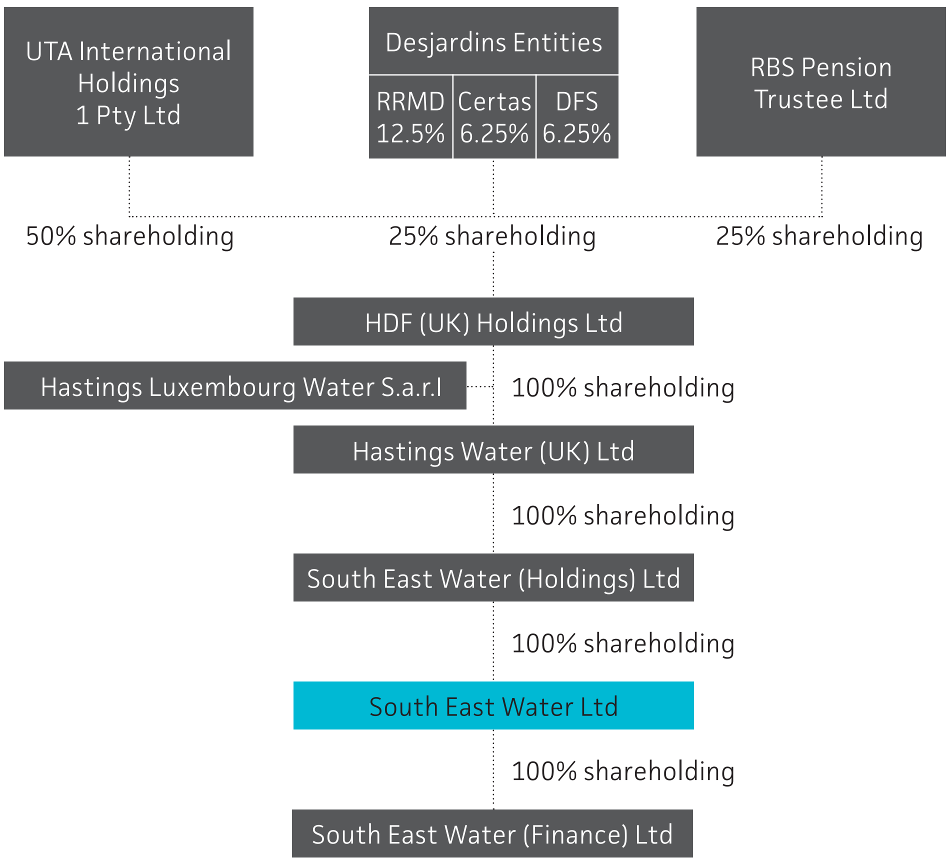
Group structure

South East Water Limited is the main operating company in the group of companies headed by HDF (UK) Holdings Limited ("HDF"). There are two intermediate holding companies between South East Water and HDF: South East Water (Holdings) Limited and Hastings Water (UK) Limited, both of which, together with HDF, are registered and resident in the UK.

The ultimate owners of HDF are Utilities of Australia Pty Ltd as Trustee for the Utilities Trust of Australia, RBS Pension Trustee Ltd as trustee for the Royal Bank of Scotland Group Pension Fund (Main Fund Section) and three entities of the Desjardins cooperative financial group based in Quebec (Régime de Rentes du Mouvement Desjardins, Desjardins Financial Security Life Assurance Company and Certas Home and Auto Insurance Company).

Recent debt financing has been arranged through South East Water. Historical debt financing of South East Water has been arranged through our only subsidiary, South East Water (Finance) Limited. South East Water (Finance) Limited is a company registered in the Cayman Islands but the company does not gain any tax benefit from this as the company is resident for tax purposes in the UK. There is further debt finance in the group which is a mixture of both external and shareholder loans and this debt is issued by a separate group company, Hastings Luxembourg Water S.a.r.l.

Group of companies



Business performance

We use a range of measures and targets to track our performance during our five year business plan. We call these "outcomes". An outcome is our promise to customers, regulators and those with a stake in our business. It sets out what we are trying to achieve, rather than just what we will do. These include some innovative outcomes, relating to continuous assessments of our customers levels of satisfaction which will help us demonstrate how we keep our customers at the heart of everything we do.

Traditionally, water companies have focused on output based measures, for example the number of customer complaints, rather than focusing on how satisfied customers are and how they feel about the service they receive from their water company. In 2015/16 we introduced seven customer satisfaction measures where we contact customers at random on a monthly basis to understand how satisfied they are with elements of our service.

The outcomes that are surveyed are as follows:

- customers consider the appearance of their water to be acceptable
- customers consider the taste and odour of their water to be acceptable
- customers consider the level of leakage to be acceptable
- customers consider their direct interaction experience to be positive
- customers consider their water supply is of sufficient pressure
- customers consider the frequency and duration of supply interruptions is acceptable
- customers consider the frequency of water use restrictions to be acceptable

Our customer satisfaction performance has remained stable for the majority of measures this year. The average score for the year is 4.3 out of five across our suite of measures. This means that the majority of our customers are either satisfied or very satisfied with the service we provide.

The service incentive mechanism (SIM) is a water industry customer satisfaction measure designed to encourage companies to provide a better service to their customers. In 2018/19 we have scored 85.4 out of 100 compared to 85.6 in 2017/18. During the year we have continued our focus on improving our customer service on every contact we receive with our teams striving to give a five-out-of-five experience every time a customer contacts us.

Customers can visit the website ***discoverwater.co.uk*** which gives everyone access to comparative information on the performance of water companies. We believe this is an important tool which enables customers and stakeholders, in particular our Customer Challenge Group, to compare the progress on our target with other water companies to ensure we are striving for continuous improvement and stretching ourselves to provide the best possible service.

For further information on all of our outcomes and targets please refer to our performance, people and planet report and table 3A in our annual performance report on page 216.

Financial performance

We have had a strong financial performance in the year and we are well placed to continue to deliver on the financial requirements of all of our stakeholders as we approach the end of the Asset Management Period (AMP). This year our operational focus has been on improving the delivery of services to customers and fulfilling our environmental obligations. This financial year was the second year of competition in the non-household market and one which we had to contend with the final stages of the Freeze/Thaw event which was shortly followed by the hot summer which resulted in exceptional pressure on our network.

There are a range of financial performance indicators that we use to monitor our business. These are linked to the key strategic financial requirements of our instrument of appointment and to those of our investors which underpin our capital structure and the financial governance that we apply to our business.

In addition, we monitor profitability, capital expenditure and cash performance, further details of which are set out in the table below.

The group financial statements are set out on pages 116 to 177. The group accounts are prepared under International Financial Reporting Standards (IFRS) and report the results for the consolidated South East Water group. The group accounts include the results of South East Water (Finance) Limited.

Revenue

The turnover for the year was £238.3 million compared to the previous year of £221.5 million, after allowing for £3.3 million reported under discontinued operations. Under the regulatory price control mechanism, our revenue is allowed to increase each year. In 2018/19 our tariffs increase was maintained under five per cent. Additional revenue generated from an increase in prices of £9.2 million, after allowing for the disposal of the non-household business, has been supplemented by an increased demand due to the hot summer weather of £1.4 million.

The increased turnover was offset by a loss of revenue from customers who switch from unmetered to metered supply of £4.5 million. As customers switch from unmetered to metered supply, we see a reduction in bills as customers use less water and therefore, in turn, revenue to the company reduces.

Additionally, changes in our accounting policies following the adoption of IFRS 15 have resulted in additional turnover in the income statement of £7.5 million in respect of new connections charges and infrastructure income.

Other income has also increased significantly in the year largely due to an expansion of our non-regulated business providing an extra £3.1 million of income.

As the South East of England is classed as a water stressed area, one of our strategic objectives is to improve water efficiency by increasing the number of customers on metered supply. This is part of our longer term strategy to monitor and improve water efficiency. Approximately 84 per cent of our water revenue is from measured supply in the year. This has increased from 78 per cent in the previous year.

KPI	Measure	2018/19	2017/18
Credit rating	Standard & Poors	BBB	BBB
	Moodys	Baa2	Baa2
Interest cover	multiple	3.3	3.6
RCV (Regulated Capital Value)	£m	1,365.0	1,307.5
Net debt to RCV	%	78.6	77.7
Turnover	£m	238.3	221.4
Operating profit	£m	86.4	75.0
Profit before tax	£m	36.4	23.8
Capital expenditure	£m	104.7	96.0
Cash	£m	12.8	6.5

Operating expenditure

Our operating costs for the year, including charges for doubtful debts, have increased from £155.3 million to £164.8 million, an increase in costs of £9.5 million. The most significant impact on costs in the year was the introduction of IFRS 15 which has resulted in the £2.3 million overhead recovery on new connections, previously offset against operating costs, now included in income. Other increases include additional depreciation of £1.5 million in respect of new fixed assets introduced to operations, £1.4 million of additional energy and bulk water supply charges due to increases in prices in the year and additional demand due to the hot summer and increased maintenance costs, again due to the summer heatwave.

Higher debt collection fees of £0.8m have also been incurred in the year largely in respect of collection services following the exit from the non-household retail market. Additionally, we have seen other operational and inflationary pressures on our costs, particularly with respect to business rates and insurance.

Partly offsetting this were lower compensation payments of £1.1m following the additional payments in respect of the freeze/thaw incident in 2017/18.

Operating profit

Operating profit has increased from £75.0 million to £86.4 million, an increase of £11.4 million. This increase in operating profit reflects the additional income in excess of additional costs, as detailed above.

Finance costs

We hold a number of listed bonds and indexed linked loans. The maturity dates of the loans range from 2019 to 2045 and further details with respect to these loans are set out in note 23 to the accounts. The associated finance costs of these loans are £56.1 million in the year which is largely the same finance cost as the previous year. Offsetting the loan costs is interest receivable of £6.1 million (2018: £4.8 million) mainly from South East Water Limited's parent, South East Water (Holdings) Limited. Although finance costs overall have remained constant, indexation charges in the year have been better than the prior year by £1.1 million. These savings have been offset by the increased cash interest paid on the company's bonds and loans as the indexed principal increases each year.

The £1.3 million improvement in interest receivable is largely due higher LIBOR, the London inter-bank lending rate, increasing the interest received from the company's parent in the year.

Profit before tax

During the year the company sold its non-household retail business to another company in the HDF group, Invicta Water Limited, for £10 million, resulting in a profit on disposal of £9.2 million.

The improved operating performance detailed above together with the profit on disposal of the non-household retail business has resulted in an improved profit before tax of £36.4 million compared to £23.8 million in 2017/18.

Profit after tax

Profit after tax has increased from £16.2 million in the prior year to £38.7 million. Tax of £7.0 million has been charged in the year compared to a charge in the prior year of £7.6 million. The reduction in tax during the year is largely due to the treatment of deferred tax on the group's revaluation reserve being revised in the prior year. Further details on the current and deferred tax calculations are set out in note 13 to the accounts.

Treasury

Our treasury policy seeks to ensure that sufficient funding is available to meet foreseeable requirements and maintain appropriate headroom for contingencies. We manage the financial risks of the business through a series of hedging policies and ensure that our short and long term facilities are appropriate to the strategic objectives of the business. Our policy considers inflation risk, interest rate risk, currency risk and investment criteria. The policy is underpinned by the obligations of our securitisation structure. Our assessment of the associated risks are set out in note 27 and details of our long term loans are set out in note 23.

Pensions

The company pays contributions to the South East Water and Mid Kent Water defined benefit schemes which both closed on 31 March 2015 to future accrual. During the year £3.8 million was paid to the South East Water scheme and £1.3 million was paid to the Mid Kent Water scheme.

These contributions are broadly in line with the prior year. Further details on these schemes are set out in note 28 to the accounts.

In addition the company operates and funds a stakeholder pension scheme which is a defined contribution scheme. During the year 1,000 employees contributed to the scheme and the company made payments of £2.1 million by way of employer contributions to this scheme.

Net debt and cash flow

We use a combination of long term funding and short term working capital to finance the extensive capital programme and to fund the ongoing operations of the business. During the year the net operating cash generated was £125.0 million. Also, during the year, we drew an additional £35.0 million from our committed loan facilities, bringing the balance owing on this facility to £55.0 million. These funds were used to pay interest of £36.9 million and capital expenditure of £100.5 million.

The group statement of cash flows on page 122 shows an increased cash balance, from £6.5 million at the beginning of the financial year to £12.8 million at the end of the year.

Dividend

The company's dividend policy is to ensure that a suitable return is paid to our shareholders, while ensuring that the company is able to finance the business and meet the requirements of our instrument of appointment, both as at the date of the proposed dividend and prospectively. When assessing the appropriate level of dividend, considerations will include the company's actual and forecast level of gearing, the need to maintain the company's credit rating, the allowed cost of capital, and the performance of the business. Dividends paid in the year were £28.0 million (2018: £18.0 million).

Credit Rating

Under our instrument of appointment, we are required to maintain an investment grade rating, and we are currently rated BBB with Standard and Poor's and Baa2 with Moody's. Our financial performance targets support these ratings and we review our actual and forecast indicators regularly to ensure that we are on track to maintain compliance. Equally important are the requirements of the securitisation underlying the capital structure of the business. The maintenance of the financial covenants set out under our loan documentation is essential for the continued support of our investors.

We manage our capital structure in a way that enables us to maintain our investment grade credit rating and comply with our loan covenants. We monitor interest cover ratios and the ratio of net debt to regulated capital value (RCV), ensuring covenant compliance both in the current and future reporting periods.

Gearing

The company operates a securitisation structure. Our long term funding at the end of March 2019 was £1,078 million which represents 78.9 per cent of our regulated capital value. Our securitisation requirements are that we should maintain a level of gearing of 85.0 per cent or less. Our gearing levels are in line with expectations. We monitor the gearing closely and there is sufficient headroom as at 31 March 2019. During the coming year the company will be restructuring its financing arrangements with the repayment due in September 2019 of the £200 million swapped index linked bond. As part of this restructuring the long term funding as a percentage of regulated capital value will be reduced to approximately 75 per cent with the introduction of new capital higher in the HDF group's structure.

Taxation and tax policy

Our taxation policy is set out in the directors' report and the regulatory annual performance report. A more detailed explanation of our tax policy is available on our website. We have a significant capital programme and as such hold significant capital allowances to offset tax liability, coupled with losses generated elsewhere in the group.

Find out more at corporate.southeastwater.co.uk/about-us/our-governance

Risk management

How we manage risks

We have comprehensive systems of internal control and risk management and we monitor their effectiveness regularly in compliance with the principles of our corporate governance code. This risk management framework is also closely linked to the way we monitor and measure our performance and compliance with our statutory obligations and commitments which is subject to external assurance by third parties. This ensures that the board and the audit and risk committee review all material controls including financial, operational and compliance controls.

In January 2019 Ofwat published its company Monitoring Framework Assessment 2018 in which we were recognised for the quality of the information we provide in most areas, but had four areas with minor concerns. This resulted in South East Water being moved into the targeted category.

The report is an annual assessment on the quality of information and assurance all water companies provide customers about their performance and is intended to challenge them to publish information that can be trusted by their customers.

In their assessment, Ofwat said: “The company met our expectations in many areas and exceeded our expectations in two areas, the assurance plan and water resources management plan (WRMP) and market information. However, we had minor concerns in four areas; the financial monitoring framework, charges engagement, PR19 business plan data consistency and PR19 business plan data quality.

“Given the number of concerns we consider that overall the company has not consistently met the high standards expected in order to be assessed as self-assurance.”

This status means that we are required to publish a full analysis of the strengths, risks and weaknesses in relation to data and information provision and we need to publish a summary of the outcome of the assurance that has been carried out. In practice we have always published this for these elements, while self-assured (though not required to), so the format of our company monitoring framework remains unchanged.

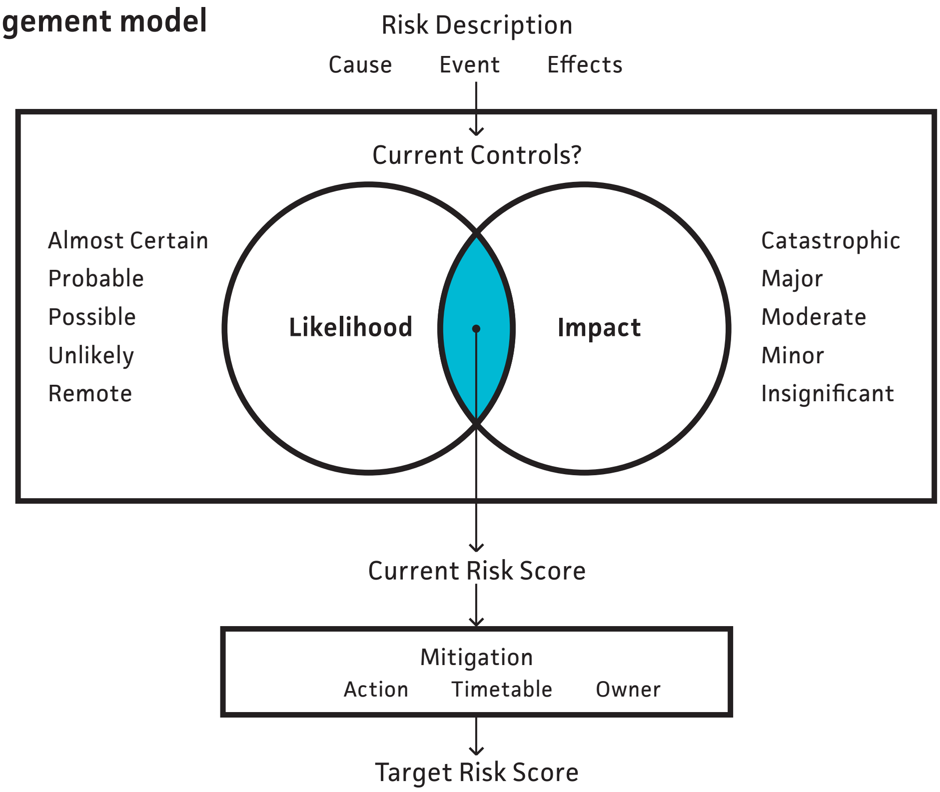
Read more at
southeastwater.co.uk/cmf

We will continue to learn from our individual assessment and the best practice identified during the industry assessment to ensure that we improve the information that we provide to our customers and stakeholders.

We maintain a formal risk register and risk management system for the identification, evaluation and mitigation of risks. The board defines South East Water’s risk management framework and reviews the risks on the register and the effectiveness of the relevant mitigation measures at least once a year. The board also reviews monthly, quarterly and annual reports on performance which highlight risks and business or operational issues as they arise. Please see page 81 for a summary of the board activities in the year. The audit and risk committee monitors the effectiveness of our systems of risk management and internal controls on an ongoing basis. Please see page 86 for the report from our audit and risk committee.

Individual managers and heads of department are responsible for identifying risks relevant to their area of responsibility and defining and implementing mitigation. Risks relevant to each directorate are monitored by the relevant director every month and the risk profile of a particular area is presented by the relevant head of department to the executive team each month ensuring that an in depth review of each department’s risks is carried out at regular intervals.

Risk management model



Key characteristics of our risk management model

- **Risk description –** the tool ensures a consistent language regarding the description of risks is maintained. A risk must satisfy three criteria
- **Cause –** are definite events or set of circumstances that exist which will give rise to uncertainty
- **Event –** an uncertain event is the true risk, as it may or may not happen and gives rise to uncertain outcomes
- **Effects –** are unplanned variations that would arise as a result of the risk occurring
- **Current controls –** the controls that are already in place to deal with the identified risk
- **Likelihood –** the likelihood of the risk occurring must be assessed using set criteria
- **Impact –** risks are categorised and their impacts determined. There are 12 categories ranging from financial through to operational or reputational impacts. Each category has a defined level of impact ranging between insignificant and catastrophic. This allows for a consistent approach to be adopted across the whole of the business. Where appropriate a risk may have more than one category e.g. both financial and reputational
- **Current risk score –** this is the product of impact and likelihood. The most catastrophic risk is calculated with a score of 25, with the most insignificant scored at 1
- **Mitigation –** actions we are undertaking to reduce or manage a risk. Once embedded these mitigation steps will form part of the current control assessment
- **Target risk score –** A target risk score can be calculated to show where the risk level will be once the controls and actions are put in place

Our risk management model uses standardised risk descriptions and categories for the controls, impact and likelihood of risks. Each risk is allocated a priority score based on its potential impact and likelihood. The prioritisation of risks in the register takes account of the controls and mitigation measures currently in place. Our risk management model also includes an assessment of planned mitigation measures. This gives visibility of the reduction in risk exposure expected from planned mitigation and is also used for reviewing the actual effectiveness of mitigation. This model allows the board to assess and manage risks at a strategic level and the executives to manage risks at an operational level.

For our latest annual review, we have compared our latest risk profile with the risk profile at our previous review. Our risk profile remained stable and there were no significant changes in the nature of the risks identified.

Risks relating to asset resilience and in particular the impact of large bursts on our performance on interruption were considered in the context of our ODIs, with an increased risk of penalty in respect of this measure due to exceptional incidents (such as the freeze/thaw in March 2018) and the impact of large bursts despite a good underlying performance.

We also monitor closely the risk of under-performance in respect of discolouration contacts and have implemented a number of mitigation measures, but the target remains tough.

Principal risks and uncertainties

Principal risks are those which due to their likelihood or magnitude can significantly impact on the long-term success of our company. We considered their impact on our business model, future performance, solvency and liquidity. We also reviewed the adequacy of the mitigation in place as recorded in our risk register.

As required by our corporate governance code, the audit and risk committee and the board carried out a robust review of our principal and strategic risks and of high impact and emerging risks on our risk register. We also compared them with risks identified by other companies in the water industry.

We describe our principal risks, their potential impact and how they are managed on the following pages. These principal risks have been considered in the context of our business model and strategy.

Some of the risks described in this section also bring business opportunities which we are preparing for. We also take advantage of the potential for business improvement that arises from risk management and the implementation of mitigation.

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Our risk management model also includes an assessment of planned mitigation measures

Our principal risks

Category	Risks description	Mitigation
Health & Safety	Our activities and assets present risks to the health and safety of our employees, contractors and the public. Failure to prevent accidents could have tragic implications for individuals and their families. There are severe criminal sanctions and civil sanctions for failing to have appropriate safety measures and failure to meet health and safety standards.	We have comprehensive processes in place including policies, standard operating procedures, risks assessments and toolbox talks involving our employees, partners and contractors. We continuously take actions on training and awareness to ensure that our employees and contractors always adopt safe practices. This year we have continued to build on our Thrive 365! safety strategy designed to support the company vision and provide clear direction and a road map for continuous improvement of our health, safety and wellbeing performance. Our Directors review health and safety performance at each Board meeting.
Water quality	A water quality incident could lead to a failure to supply wholesome water and public health incidents which would significantly affect customer trust. This may also result in investigations and enforcement actions and potential prosecutions from the Drinking Water Inspectorate. Significant water quality events may also lead to significant costs being incurred and have a significant impact on our revenue. This could relate to our own water treatment facilities or to bulk supplies of treated water we receive from other water companies.	We control water quality risk through the operation of our treatment works and distribution network which are constantly monitored. We carry out extensive sampling of our water every day at our accredited laboratory. We follow the World Health Organization (WHO) water safety plan approach which includes risk assessments and management of all aspects of our water supply chain from catchment to customers' taps. We invest in our treatment works to improve water quality and actively manage our catchments to reduce the discharge of chemicals by third parties. We have emergency plans for the deployment of alternative supplies if necessary. We have implemented a programme of flushing, network management and investment in our treatment works to meet our targets on discolouration contacts. We share lessons learnt with other companies which we use to update and improve our own practices and procedures.

Category	Risks description	Mitigation
Operational performance	Strategic asset failures and significant operational incidents (such as bursts, severe weather events or water quality events) may affect our ability to deliver a safe and uninterrupted water supply to a large number of customers or cause damage to third parties. This can lead to penalties and legal action and impact customers' perception and satisfaction. This also leads to additional compensation costs. These risks may affect our own water infrastructure or those of other water companies that provide us with a bulk supply of treated water.	We have established procedures and emergency plans for dealing with incidents and targeted investment to address specific operational risks when identified. We have put in place a dedicated operational steering group to identify potential risk and work on prevention and mitigation. We are putting particular emphasis on this area to improve our performance on interruption which was affected by a small number of large bursts at the beginning of the regulatory period and by the freeze/thaw in 2017/18 despite good underlying performance. Following the freeze/thaw, we used our reports on lessons learnt to prepare a comprehensive action plan to improve our readiness, resilience and our response capabilities in case of severe weather events.
Market reforms	The extension of competition on the non-household retail market, the evolution of the new connections market, the introduction of competition for water resources, demand management and leakage services and the introduction of direct procurement at PR19 as well as the potential introduction of competition for household retail customers in the future create new risks of disruption to our business model and operations. There are implementation risks in establishing new methods of working and processes. They could also create new business opportunities. We could face reputational damage and possible enforcement action if we do not demonstrate compliance with the new market arrangements. We must also ensure continued compliance with competition law as the environment in which we operate evolves.	We are keeping the proposals from Ofwat and government under review and contributing actively to ensure that risks are identified and taken into account in the definition of policy. We maintain our compliance processes up to date. We are reviewing and anticipating the potential impact of regulatory changes on our ability to secure finance at no less favourable terms. We keep our commercial strategy and the structure of our business under review to be able to adapt to changes and to take advantage of new opportunities.

Category	Risks description	Mitigation
Adverse changes to the regulatory framework and political risks	Decisions to change the approach to established aspects of the regulatory framework have an impact on our overall risk profile and on our medium and long-term planning. This included Ofwat's decision to reduce the RCV and the use of CPI instead of RPI for the indexation of the RCV. Potential nationalisation (or renationalisation) of water companies has the potential to cause significant disruptions to our operations. It would potentially affect our existing financing structures. This creates uncertainty relating to our long term planning and our ability to maintain the investment required to meet our long term service obligations. Nationalisation could lead to the business being acquired below fair value.	We are assessing the implications of political risks including the risk of nationalisation. We work with the industry and stakeholders to anticipate the potential effects of the proposals and to contribute actively to the debate to ensure that risks are identified and taken into account in the definition of policy proposals.
Price determination	The current price review introduces separate water resources and network plus wholesale price controls. It maintains the use of totex and outcome delivery incentives (ODIs) with reference to upper quartile performance and with the introduction of in-period reward/ penalty adjustments. The price review also introduced new customer satisfaction measures (C-MeX) and new developer services satisfaction measures (D-Mex). These changes bring new compliance requirements and related compliance risks and some uncertainty as all aspects of the new measures are not fully defined. Our business plan for 2020 to 2025 had been submitted and Ofwat has carried out its initial assessment of our plan. The outcome of the price determination is not yet known.	We have detailed processes to ensure compliance with our price determination and to ensure that we operate within the assumptions of the price determination (including ODIs and investment). We have processes to monitor and report on our compliance with regulatory obligations. We are continuing to clarify and defend the strength of our business plan submission through the post initial assessment and draft determination process providing additional evidence and information where required. We are continuously assessing the deliverability and financeability of the determination and any risk it may create for the company for the next regulatory period.

Category	Risks description	Mitigation
Delivery of business plan and performance against ODIs	There are financial and reputational risks associated with a failure to deliver our business plan commitments and ODIs and our position at the next price determination may also be impacted. The introduction of in-period ODI adjustments could have an impact on our revenue during 2020 to 2025. Our ODI performance could also be affected by incidents affecting other companies that provide us with a bulk supply of treated water.	We have taken a number of business improvement initiatives to deliver our ODIs and ensure customer and employee engagement. Dedicated steering groups monitor key measures such as interruption, water quality, customer services, customer perception and leakage. We are preparing our corporate plan throughout the preparation of our business plan and the price determination process to identify and start the early implementation of business changes required to deliver our performance commitments. We are developing resilience and innovation action plans to help achieve there stretching performance commitments.
Investment programme delivery	We need to ensure that we deliver the investment necessary to maintain and improve our services to customers. The risks affecting the delivery of our investment are internal, relating to the management of the delivery of our programme, and external such as extreme weather conditions, incidents affecting the works, or supply chain risks.	We have comprehensive processes involving our asset, engineering and operations functions to ensure that projects are planned and delivered on time and budget. Projects are reviewed by an investment committee and a programme management office. Project scopes and planned efficiencies are reviewed with our engineering partner and the early involvement of our framework contractors to identity risks and opportunities for innovation and savings.
Water resources and climate change	Failure to develop our infrastructure, to improve its resilience and to manage demand would mean that we would not be able to meet our statutory duties and meet future demand. Climate change will increase instances of severe flooding and drought which can affect the availability of resources and the operation of our infrastructure.	We operate in an area of serious water stress and manage demand through our metering programme which will be completed by 2020. We have an ambitious programme to drive behavioural changes from customers for 2020 to 2025. We have also consistently met our leakage targets and have committed to significant leakage reductions at PR19. Our Water Resources Management Plan is developed to take account of opportunities for cooperation between water companies in the south east. We also invest in flood protection at our operational sites and to improve our resilience to power outages, and manage drought risks through a dedicated team. We have a significant programme of environmental schemes including to manage the impact of our water abstraction.

Category	Risks description	Mitigation
Regulatory and legal compliance	Our business operates within a specific legislative and regulatory framework and many of our activities have an impact on the environment. Failure to ensure compliance with regulatory and legislative requirements may lead to criminal and civil liability, regulatory enforcement actions and disruption to the business and loss of management time. It would also affect the perception of South East Water by customers, regulators and others stakeholders and affect the trust they have placed in us as a provider of an essential public service.	We have a wide range of policies, processes and controls to ensure that we meet our duties and obligations. We also monitor compliance with our statutory obligations for the purpose of reporting on our performance and for the purpose of our ODIs. We review annually compliance performance and processes with the relevant department. We monitor changes to compliance requirements in order to adapt our processes and policies when required.
Security and information security	The security and resilience of our information infrastructure is essential to maintain our service to the public. We must protect ourselves from loss of data and systems and cyber-attacks and keep customers' data up-to-date and safe. Failure to protect personal data may lead to fines, enforcement actions and legal actions and would cause reputational damage. Loss or corruption of data would result in disruption to the business and additional costs. We must ensure compliance with the new requirements imposed by the General Data Protection Regulation and the EU Directive on the security of Network and Information Systems.	Our corporate security steering group continuously monitors all physical and data security aspects and data protection to identify new risks and the effectiveness of our security processes. We have department champions who are specially trained on these issues and we continuously promote awareness of risks, highlighting how unsafe behaviour could be exploited by external threats. We maintain disaster recovery systems and facilities which are regularly tested. We invested in security measures against unauthorised access to our systems and in software to help us monitor activity on our network. We achieved recognised cyber security certifications. We work with relevant external organisations to test the effectiveness of our resilience and security measures and review the maturity of our security systems and procedures. We maintain this risk as a high level due to the constant emergence of new threats and the risk of exploitation of vulnerabilities that may not have yet been fixed by software providers. We have implemented an extensive programme to achieve readiness for GDPR and continue to develop our GDPR compliance.
Financing	Unfavourable market conditions (including the impact of "Brexit") and regulatory changes may affect our ability to obtain financing or low interest rates. We must ensure that we comply with covenants in our agreements with our debt providers and maintain our credit rating.	We continuously monitor and report regularly to our board on compliance with our financial covenants. We have successfully completed the refinancing of a significant part of our debt and maintain our credit rating. Our refinancing has allowed us to reduce gearing and also gives us additional flexibility to further gearing reduction.

Category	Risks description	Mitigation
Bad debt	Customer bad debt and increased collection costs is an issue faced by all water companies which affects cash and liquidity and the cost incurred to recover income.	We maintain strict processes for the collection of debt and take steps to encourage payments through direct debits. We have maintained a good performance on collection of bad debt but keep the effectiveness of our recovery process under constant review. We also offer a social tariff and other similar tariffs to assist customers who may struggle to pay. We have reviewed our approach to customer engagement and are implementing a number of new initiatives on affordability and vulnerability led by a new dedicated team.
Human resources and culture changes	Employee retention and talent management is important to deliver performance and maintain company knowledge especially in operational areas with a more mature workforce and the need to manage planned retirements.	We have implemented a successful apprenticeship scheme in operations and the “steps to leadership” programme is developing managers over four levels. We have extensively communicated our values and objectives with employees to ensure their support and their involvement in cultural changes required to deliver the next step of performance improvements. Our people plan includes a number of initiatives on diversity, talent management and succession planning.

Category	Risks description	Mitigation
Economic environment and Brexit	Changes to the economic environment of the UK relating to "Brexit" will affect our business. We may see an increase in the cost of key inputs in our operations and rising inflation may affect customers' ability to pay and the level of bad debt. Our supply chain may be affected as well as our ability to access skilled resource if unfavourable changes affect the circulation of persons. Uncertainties due to changes in legislation, tax law and regulation will affect our ability to plan for the medium and long term and may also affect our day to day operation and increase the complexity of our compliance activities. A "no-deal" Brexit would lead to disruption to our supply chains and our operations for a period of potentially several months after a "no-deal" Brexit. Our main risk in a "no-deal" scenario would be the disruption to our supplies of chemicals used in the treatment of water caused by changes to customs requirements as our chemicals are largely procured from the EU. Supplies to other equipment and materials from the EU would also be disrupted. Other risks include possible traffic disruptions and localised fuel shortages especially in the company's area due to disruptions to Kent ports which could affect our operations. Additional costs have been and will be incurred for preparation and risk mitigation.	We are working to anticipate the impact of macro-economic changes on our business and the other impact on our operations. We are monitoring changes in the economic environment as well as considering the impact of future tax changes. We will consider the potential direct impact on our operation as more detailed information becomes available. The water industry has developed a national readiness and risk mitigation plan to prepare for a "no-deal" Brexit in consultation with Defra, the Drinking Water Inspectorate, the Environment Agency, public health bodies and other relevant authorities. An incident management manual for operating in these circumstances has been developed by the industry. Emergency planning exercises were also carried out. Weekly then daily calls will take place if a "no-deal" scenario becomes more likely including chemical stock reporting. The industry and our own plans include the creation of additional stocks of chemicals by both companies and their suppliers to the extent permitted by shelf-life and safety requirements, the review of the suppliers supply chains and their readiness, and the creation of additional stocks of materials and equipment. Our preparation is integrated with our incident management plans and our preparation is managed by a specific incident management team. We have also worked with relevant local authorities to agree the support that we may receive in case of disruptions to traffic and fuel supplies especially in Kent that would be affected by disruptions to Kent ports and Operation Stack.

Long term viability statement

To prepare our long-term viability statement (LTVS), we have conducted our long-term viability assessment, taking into consideration our business model, including both appointed and non-appointed activities, our current financial position and principal risks that can affect our business.

The company is a regulated long-term utility business characterised by multi-year investment programmes and stable revenues. The water industry in England and Wales is currently subject to economic regulation rather than market competition and Ofwat, the economic regulator, has a statutory obligation to secure that water companies are able to finance their appointed activities. Ofwat meets this obligation by setting price controls for five year Asset Management Periods ('AMPs'). This mechanism reduces the potential for variability in revenues from the regulated business. The current AMP6 runs until March 2020. The price review period for the AMP7 period 2020 to 2025 is currently ongoing, with Ofwat to publish its Draft Determination on 18 July 2019.

Our assessment of the current financial position is set out on page 118.

Our long-term viability assessment reviewed the company's prospects and considered the potential impacts of the principal risks and uncertainties. Downside sensitivities have been developed based on an assessment of the likelihood and financial scale of these principal risks. Stress tests have been performed based on these downside sensitivities (individually and in combination) to assess the potential impacts of these risks and uncertainties. The assessment also considered the mitigating actions that might be taken to reduce the impact of such risks and uncertainties and the likely effectiveness of mitigating actions. Additional detail on the downside sensitivities tested is set out below.

Assessment period

We have considered the appropriate length of time over which to provide the viability assessment. In making an assessment, we have taken account of the balance between the length of the period assessed and robustness of such analysis, alongside recent guidance from Ofwat. In extending our outlook period we had regard to the long term nature of our business and the characteristics of our regulatory regime described above.

On the recommendation of the audit and risk committee, and in line with Ofwat's guidance, we have assessed the prospects of the company over a period of 10 years to March 2029. This duration is consistent with the commitment we set out in our response to Ofwat's IAP to assess viability over the long term.

At this stage there remains uncertainty about the outcome of the PR19 process and as a result financial projections for AMP7, which the company has taken into account in its assessment through modelling of different potential AMP7 outcomes. Analysis of resilience extending beyond 2025 remains subject to greater uncertainty surrounding the assumptions underpinning financial projections for the AMP8 price control period, with greater variability of potential outcomes.

Uncertainties arising from market competition within this period have been taken into consideration but do not affect the result of our assessment. This is due to the fact that monopoly activities form the main part of the business of the company.

Assessment results and mitigation strategy

The results of our assessment revealed that none of the stress-testing scenarios would lead to a default event in servicing the company's debt, nor would they lead to adverse impact on customer service or the company's ability to carry out normal operational activities.

Furthermore, none of the scenarios resulted in an impact on the company's expected financial metrics that cannot be reasonably mitigated using the existing safeguards within the company's financing structure.

The assessment also considers potential mitigating actions that the company could undertake to reduce the impact of the sensitivities considered.

The Directors have identified actions, including reducing discretionary outflows of funds and working with providers of finance that would be available to the company to mitigate the impact of adverse outcomes.

We have secured the financing in order to refinance our debt maturing in September 2019 amounting to £311.5m. On this basis, we maintain that the successful completion of our refinancing is a further demonstration of our financial resilience.

The plan submitted for the appointed business in response to Ofwat's IAP was prepared on the basis of financial projections consistent with a Baa2 credit rating. If the PR19 Final Determination is materially different to the business plan submitted, there may be limited financial headroom available relative to credit metric thresholds consistent with a Baa2 credit rating.

As part of the assessment of the resilience of the company and the regulated business we take into account the impact of the overall group structure and intra-group transactions. The resilience and viability of the group is assessed on a continuous basis including any implications of the financial projections of the wider group for the regulated business and vice versa. We have not identified any issues from our recent analysis of viability across the group that are likely to impact on the resilience of the company.

Stress testing

The company reviews and considers the risks to which the business is exposed and potential impacts on viability on an ongoing basis; this includes structured, systems-based risk identification processes and management controls, robust budgeting and forecasting and continuous sensitivity analysis.

Principal risks represent all factors that could prevent the company from delivering its strategic objectives and business plan. As a result not all principal risks translate directly into a downside sensitivity. The company has considered the principal risks set out above and uncertainties for the company and their potential impact on viability. Where it is assessed that (1) a principal risk is likely to occur and (2) the financial impact could be material, the implications for financial resilience are assessed in the LTVS through defined downside sensitivities

Based on the principal risks, we have identified below the relevant risk factors that can cause negative impact on the financial position of the company. We then construct downside sensitivities focusing on different combinations of the risk factors.

Our sensitivities combine qualitative and quantitative criteria and cover the following risk factors to assess their impact on liquidity and compliance with financial ratios until March 2029:.

- **Outturn inflation under forecast:** Inflation risk primarily relates to the fact that the price control is in real terms and the allowed revenue moves up by a designated inflation figure (CPIH for PR19) while some of the costs are fixed in nominal terms. This means that when inflation is lower than assumed when the real-term costs were calculated, the company will face the risk of underfunding on these elements
- **Interest rate above forecast:** Interest rate risk can result in an increase in borrowing rate for new debt raised, and it can increase the borrowing cost for any floating rate debt
- **Revenue losses/financial penalties:** Revenue risk may manifest itself as wholesale revenue under recovery as the amount that the vast majority of our customers pay depends on the amount of water they consume
- **Financial penalties:** We have also considered the risk of financial penalties in this category to capture the possibility of the company receiving (non ODI) fines from regulators
- **Compensation payments:** Compensation payments can be due to one-off unexpected events, such as major incidents caused by severe weather events or critical asset failure. The recent freeze/thaw event provides a good example of the level of compensation payments the company can incur
- **ODI penalties:** The effect of ODI penalties as a result of company underperformance or unexpected adverse conditions can materialise within the AMP7 period, which have been taken into account in our assessment
- **Totex overspend:** Totex overspend is a risk that we have assessed carefully, when considering scenarios of company underperformance as well as unexpected costs due to severe weather related incidents
- **Retail cost overspend:** Retail cost to serve forms a part of the allowed revenue, which the company may underperform against for reasons such as cost escalation and bad debt

The company's business plan and financial projections are based on the current regulatory framework and do not take into account any changes that might arise if a policy of renationalisation of the water sector is implemented.

Our downside sensitivities include individual and combination scenarios that we considered to be severe but plausible. These are summarised in the table overleaf:

Sensitivity tested	Related principal risks	Related principal risks
Macroeconomic shock - High inflation and interest/low inflation and interest	The company's revenues are linked to inflation. Low or negative inflation tends to adversely impact profits and cash flows as decreases in revenues exceed decreases in costs.	Economic environment and Brexit Financing
Totex underperformance	Significant overspending could result in a deterioration in financial metrics and performance, which could impact on the company's liquidity and credit rating.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs
ODI penalty	Failure to deliver performance at the committed level can lead to significant ODI penalties.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs
Severe major incident	The company's risk management process has identified a number of risks including extreme weather events that might have a significant impact on the company's operational and financial performance. This scenario considers a severe major incident comparable to the freeze/thaw in 2018.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs
Sustained adverse conditions	The company's risk management process has identified a number of risks including a deflationary environment. This scenario considers a combination of low inflation and cost overspending. Significant overspending could result in a deterioration in financial metrics and performance, which could impact on the company's liquidity and credit rating.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs Economic environment and Brexit

Sensitivity tested	Related principal risks	Related principal risks
Pervasive under-performance	The company's risk management process has identified a number of risks including extreme weather events and failure of key assets and that might have a significant impact on the company's operational and financial performance. This sensitivity will focus on shorter-term external shocks potentially caused by wider economy, weather conditions, or a combination of the two, leading to short-term adverse effect on multiple risk factors.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs Economic environment and Brexit
Severe scenario	The company's risk management process has identified a number of risks including extreme weather events and failure of key assets and that might have a significant impact on the company's operational and financial performance. The combined scenario represents a situation where several of the severe scenarios above occur simultaneously.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs

Viability statement

The board has assessed the viability of the company over a 10 year period to March 2029, taking into account the company's current position and principal risks. The board was satisfied that they had sufficient information to judge the viability of the company, and have a reasonable expectation that the company will be able to continue to operate and meet its obligations over the period to March 2029.

Governance and assurance

The board reviews and approves the medium term plan on which this viability statement is based. The board also considers the period over which the assessment of prospects and viability statement should be made.

The audit and risk committee supports the board in performing this review. This statement has also been read by Deloitte, our External Auditor. Their audit report, including comments on the viability statement, is set out on pages 106 to 115.

Going Concern Statement

In preparing the financial statements the Directors considered the company's ability to meet its debts as they fall due for a period of one year from the date of this report. This was carried out in conjunction with the consideration of the long-term viability statement above. On this basis the Directors considered it appropriate to adopt the going concern basis in preparing the financial statements.

Paul Butler

Managing Director
15 July 2019

Transparency

To build trust transparency is vital. We aim to clearly report on our performance and give everyone the opportunity to work with us to develop our future plans.

Governance

Corporate governance report

Introduction from the Chairman

Corporate governance and compliance are an integral part of how our board and our business as a whole operate.

We keep our governance under constant review and our efforts to demonstrate that South East Water can be trusted as a provider of an essential public service were redoubled this year as we prepared our business plan for 2020 to 2025.

We dedicated time to provide the leadership, governance and assurance needed to produce a high quality plan. Understanding the expectations of our customers and communities was an essential part of this. We also wanted to demonstrate that this board had considered how to balance the interests of customers and those of the environment, of our partners and stakeholders, and of our employees in its business plan. We have also considered how to prepare for the long term challenges of managing our water resources in the context of climate change and changing expectations from the public and stakeholders.

To help us place customers at the centre of what we do, we participated in our own customer engagement programme, complementing the company's comprehensive and innovative customer engagement and research programme.

We listened to the suggestions of our CCG on how to incorporate customer engagement further into the day to day operations of the business. We have reviewed our structure and created a new customer insight team.

We have also reviewed our operational readiness and how we can be more effective when responding to sudden operational events to maintain a resilient supply and protect customers from interruptions of supply.

We have also increased our efforts to incorporate environmental, social and governance matters in our strategy and make this a central part of the day to day business. We have adopted new responsible business commitments in our business plan and our responsible business committee has been set up. It will assist the board in defining its strategy relating to environmental, social and governance matters and ensuring our initiatives remain effective and follow best practice. It will also oversee the execution of our ESG strategy and will monitor performance against our responsible business commitments. We will also continue to measure our performance against the Global Real Estate Sustainability Benchmarking ("GRESB").

We reviewed the effectiveness of our processes and reporting in relation to our key outcome delivery incentives and our risks. In doing so, we relied on the governance framework we have developed in the last few years in line with our own code of corporate governance which incorporates the principles of governance published by Ofwat, our economic regulator. We have also made sure that we integrated the commitments we set out in our company monitoring framework in our approach.

We are updating our corporate governance framework to reflect the changes introduced by the corporate governance reform, new reporting requirements on how we meet our duties as directors, the revised principles of board leadership, transparency and governance published by Ofwat in January 2019 and a new licence obligation to meet the objectives of these principles.

During the year we completed the recruitment of Célia Pronto, a new independent non-executive director with a strong customer focus and appointed Stephen Jordan as a new shareholder nominated director. We have maintained a compact board with a strong representation of independent non-executive directors and a good balance of experience and skills. We provide more details on the changes to the board on page 77 and on the activities of the nomination committee on page 76.

This annual report has been prepared to provide clear and concise information on our business to our customers, investors, regulators and other stakeholders. We describe in more detail our corporate governance framework and how we put governance into practice in this corporate governance report which I hope you will find helpful in demonstrating our commitment to excellence in governance.

Nick Salmon

Chairman
15 July 2019

Every drop counts
Our infrastructure delivers a reliable service to our customers

Our directors on 15 July 2019

Independent Non-Executive Directors*

Nick Salmon
Independent Chairman

Nick was appointed Chairman of South East Water on 1 April 2015. He brings a wealth of experience from a number of senior roles, including as a Senior Independent Non-Executive Director of United Utilities, and an engineering background. He is currently the Senior Independent Director of Elementis plc and a Non-Executive Director at Scotia Gas Network Limited. Nick holds a BSc. Degree in Mechanical Engineering and is a Fellow of the Royal Academy of Engineering.

John Barnes
Independent Non-Executive Director

John was appointed a Non-Executive Director on 28 January 2016. Prior to his more recent involvement with a start-up company developing renewable energy schemes, John had gained over 30 years' experience in the water industry, mainly in the UK, but with spells in the Middle East and New Zealand. John is a former non-executive director of the Mid-Cheshire Hospitals Foundation Trust and was Executive Chair of All Change for Crewe, focused on making the most of inward investment to the town.

Chris Girling
Independent Non-Executive Director

Chris was appointed a Non-Executive Director on 30 October 2014. Chris, an experienced finance professional, has a background in a variety of sectors, including construction, support services, pharmaceuticals and aerospace. Chris retired as Group Finance Director of FTSE 250 Carillion plc in 2007 and since then he has chaired three audit committees and one pension fund.

Célia Pronto
Independent Non-Executive Director

Célia was appointed a Non-Executive Director on 1 June 2018 and has a wealth of experience and expertise of the service sector in a range of industries. Célia is currently Chief Customer and Digital Officer of Casual Dining Group Ltd. She was previously Group Marketing & E-Commerce Director and board member of the Ford Retail Group. Célia is also a member of the board of Trustees of Yes to Life, a cancer charity.

*As defined in the UK Corporate Governance Code 2016

Our directors continued

Non-Executive Directors

Marissa Szczepaniak
Non-Executive Director

Marissa is Investment Director at Vantage Infrastructure responsible for infrastructure and was appointed to the South East Water board in December 2016. Marissa has a Bachelor of Science in finance, accounting and economics and is also a non-executive director at rail company Porterbrook.

Stephen Jordan
Non-Executive Director

Stephen joined the South East Water board in August 2018 as a representative of Morrison & Co. He has more than 15 years' experience in asset management with his current responsibilities including portfolio management, investment across mandates and deal origination on behalf of institutional clients. At Morrison & Co Stephen has worked across a range of infrastructure sub-sectors, predominantly in energy and utilities. He has a specialist interest in hydrocarbon markets.

Executive Directors

Paul Butler
Managing Director

Paul has a wealth of water industry experience, having previously been Managing Director of Mid Kent Water from 2001 to 2006 and Chairman of UKWIR, a water industry research organisation from 2005 to 2012. A Chartered Accountant, he previously worked for Mid Kent Water as Group Financial Controller, Ernst & Young and Marks and Spencer.

Andrew Farmer
Finance Director

Andrew, who joined as Finance Director on 1 August 2015, has held a number of senior management posts in finance, most recently at MAG plc, the country's largest UK owned airport operator, and Doosan Power Systems, a leading manufacturing, energy technologies and services company.

David Hinton
Asset and Regulation Director

David, who was appointed Asset and Regulation Director on 1 June 2013, has a breadth of experience within the water industry. Previous roles include Head of Water Quality and Head of Business Planning. A strong science background, David has held previous senior roles in microbiology including laboratory management for Public Health Laboratory Services.

Resigning directors

Our directors who were in office during the period from 1 April 2018 to 31 March 2019 and have resigned before 15 July 2019. Please see page 77 for details of the changes on our board.

Emma Gilthorpe
Independent Non-Executive Director

Emma is a lawyer with over 20 years' experience working in regulated industries, including the telecoms and airport industries. Currently working as Executive Director Expansion at Heathrow Airport Holdings Ltd, Emma was previously BT plc's Group Director of Industry Policy and Regulation.

Oliver Schubert
Non-Executive Director

Oliver leads Vantage Infrastructure's European equity investment team. He has more than 20 years' experience, and has worked on a number of acquisitions in the regulated electricity and gas distribution and transmission network industries across Europe, as well as in the renewable energy industry. He has a thorough understanding of regulatory regimes in the UK, Germany, Finland and Spain and of the relationships with the relevant regulators.

Read more online at
You will find our corporate governance code on our website at
southeastwater.co.uk/ourgovernance

Leadership and effectiveness

In compliance with our licence, we are required to conduct our regulated business as if we were a separate public limited company and to have regard to the principles of good governance of the UK corporate governance code and to follow the disclosure and transparency rules. We are also expected to apply Ofwat's principles of leadership, transparency and governance. Our own corporate governance code combines these principles that can be reasonably applied to a privately owned company. This report describes how the board has applied the principles of our corporate governance code in the financial year.

The role of the board and of its committees

The board and its committees have overall responsibility for the management of South East Water. It is responsible for the long term success of the company and sets the strategic aims, values and standards to ensure that the company meets its statutory duties and other obligations now and in the future and meets customers and stakeholders' expectations. It provides leadership within a framework of prudent and effective controls and ensures that the necessary financial, operational and human resources are in place. The board has a strong Non-Executive component which provides both challenge and support to the executives in reviewing management performance.

The board's aim is to ensure that the company meets its responsibilities as a provider of an essential public service and maintains a reputation of high standards of business conduct. In doing so the board considers the long term consequences of its decisions and the appropriate balance that must be achieved between the expectations of customers, employees and stakeholders, the impact of the company on the environment and communities and the need to act fairly between members of the company.

The systems of risks management and controls described in this report, the company's commitments in its business plan including its responsible business commitments, the engagement with customers and initiatives on affordability and vulnerability and our Responsible Business Committee are examples of how these principles are concretely applied by the board to meet its overarching objectives.

Board balance and composition

Independent Non-Executive Directors are the majority group on the board and on our audit and risk committee, nomination committee and remuneration committee. These committees are also chaired by an Independent Non-Executive Director. Nick Salmon, Chairman of the board, is independent of management and has no link to shareholders that could affect his impartiality as required by our corporate governance code and Ofwat's principles of governance. This ensures Non-Executive Directors play a significant role in challenging Executive Directors and management as well as in developing strategy. The wide range of their experience also ensures that a variety of views are considered in the board's deliberations.

The independence of Non-Executive Directors is assessed by the board following the criteria of the UK corporate governance code. Non-Executive Directors also meet with the Chairman in the absence of the Executive Directors at least once a year. All Independent Non-Executive Directors have been Directors of South East Water for less than six years as shown in the table below.

Shareholders are represented on the board which ensures that there is constant communication between Independent Non-Executive Directors and shareholders and between Executive Directors and shareholders.

The Managing Director, the Finance Director and the Asset and Regulation Director ensure that management and operational information is presented to and that operational issues are discussed by the whole board.

We believe that our board has a good mix of skills and experience and has reached a good balance between new directors and directors who have had time to acquire a good knowledge of our company and of our environment including the last price determination and our strategy and long term plans. We also believe that the mix of Executive and Non-Executive Directors is appropriate.

The whole board has been directly involved in the preparation of our new business plan and is well prepared to closely monitor the delivery of performance commitments and wider objectives in the next regulatory period.

Non-Executive Directors and Independent Non-Executive Directors are given direct access to management as requested and review specific areas of the business directly with management drawing on their particular expertise and to provide oversight and challenge on key regulatory matters or the review of the company's response to significant operational events.

Our directors' biographies can be found on page 68.

Read more online at
You will find our reserved matters and the terms of reference of our committees on our website at **southeastwater.co.uk/ourgovernance**

Board balance and composition

Independent Non-Executive Directors	Appointment	Resignation	Term*	Audit & Risk	Remuneration	Nomination	PR19	PR19 Technical
Nick Salmon (Chairman)	01/04/15	na	4 yrs		●	Chair		
John Barnes	28/01/16	na	3 yr 2 m	●	Chair	●	●	
Chris Girling	30/10/14	na	4 yrs 5 m	Chair				
Celia Pronto	01/06/18	na	10 m	●	●	●		

Non-Executive Directors (shareholder nominated)	Appointment	Resignation	Term*	Audit & Risk	Remuneration	Nomination	PR19	PR19 Technical
Stephen Jordan (Morrison & Co)	17/08/18	na	7 m	●	●	●	●	●
Marissa Szczepaniak** (Vantage Infrastructure)	08/12/16	na	2 yr 3 m	●	●	●	●	●

Executive Directors	Appointment	Resignation	Term*	Audit & Risk	Remuneration	Nomination	PR19	PR19 Technical
Paul Butler (Managing Director)	02/10/06	na	12 yrs 6 m				●	●
Andrew Farmer (Finance Director)	01/08/15	na	3 yr 8 m				●	●
David Hinton (Asset and Regulation Director)	01/06/13	na	5 yrs 10 m				●	●

Resigning Directors	Appointment	Resignation	Term*	Audit & Risk	Remuneration	Nomination	PR19	PR19 Technical
Emma Gilthorpe (Independent non-executive)	18/10/12	30/09/18	na	●	Chair	●	●	●
Oliver Schubert (Vantage Infrastructure)	03/05/17	30/01/19	na	●	●	●	●	●

* As at 31 March 2019.

** From first appointment on 08/12/2016. Resigned as a director on 17 August 2018 due to maternity leave and was reappointed as a director on 30 January 2019.

How the board operates

The board endeavours to reach unanimous decisions taking account of the views of all directors.

Chairman

The Chairman ensures the effectiveness of the decision making process of the board and promotes discussion on key issues based on quality information. The Chairman is also responsible for maintaining a direct channel of communication with shareholders and ensures that their concerns and objectives are taken into account and conveyed to the directors.

The Chairman and the Managing Director meet regularly throughout the year to maintain a good communication between the board and the Executive Directors and to review the board forward programme and the agendas of board meetings. There is also a formal schedule setting out the division of responsibilities between the Chairman and the Managing Director.

Division of responsibilities

The board has adopted a formal list of reserved matters that it must consider and approve. These matters expressly refer to the relevant corporate governance requirements, our licence and regulatory obligations as well as our statutory obligations. They also reflect the allocation of responsibilities between the board and its committees as set out in the terms of reference of the committees.

The executive team manages matters that are not reserved to the board and its committees under their supervision which is achieved through regular reporting and specific updates. The main decisions delegated to management are taken after consideration by the executive team which includes the Managing Director, Finance Director, Asset and Regulation Director, Customer Services Director, Operations Director and Commercial Director. There are several steering groups which deal with key aspects of the business.

Committees

Nomination, remuneration and audit and risk committees

The audit and risk committee, nomination committee and remuneration committee are chaired by and have a majority of Independent Non-Executive Directors as required by our corporate governance code.

Board committees have formal terms of reference. Chris Girling, the Chair of the audit and risk committee has recent and relevant financial experience. We have approved a formal schedule describing specifically the allocation of responsibilities and interactions between the board and the audit and risk committee.

PR19 committees

We created two special committees of the board in January 2017 continuing the implementation of our board governance programme for our PR19 business plan which we have developed since 2016. These committees were set up to allow us to provide strategic input, oversight and challenge for the preparation of the business plan. This means that we have been more closely involved in the key strategic decisions and in ensuring that our plan meets our ambition for South East Water and is centred on customers. This also helps us influence how South East Water will deliver the other key themes and objectives defined by Ofwat in their PR19 methodology.

We have set the strategic direction and provided the overall oversight of the preparation and delivery of the plan. In addition through the PR19 committee, we have been able to monitor closely the progress of the PR19 programme and to discuss the key deliverables and strategic areas of the business plan and to challenge management. These key areas included in particular our customer engagement and research, our initiatives on vulnerability, how our findings and the input of our customer challenge group were built into our decision making, the definition of our performance commitments, operational and financial resilience, and the format of our plan and how we can differentiate South East Water. The PR19 Technical committee allowed us to dedicate time to the more technical, regulatory and financial matters and provide relevant information to the PR19 Committee and the board as a whole.

These committees will continue to operate as required to support the board until our final determination for 2020 to 2025.

Refinancing committee

We set up a debt refinancing committee to oversee our refinancing in 2018/19. This committee also considered the wider aspects of our financing structure with a view to ensure resilience and transparency. Our refinancing was successfully completed in the first quarter of 2019 and places us in a good position for the next regulatory period. It was also designed to allow the company to reduce gearing to improve financial resilience as required by Ofwat.

“Our responsible business committee was formally constituted on 7 March 2019

Responsible business committee

We reported our decision to establish an environmental, social and governance committee in our previous annual report. Accordingly, our responsible business committee was formally constituted on 7 March 2019 and its terms of reference approved by the board.

The main purpose of the responsible business committee is to assist the board in defining its strategy relating to environmental, social and governance (ESG) matters and in reviewing the practices and initiatives of the company relating to ESG matters ensuring they remain effective and up-to-date.

The responsible business committee will also oversee the execution of our ESG strategy and initiatives and will monitor performance against the responsible business commitments adopted by the Board in our business plan. The responsible business committee will ensure that the board maintains a primary focus on customer engagement, our communities and the environment.

The responsible business committee is chaired by Marissa Szczepaniak and will also include an independent non-executive director and an executive director. Non-director members of the committee will also ensure that a wide range of skills and knowledge is represented on the committee and provide a clear line of sight into the business. The appointment of Marissa Szczepaniak (Vantage Infrastructure) and Rachel Drew (Morrison & Co as a non-director member), both representatives of shareholders, reflects the emphasis placed by shareholders on strong ESG performance.

Read more online at
You will find the terms of reference of our responsible business committee and more information on governance on our website at **southeastwater.co.uk/ourgovernance**

Read more online at
You will find our business plan and the responsible business appendix on our website at **corporate.southeastwater.co.uk/news-info/publications/business-plan-2020-2025/**

Our governance structure

Board

Chair: Nick Salmon

Is responsible for the long term success of the company. It sets strategy within a framework of effective controls and ensures the company has the necessary financial and human resources. It sets our values and standards of governance and it monitors compliance with regulatory and statutory obligations. It balances the interests of customers, the environment, shareholders and stakeholders.

Responsible Business Committee

Chair: Marissa Szczepaniak

It assists the Board in defining its strategy relating to environmental, social and governance (ESG) matters and in reviewing the practices and initiatives of the company relating to ESG matters ensuring they remain effective and up to date. It monitors performance against the company's responsible business commitments.

Refinancing Committee

Oversaw the company's refinancing in 2018/2019. It also considered the wider aspects of the company's financing structure with a view to ensure resilience and transparency.

Managing Director
Paul Butler

Chair: Paul Butler

The Executive Team under the direction of the Managing Director comprises the Finance Director, Asset and Regulation Director, Customer Services Director, Operations Director and Commercial Director. It implements the strategy, manages the operational and financial performance of the company, and matters not reserved to the Board.

Customer Insight Committee

Monitors the progress and effectiveness of our customer engagement and insight programme across all areas of the business to improve the satisfaction of our customers including vulnerable customers and stakeholders. It monitors how effectively this influences our day-to-day business. One of its members is an independent non-executive director.

Competition and Regulatory Strategy

Our Wholesale Markets Steering Group and the Regulatory Strategic Group provide oversight of the implementation of competition and regulatory strategies including compliance with markets requirements and our main regulatory plans. They also review and define management's strategy proposals to the Board.

Corporate Security

The Corporate Security Steering Group monitors the implementation and effectiveness of security measures and policies covering all aspects of security: information and data protection, cyber risks, physical security and prevention of fraud. It monitors emerging threats and opportunities to improve resilience.

Audit and Risk Committee

Chair: Chris Girling

Exercises oversight over financial statements and reports to the Board on significant aspects of financial reporting. It reviews the scope and results of financial audits, accounting policies and judgements. It assesses the systems of internal control and risk management and the prevention and detection of fraud and reviews whistleblowing arrangements.

Remuneration Committee

Chair: John Barnes

Reviews the remuneration policy for the executive directors and ensures executive pay rewards performance in areas that are important to customers. It determines the remuneration package of executive directors, and other designated senior executives including the design and application of any performance based remuneration.

Nomination Committee

Chair: Nick Salmon

Reviews the structure and composition of the Board taking account of the Board evaluation, succession planning of the board and senior management. It makes recommendations on proposed Board appointments and committees' membership.

PR19 Committees

The PR19 Committee monitors the progress of the PR19 programme and of the preparation of the business plan. It discusses and defines the key strategic areas of the business plan including customer research, vulnerability, innovation and differentiation, resilience, ODIs, key strategic objectives, and key messages and the overall presentation of the business plan. It also oversees the effectiveness and robustness of the data and of the processes relied on to prepare the business plan.

The PR19 Technical Committee focuses on key technical aspects and informs the PR19 Committee. It considers in detail the definition of totex, financing requirements and financeability, and the design of rewards and penalties.

Health & Safety

The Health & Safety commitee monitors the effectiveness of health and safety practices, policies, procedures, training and communication. It analyses safety audit reports and through sub-committees ensures practices are adapted to the different areas of the business.

Investment

The Executive Investment Commmittee approves and ensures the governance of capital investment and the Programme Management Office controls the delivery of capital expenditure. The Information Systems Steering Group approves and controls IT investment. The Strategic Procurement Group approves and monitors key procurement activities.

Outcomes Delivery

The Every One Counts Steering Group and the Responsible Business Steering Group monitor the implementation of our people initiatives and of our responsible business commitments and related corporate plan objectives and business improvement initiatives.

Report from the nomination committee

I am pleased to report on the work of the nomination committee over the last 12 months. The changes to the composition of the board and its committees were due primarily to the appointment of Morrison & Co as the new asset manager for UTA and the replacement of Emma Gilthorpe in September 2018.

- The committee managed the recruitment of a new independent non-executive director which concluded with the appointment of Célia Pronto in June 2018 by the board on the recommendation of the committee. The committee considered the overall balance of skills on the board and defined the profile of the new director recognising the need for experience in customer engagement and new technology. The recruitment was guided by our willingness to increase our focus on customer satisfaction and engagement. It was carried out through the external search consultancy firm, Ridgeway Partners, a firm accredited under the Women on Board code. Ridgeway Partners did not have any other connection with South East Water. Célia brings her experience in customer engagement and service improvement, digital engagement and e-commerce.
- We recommended the appointment of Stephen Jordan from Morrison & Co to the board following his interview with Ofwat. With the support of shareholders we maintained the number of shareholder nominated directors to two keeping a compact board, maintaining independent directors as the largest group and the overall balance between independent non-executive directors, shareholder nominated non-executive directors and executive directors.
- The committee also considered and recommended changes to the composition of our committees which are detailed in the following pages of this report to maintain the balance of independent non-executive directors and the appropriate balance of skills. John Barnes was appointed Chair of the remuneration committee replacing Emma Gilthorpe.
- The committee considered and recommended the renewal of the appointment of John Barnes concluding that he continued to meet the requirements of independence set out in our corporate governance code.
- We also recommended the appointments of the members of the new responsible business committee which includes directors and non-director members to ensure a wide range of skills and the involvement of the key functions of our business for a cohesive approach to environmental, social and governance matters. The committee will play an important role in monitoring the delivery of our responsible business commitments. The committee also reflects the commitment of our shareholders to ESG.
- The committee reviewed its effectiveness as part of the overall board evaluation process and the members of the committee and directors were satisfied that it is operating effectively in accordance with its terms of reference.

Nick Salmon

Chairman
15 July 2019

Changes to the composition of the board

The appointment of Nick Salmon was extended in March 2018 for a period of three years from 1 April 2019 to 31 March 2021 on the recommendation of the nomination committee which concluded that he continued to satisfy the criteria of independence set out in our corporate governance code.

Célia Pronto was appointed to the board on 1 June 2018. Célia has specific expertise in customer engagement and service improvement, digital engagement, e-commerce and technology and innovation which will reinforce the skillset of the board as we continue to focus on placing customers at the heart of what we do.

Stephen Jordan was appointed to the board on 17 August 2018 as a representative of UTA on the recommendation of the nomination committee following a pre-appointment interview with Ofwat. Stephen has experience in asset management, his current responsibilities include portfolio management, investment across mandates and deal origination on behalf of institutional clients. At Morrison & Co Stephen has worked across a range of infrastructure sub-sectors, predominantly in energy and utilities.

Emma Gilthorpe resigned as a director on the expiry of her appointment on 30 September 2018 to take on other responsibilities.

Marissa Szczepaniak resigned as a director on 17 August 2018 due to her maternity leave and was re-appointed on the recommendation of the nomination committee on 30 January 2019. Oliver Schubert resigned as a director on 30 January 2019.

The appointment of John Barnes as a director of the company was extended on the recommendation of the nomination committee for a period of three years until 27 January 2022.

Composition and changes to the audit and risk, remuneration and nomination committees

Nomination Committee

Current members

Director		Appointment date
Nick Salmon (Chair)	INED	01/05/15
John Barnes	INED	06/07/17
Célia Pronto	INED	01/06/18
Stephen Jordan	NED	17/08/18
Marissa Szczepaniak*	NED	30/01/19

Membership changes in 2018/19

Director	Appointment	Resignation
Marissa Szczepaniak*	–	03/05/18
Oliver Schubert	03/05/18	30/01/19
Célia Pronto	01/06/18	–
Stephen Jordan	17/08/18	–
Emma Gilthorpe	–	30/09/18
Marissa Szczepaniak	30/01/19	–

* Previously a member from 08/12/16 to 03/05/18

Remuneration Committee

Current members

Director		Appointment date
John Barnes (Chair)*	INED	10/03/16
Célia Pronto	INED	01/06/18
Nick Salmon	INED	25/09/18
Stephen Jordan	NED	17/08/18
Marissa Szczepaniak**	NED	30/01/19

Membership changes in 2018/19

Director	Appointment	Resignation
Marissa Szczepaniak**	–	03/05/18
Oliver Schubert	03/05/18	30/01/19
Celia Pronto	01/06/18	–
Stephen Jordan	17/08/18	–
Emma Gilthorpe	–	25/09/18
Nick Salmon	25/09/18	–
Marissa Szczepaniak	30/01/19	–

* John Barnes became Chair of the remuneration committee on 17/08/18
** Previously a member from 08/12/16 to 03/05/18

Composition and changes to the audit and risk, remuneration and nomination committees continued

Audit & Risk Committee		
Current members		
Director		Appointment date
Chris Girling (Chair)	INED	20/05/15
John Barnes	INED	06/07/17
Célia Pronto	INED	01/06/18
Stephen Jordan	NED	17/08/18
Marissa Szczepaniak*	NED	30/01/19

Membership changes in 2018/19

Director	Appointment	Resignation
Marissa Szczepaniak*	–	03/05/18
Oliver Schubert	03/05/18	30/01/19
Célia Pronto	01/06/18	–
Stephen Jordan	17/08/18	–
Marissa Szczepaniak	30/01/19	–

* Previously a member from 08/12/16 to 03/05/18

Composition and changes to the PR19, PR19 Technical and Refinancing Committees

PR19 Committee		
Current members		
Director		Appointment date
John Barnes	INED	26/01/17
Stephen Jordan	NED	17/08/18
Marissa Szczepaniak*	NED	30/01/19
Paul Butler	Executive	26/01/17
David Hinton	Executive	26/01/17
Andrew Farmer	Executive	26/01/17

Membership changes in 2018/19

Director	Appointment	Resignation
Marissa Szczepaniak*	–	17/08/18
Oliver Schubert	–	30/01/19
Stephen Jordan	17/08/18	–
Emma Gilthorpe	–	30/09/18
Marissa Szczepaniak	30/01/19	–

* Previously a member from 26/01/17 to 17/08/18

PR19 Technical Committee		
Current members		
Director		Appointment date
Stephen Jordan	NED	17/08/18
Marissa Szczepaniak*	NED	30/01/19
Paul Butler	Executive	26/01/17
David Hinton	Executive	26/01/17
Andrew Farmer	Executive	26/01/17

Membership changes in 2018/19

Director	Appointment	Resignation
Marissa Szczepaniak*	–	17/08/18
Oliver Schubert	–	30/01/19
Stephen Jordan	17/08/18	–
Marissa Szczepaniak	30/01/19	–

* Previously a member from 26/01/17 to 17/08/18

Composition and changes to the PR19, PR19 Technical and Refinancing Committees continued

Refinancing Committee		
Current members		
Director/members		Appointment date
Chris Girling	INED	08/03/18
Nick Salmon	INED	11/10/18
Stephen Jordan	NED	17/08/18
Andrew Farmer	Executive	08/03/18
Oliver Schubert**	Non-Director	30 /01/19

Membership changes in 2018/19

Director	Appointment	Resignation
Marissa Szczepaniak	–	17/08/18
Oliver Schubert	–	30/01/19
Oliver Schubert**	30/01/19	–
Stephen Jordan	17/08/18	–
Nick Salmon	11/10/18	–

** Was reappointed as a non-director member from 30/01/19

The changes to the membership of the committees shown in the summary tables above were due to the appointment of Stephen Jordan as a new shareholder nominated director, the maternity leave of Marissa Szczepaniak and the end of the appointment of Emma Gilthorpe.

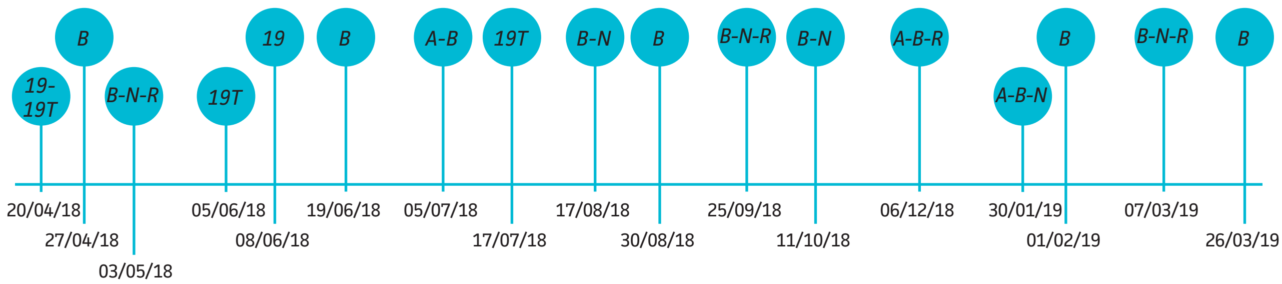
Board activities in 2018/19

During the period from 1 April 2018 to 31 March 2019 the board met on 13 occasions. The board meets for regular meetings every two months but receives a full performance report every month. Committee meetings are normally held on the same days as board meetings. There were seven scheduled board meetings and six additional board meetings this year to dedicate additional time to the preparation of the business plan and PR19 related approvals and to deal with matter's arising outside of scheduled boards.

A specific strategy session focusing on the preparation and delivery of our business plan was held in October 2018. We reviewed our performance commitments and ODIs, the delivery of these commitments through our corporate plan analysing the company's strengths and weaknesses and our strategic focus for the next regulatory period and the long term across key themes including engagement with customers and insight, changing customers and stakeholder behaviours and expectations, responsible business, the environment, innovation, network management and the effectiveness of our operational structure. We also carried out an analysis of the external factors that should be incorporated into our business plan.

Attendance at board and committee meetings

Director	Board	Audit	Nomination	Remuneration	PR19	PR19 Technical
N Salmon	12/13		6/6	3/3		
J Barnes	12/13	3/3	6/6	4/4	1/2	
E Gilthorpe – R: 30/09/18	4/7		3/3	1/1	2/2	
C Girling	12/13	3/3				
C Pronto – A: 01/06/18	10/11	3/3	5/5	2/3		
M Szczepaniak – R: 17/08/18 – A: 30/01/19	3/7		1/2	1/1	2/2	3/3
O Schubert – R: 30/01/19	9/10	3/3	4/4	3/3	2/2	3/3
S Jordan – A: 17/08/18	8/9	2/2	4/4	3/3		
P Butler	13/13				2/2	3/3
A Farmer	13/13				2/2	3/3
D Hinton	13/13				2/2	3/3



B: Board   A: Audit and risk   N: Nomination   R: Remuneration   19: PR19   19T: PR19 Technical

Summary of our activities

Business performance

- considered updates and reports on the freeze/thaw incident in late February and early March 2018 which caused significant interruptions of supply to our customers and how the company had responded to it. Approved the compensation package offered to customers affected by interruptions. Reviewed the lessons learnt and approved our incident report and customer follow up report in response to Ofwat's information requests. Reviewed Ofwat's report and their letter to the company and considered and approved our externally assured action plan for publication. Monitored the progress of the implementation of our action plan and the company's readiness. Considered Ofwat's recommendations to government on revised GSS payment
- reviewed the performance against KPIs, performance commitments and ODIs at board meetings and in monthly performance reports. Carried out an annual review of performance against our operational commitments and outcome delivery incentives and of the initiatives taken to ensure we meet our targeted performance
- reviewed the annual report on the delivery of our capital programme and capital expenditure in 2017/18, our capital programme for 2018/19 as well as updates on its delivery and progress of the main schemes in the programme. Considered the extension of agreements relating to the delivery of our capital programme
- reviewed the water resources position, the readiness and resilience of the company in case of drought in accordance with our drought plan and the impact of a possible drought on our bulk supplies

- reviewed the process for the retendering of our main network maintenance contract and the alignment of the contract requirements with our operational need and performance targets
- carried out the review of half-year customer services performance including SIM and the full year review of performance for 2018/19 and of the preparation for the new C-MeX measure
- carried out the annual review of operational performance and winter readiness
- considered the proposed transfer of abstraction licence and purchase of land from the administrators of Aylesford Newsprint for the construction of water treatment works
- carried out a review of our environmental function and of the company's environmental performance and reviewed our main schemes under the Water Industry National Environment Programme

Financial, reporting and transactional

- reviewed and approved the annual report and financial statements and the regulatory accounts for 2017/18 and the half-year financial reporting for 2018/19. Considered the viability statement in line with specific requirements set out by Ofwat
- completed the exit from the non-household retail market on 1 May 2018 based on the valuation method approved by the board which took account of the sale of the acquiring licensee, Invicta Water Limited, to Castle Water which took place on 1 July 2018 to ensure the transaction was at arm's length. Considered the implication of this exit on employees and transferring customers
- reviewed the possible approaches for our debt refinancing taking account of the requirements of the PR19 methodology on financial resilience and gearing. Considered how the planned refinancing would allow the company to reduce gearing. Approved the necessary delegation to the refinancing committee, and approved the transaction documents for loans and private placement
- considered the report from the audit committee on the audit plan, on the independence of the auditors, on the audit fees and on new reporting requirements for the 2019/20 annual report. Approved the audit fees
- approved the budget assumptions and the financial budget for 2019/20
- considered and approved dividends

Governance, internal controls and risk management

- reviewed the composition of the board and its committees and the recommendations of the nomination committee on the appointment of new directors to the board. Considered the changes of investment managers of the ultimate shareholders of the company and their impact on the composition of the board
- carried out the annual evaluation of the board's effectiveness
- carried out the annual health, safety and wellbeing performance review and considered the effectiveness of our Thrive 365 strategy and related initiatives. Reviewed the initiatives implemented in 2017/18 and the programme of actions for 2018/19
- reviewed our employee performance assessment and annual review system and the results of the review process. Reviewed our talent management initiatives. Considered our gender pay gap annual reporting and the actions to take to address gender pay gap. Carried out the annual review of our human resources initiatives, including our IIP silver certification
- considered the reports from the remuneration committee on executive performance related pay, the relevant performance measures and objectives for the financial year
- considered the review carried out with the support of PWC of our information technology systems and infrastructure and of our information technology strategy. Also considered the report from the audit and risk committee on the review of the IT function and security by NCC
- adopted our modern slavery statement and reviewed the related procedures implemented to ensure compliance with legislation on modern slavery
- reviewed our insurance programme and the renewal of the policies and benchmarking
- considered the implications on the sector and the company of the proposals for nationalisation of the water industry

- reviewed the water industry and the company's preparation for a no-deal Brexit and the coordination with Defra. Reviewed the implementation of the industry's and company's risk management plans relating in particular to the supply of chemicals, additional stocks of chemicals and equipment, and the coordination with suppliers and emergency services
- reviewed the assessment of the company under the GRESB global ESG benchmark and the preparation for the 2019 survey
- considered the company's response to Ofwat's consultation on its revised board leadership, transparency and governance principles and the revised principles published in January 2019. Considered Ofwat's proposals to introduce a new licence condition to comply with the objectives of the new principles and approved that the company provide its consent
- carried out the annual review of risks and of the effectiveness of our risk management process
- approved the terms of reference and the appointment of the members of our responsible business committee
- considered the adoption by the company of the water industry public interest commitments published by Water UK

Strategy, regulation and stakeholders

- considered the implications for the water sector and the company's strategy of the correspondence between the Secretary of State for Environment, Food and Rural Affairs and the Chairman of Ofwat and of Ofwat's letter to water companies' CEOs on putting the sector back in balance. Considered how to incorporate these considerations into our strategy
- considered the company's response to Ofwat's consultation on changes to the PR19 methodology relating to financial outperformance, transparency of policies on dividends and performance related pay, gearing and financial resilience and the viability statement and the effect the outcome of that consultation had on the company's business plan
- dedicated our strategy session to PR19 and especially to our performance commitments and ODIs and the delivery of these commitments through our corporate plan. Analysed the company's strengths and weaknesses and our strategic focus for the next regulatory period and the long term across key themes including engagement with customers and insight, changing customers and stakeholder behaviours and expectations, responsible business, the environment, innovation, network and the effectiveness of our operational structure. Carried out an analysis of the external factors that should be incorporated into the business plan
- approved the PR14 reconciliation submission to Ofwat
- reviewed the development of our business plan at our board meetings, and through two dedicated PR19 committees. Developed and participated in our programme of direct board engagement with customers and in our customer research
- met with Zoe McLeod to discuss the work of the CCG, receive feedback from the CCG on the preparation of our business plan, and for a presentation of the CCG report. Approved initiatives and commitments discussed with the CCG including the creation of a customer insight team
- approved our business plan submission to Ofwat. Set detailed conditions for the delegation of authority of the finalisation of the documentation to the PR19 committee
- considered Ofwat's initial assessment of our business plan and reviewed our responses submission
- reviewed and approved our annual regulatory reporting for 2017/18 including the annual performance report, data assurance summary, cost assessment tables and shadow reporting to Ofwat and our performance, people and planet report
- reviewed the development of our 2019 water resources management plan and approved its submission to Defra

- considered Ofwat's consultation on proposed new conditions relating to non-discrimination provisions against entities that may bid for the provision of certain services to water companies, self-lay providers and new appointees and relating to the use and dissemination of information provided by certain market participants. Approved that the company consent to the proposed change to the instrument of appointment
- met with Sir Tony Redmond, Regional Chair of the Consumer Council for Water to discuss our performance and the priorities of CCW
- approved the approach for setting and assuring our wholesale and household end-user charges taking account of customers' preference for bill stability and seeking to control increases in bills and the impact on customers. Approved our indicative and final wholesale charges, our household end-user charges and our new connection charges and infrastructure charges for 2019/20 and the related board assurance statements. Set detailed conditions for the delegation of authority of the final calculation of the charges following publication of the relevant RPI and finalisation of the charges documents
- reviewed and approved the update of the company Monitoring Framework 2018/19 and assurance plan
- considered Ofwat's final consultation on licence simplification and approved that the company consent to the proposed change to the instrument of appointment
- considered the company's response to Ofwat's consultation on strengthening the ring-fencing framework
- reviewed the development of our corporate plan for 2020 to 2025
- considered the company's response to Defra's consultation on long term planning for water resources and for revising the process for amending water companies' licences

Board evaluation

Our board evaluation was carried out by means of a confidential online questionnaire. The results were collated and summarised by the Company Secretary on a non-attributable basis and the Chairman led a discussion on the conclusions to draw from the survey results and recommendations for change or improvement.

The questionnaire covered the key aspects of the performance of the board and its committees and included open questions on the working and effectiveness of the board and committees in fulfilling their roles. Each committee also considered its own practices against its terms of reference and the chairs' reports on their findings in their respective sections of this corporate governance report. The questionnaire also incorporated questions from the Sustainability First "Check-list for energy and water board effectiveness" in line with our responsible business commitments. The questions identified in the Sustainability First check-list relate to three key challenges faced by water and energy companies:

1. How to demonstrate that total returns are acceptable?
2. What can boards do to build better regulator/company relationships?
3. The important role of Non-Executive Directors in energy and water.

The Chairman also met with each Non-Executive and Executive Director to provide feedback on their performance and to receive suggestions from them. The evaluation of the Chairman was carried out by the Non-Executive Directors and the shareholders nominated directors receiving feedback from the Executive Directors in the absence of the Chairman.

Following the 2018 board evaluation the board had agreed to work during the year to incorporate customer engagement further into the day to day operations of the business and to build on the significant engagement carried out for the preparation of the PR19 business plan. A new customer insight team was created and a new Head of Customer Insight and Strategy appointed in consultation with our CCG.

Implementing the decision made last year following our board evaluation, our responsible business committee was formally constituted in 2019. The board evaluation emphasised the desire of the directors to see the agenda of the committee develop in conjunction with the preparation of our strategy and corporate plan in 2019/20. The evaluation also reinforced the need for continued action to improve diversity, succession planning and retention.

The board decided to have more involvement with and visibility of innovations in the company especially for delivering the challenges of the next regulatory period. It was also suggested that the board should hold some of its meetings at different company locations and also that directors may participate in further engagement with employee and company initiatives outside board meetings as had been done for the board customer engagement programme.

The board agreed to consider further the Sustainability First themes in its strategic session in October 2019.

The 2019 board evaluation concluded that the board and its committees were operating effectively.

Commitment, information and support

The expected commitment including outside scheduled board meetings when required is reviewed as part of the appointment process of the Non-Executive Directors. The terms of appointment of Non-Executive Directors do not include a set expected time commitment but instead include an undertaking that the director will dedicate sufficient time to discharge his or her responsibilities. None of our Non-Executive Directors has raised concerns over the time required to fulfil their duties and this aspect is also considered in the board evaluation process.

The Chairman's and directors' other commitments were disclosed and considered prior to appointment and have not materially changed since their appointment. Details on the Chairman's and directors' other commitments can be found on page 68.

The board receives monthly performance reports to ensure that directors are regularly informed of performance. Directors raise questions directly with the Executive Directors when there is no scheduled board or raise questions at the following board. The monthly report covers all aspects of performance including performance against key regulatory obligations and outcome delivery incentives.

Directors also receive specific updates and reports as appropriate at and outside of scheduled board meetings. This includes detailed reports on Service Incentive Mechanism (SIM) results or updates on significant operational events. Senior executives also regularly present board items and updates on their particular areas to ensure that the board receives the information it needs.

On joining the board each director receives a detailed, tailored induction programme which is supplemented as needed to ensure that the director's knowledge, familiarity with South East Water and our industry, and their own capabilities are maintained at the appropriate level. The induction programme includes meetings with senior managers and visits to production sites and other facilities away from the head office. Such visits give directors the opportunity to speak to a wider group of employees and contractors. The feedback provided by Ofwat following their pre-appointment interview is also incorporated into the induction programme.

Transparency and accountability

The board and the audit and risk committee ensure that the business, financial and regulatory reporting of South East Water is transparent and informative and accurately reflects material issues and describes our business model, strategy and performance.

The board is responsible for defining the risk management strategy and processes including the risk register and the identification of the principal risks. It also carries out an annual review of the effectiveness of the risk management and internal control systems (financial, operational and compliance), of the principal risks and of the prospects of our company. We provide details on these aspects on page 53 of the strategic report.

The audit and risk committee plays a key role in the ongoing monitoring of the adequacy and effectiveness of the internal controls and risk management systems established by the board. This involves reviewing the ability to identify and manage new risks types, ensuring effective controls are embedded into management and governance processes, and continuously monitoring risks with relevant items at each meeting. The audit and risk committee also ensures that appropriate audit work is carried out on risk management.

“The audit and risk committee also ensures that appropriate audit work is carried out on risk management

Report from the audit and risk committee

I am pleased to report on the work of the audit and risk committee since 1 April 2018 and in relation to this annual report for 2018/19.

- We have taken into account the increased emphasis of our revised corporate governance code on risk management and, in particular, our role in ensuring the ongoing monitoring of South East Water's risk management systems. We carried out reviews of selected key controls and transactions and ensured that the external audit covered a wider range of key controls.
- We reviewed the half-year group financial reporting and recommended to the board the approval of the half-year group financial statements, and of this annual report for 2018/19.
- We considered the prospects of South East Water for the purpose of both the going concern statement by the directors and the longer term viability described in the viability statement. We have recommended that the board maintain a lookout period of 10 years for its viability statement. We have also considered and made recommendations to the board on the appropriate nature and extent of stress testing to be used to assess the future prospects of South East Water. The description of our principal risks and our viability statement are included on pages 50 to 63 of the strategic report.
- We have considered the content and format of this annual report in line with the requirements of our corporate governance code and our company monitoring framework. Our aim is that this annual report and our regulatory reporting is informative, specific, clear and simple to understand. We have applied the same approach and scrutiny to our corporate social responsibility reporting.
- We have paid particular attention to ensure that our reporting on our outcome delivery incentives accurately reflects South East Water's performance in the year and on the quality and quality assurance of the data used for our reporting.
- We considered IFRS developments and in particular IFRS 15 which focuses on revenue earned from contracts with customers, IFRS 9 on finance instruments and IFRS 16 on leases. We approved the adoption of policies in respect of each following review by our auditors.

Financial statements and annual performance report

- Audit plan

  The committee reviewed the audit plan with the auditors and was satisfied that it covered the key issues and was consistent with prior years. We reviewed the significant audit risks typical of a water company, including revenue recognition and leakage allowance, bad debt provisioning, the classification of costs between operating and capital expenditure and management override and controls.

  We also ensured that the external environment and the impact of Brexit would be considered as appropriate. We also reviewed the areas of audit focus including the valuation assumptions of financial instruments, the validity of assumptions of the pension funds valuation, and the going concern and viability statement in light of our refinancing. Specific areas of focus for 2018/19 were the implementation of the accounting policies for IFRS 15 and 9 and the recoverability of non-household debt following the company's exit from the non-household retail business and the transfer of non-household debt from Invicta Water Ltd to South East Water upon acquisition of Invicta Water Ltd by Castle Water.

  The audit plan recognised that there would be a requirement for an enhanced audit opinion as a public interest entity. It also included an assessment of the impact of the adoption of new accounting standards, IFRS 15 on revenue recognition, IFRS 9 on financial instruments and IFRS 16 on leases and the requirement to provide explanations on the impact of their adoption.

- Fair, balanced and understandable

  The committee has reviewed this annual report and financial statements and the regulatory reporting in order to assess whether they present a fair, balanced and understandable assessment of South East Water's and the group's position and prospects. We reviewed in particular specific notes and explanations to the financial statements to ensure they provided clear explanation of accounting policies and technical matters. Following this review, we recommended to the board that, taken as a whole, the group annual report 2018/19 is fair, balanced and understandable.

  We also reviewed the report from Jacobs, our external assurance partners, on our regulatory reporting and recommended to the board the approval for publication of our regulatory reporting, cost assessment tables and our performance, people and planet report.

- Significant judgements and sources of estimation uncertainty considered

  A significant proportion of water supplied to our domestic and our smaller commercial customers remains unbilled at the end of the financial year. As such judgements and estimates are made in respect of the value of unbilled water revenue. These estimates are based on previous consumption levels and are validated to ensure that the assessments are reasonable.

  Our trade receivables balance includes a provision for bad debt, which is our assessment of debts that will be unpaid by our customers. The provision is based on the application of expected recovery rates to our aged debt balances using specific data for household and for non-household debt.

  We have a significant capital programme and therefore it is important that the policies underpinning the capitalisation of expenditure are closely validated and compliant with current appropriate accounting standards. The committee ensures that the costs capitalised as fixed assets are directly attributable to capital projects.

  Another area of judgement associated with our capital programme is the useful economic lives of fixed assets. This has a direct impact on the value of depreciation charged to the income statement. The lives of assets are reviewed annually based on managements' judgement and experience. An impairment review is also undertaken annually to write down the value of assets where it is considered appropriate to do so.

  The audit committee keeps the judgements and sources of estimation uncertainty under review and challenges as appropriate, typically as part of the half year reporting and the board also exercises scrutiny throughout the year as part of the board review of the monthly management accounts in the finance report.

- Other areas of audit and risk committee focus

  The non-household retail business of the company was transferred on exit from the non-household water retail market to Invicta Water Ltd on 1 May 2018. Non-household debtor balances were retained by the company and their recoverability and the appropriateness of the doubtful debt provision specifically considered by the committee.

  The transfer of our non-household retail business on exit to Invicta Water Ltd which occurred on 1 May 2018 and the valuation of the business and the presentations and disclosures relating to that transaction were specifically considered by the committee.

  Other areas of focus reviewed by the committee included the appropriateness of actuarial assumptions for the valuation of the assets and liabilities of the two defined benefit pension schemes to ensure they were within an acceptable range considering the economic environment, valuations assumptions relating to the valuation of financial instruments and consideration of future financing and going concern. The valuation of financial instruments was also specifically reviewed as part of the audit.

We adopted IFRS 15 and 9 for the year ending 31 March 2019 and we specifically reviewed the transition adjustments from the adoption of these standards as well as the implementation of the relevant accounting policies and the relevant disclosures. We also considered the relevant disclosure relating to the impact of the adoption of IFRS 16 as of 1 April 2019.

We also reviewed our going concern and long-term viability statement and the nature and outcome of the stress testing carried out having regard to the requirements also set by Ofwat.

External auditors

- Audit fee

  We reviewed the audit fee proposal from the auditors. Based on the audit plan, comparing with the previous year's fee and taking account of the specific work required in relation to the transition adjustments for IFRS 15 and 9, the review of the impact of the adoption of IFRS 16 and the disposal of the non-household retail business to Invicta Water Ltd and the subsequent disposal of that entity, we were satisfied to recommend the fee to our board for approval.

- Effectiveness of the external audit process

  We reviewed the effectiveness of the external audit process receiving feedback from the auditors, the Finance Director and the Head of Finance on the conduct of the audit and any issues and potential improvements. The Chair of the committee met with the auditors to discuss the audit. We were satisfied with the performance of the auditors and the effectiveness of the overall process.

- Objectivity and independence of auditors

  We reviewed the objectivity and independence of the auditors considering the proportion of the total fees received by the auditors which is paid by South East Water, non-audit services, the duration of the appointment of the auditors, and the confirmation of independence from the auditors. We also considered the level of non-audit services relating essentially to regulatory reporting which are best provided by Deloitte to ensure consistency. The committee concluded that Deloitte remained objective and independent in their role as external auditor.

  We applied our policy on non-audit services that requires approval of non-audit work by the Chair of the audit committee or, for any work in excess of £50,000, the full committee. The auditors performed tax work with the required approval in relation to items allowable under the relevant independence regulations.

Risk management and internal controls

- The committee dedicates time at each of its meetings to the monitoring of the effectiveness of South East Water's risk management systems. We also reviewed specific areas of risk or compliance.
- We reviewed the actions taken with our contractor to improve the transparency of cost information and the pain gain mechanism under our reactive maintenance contract following the external review carried out in 2017 by PWC. We reviewed the position under the pain gain mechanism agreed with the contractor.
- We reviewed a report from NCC Group on our cyber security with our IT team. We reviewed the overall assessment of the maturity of our cyber security processes against the critical security controls defined by the Centre for Internet Security and the implementation of the recommendations for improvement. We also considered the readiness of the company to meet new requirements relating to the security of Network and Information Systems (NIS).

- We considered an update on corporate governance and new reporting requirements applying to financial years starting on or after 1 January 2019 in particular under the Companies (Miscellaneous Reporting) Regulations 2018 and the preparation for that reporting.
- We considered whether or not an internal audit function was required. We considered the established processes in place for regulatory and performance reporting which include both internal and external assurance, the size and structure of the company and the nature of the core activities. We concluded that an internal audit function was not required at this stage and that the current combination of internal reviews of controls and systems carried out by the finance team and of specific reviews by external consultants was appropriate and allowed access to specialist skills and knowledge that it would not be cost effective to maintain internally.
- We also reviewed the effectiveness of our policies and practices in relation to the prevention of fraud, whistleblowing and anti-bribery.
- We reviewed the effectiveness of the committee as part of the board evaluation and the members of the committee and directors were satisfied that it is operating effectively in accordance with its terms of reference.

Chris Girling

Chair
15 July 2019

Relations with shareholders

Communication with shareholders is facilitated, as South East Water is a private limited company, with shareholder nominated Non-Executive Directors on the board.

It is important that the board appreciates the requirements of shareholders and equally that shareholders understand how the actions of the board and financial performance relate to the achievement of South East Water's longer-term goals. The reporting calendar is dominated by the publication of interim and final results each year, in which the board reports to shareholders on its stewardship of South East Water. At other times during the year, presentations to rating agencies and updates to the stock exchange are made available to all. The Chairman ensures that the Managing Director and Finance Director provide feedback to the board following presentations to investors and meetings with shareholders.

> **“The Chairman ensures that the Managing Director and Finance Director provide feedback to the board following presentations to investors and meetings with shareholders**

Remuneration

Report from the remuneration committee

On behalf of the board, I am pleased to present the directors' remuneration report for the year ended 31 March 2019. The report summarises our key objectives, our remuneration policy, the key linkages between directors' pay and the performance of the company as well as the level of each director's emoluments for the year.

Our aim is to ensure that executive pay is aligned with South East Water's strategy and that remuneration reflects the company's performance against clear operational and financial measures as well as individual objectives.

We are keen to the ensure that we link executive pay to successful business performance which is in turn linked to demonstrable consumer benefits. We set out in the Remuneration Report how this has been achieved this year.

I would highlight the following:

2018/19 Annual Bonus Scheme

- With our primary focus being to deliver strong customer performance the number of operational objectives was increased from five to six in 2017/18. This ensured that a broad range of customer outcomes were incentivised and it maintained the incentive to outperform, even if one objective was not met, which the committee felt was in the customers' interest.
- The construct of the scheme was based on that applied in 2017/18 allowing for a review to take account of the changes resulting from our exit from the non-household retail market.
- In defining objectives for the Executive Directors, we ensured that they included improving diversity and inclusion, the development of our ESG framework and of our customer engagement strategy beyond PR19. We agreed the personal objectives of the new Commercial Director appointed on 1 July 2018 under the annual bonus scheme.
- We reviewed the full year performance of the company and that of individual executive directors, taking account of their contribution in delivering the targets set.
- During the year we did not meet all the targets that we set ourselves and the payments to Executive Directors under the scheme have been calculated reflecting this. The committee decided to use discretion in determining the awards to take account of the overall operational and financial performance in the year. We explain how we used our discretion in the body of the directors' remuneration report.

2018 Annual salary review

- The committee decided that the Executive pay award would continue to follow the company wide pay award. The same principle was applied to the remuneration of Independent Non-Executive Directors.

2019/20 Annual Bonus Scheme

- We decided that the construct of the 2019/20 bonus scheme should follow that applied in 2018/19, replacing the SIM measure which would no longer apply with the number of burst mains.
- In defining 2019/20 objectives for the Executive Directors, we have ensured they further build on the objectives set in the previous year on improving diversity and inclusion, succession planning, the development of our customer engagement strategy beyond PR19, of our environmental strategy and our corporate plan.

Long Term Incentive Plan (LTIP)

- South East Water operates a Long Term Incentive Plan (LTIP) covering the five year period from April 2015 to March 2020. Similar to the annual bonus plan, the LTIP is designed to give priority to delivering operational objectives linked to customer outcomes. The related bonus payments are phased 20 per cent in 2018, 30 per cent in 2019 and 50 per cent in 2020. In 2018, the committee reviewed progress against the LTIP targets considering actual performance in 2015/16 and 2016/17, pre-audited performance in 2017/18 and estimated performance in 2018/19 and 2019/20. We authorised the first 20 per cent payment after the publication of the audited performance for 2017/18 in 2018.
- The committee has reviewed the pre-audited performance in 2018/19 and the estimated performance in 2019/20 and decided not to make the second 30 per cent payment in 2019.
- The committee approved a two year commercial bonus scheme for 2018 to 2020 which applies to the new Commercial Director only.

Governance

- We reviewed the effectiveness of the committee as part of the overall board evaluation process and the members of the committee and directors were satisfied that it is operating effectively in accordance with its terms of reference

John Barnes
Chair
15 July 2019

Directors' remuneration report

Remuneration policy

The remuneration of Independent Non-Executive Directors' is built on a structure of fixed fees which are periodically compared with market practice, ensuring that pay is competitive in order to encourage the retention and motivation of board members.

Rewards for the Managing Director and senior executives are based on a total reward package of basic salary and annual performance and long-term incentive schemes in addition to benefits sufficient to attract, motivate and retain individuals of the required calibre to lead the business. Our policy aims to be around median market practice, with performance incentives for achieving challenging operational, financial and personal targets to motivate strong commitment to achieving the goals set, as well as to establish a close link between overall rewards, corporate performance and the benefits delivered to our customers. Operational targets include improving South East Water's customer satisfaction and service incentive mechanism scores, health and safety performance in addition to performance measures such as leakage, interruptions and discolouration.

Financial performance targets are focussed on "totex" costs and cash collection efficiency. The remuneration committee establishes annual bonus targets at the beginning of each financial year and decides the performance bonus payment to each member of the executive team based on an assessment of their performance at the end of the year. For the long-term incentive scheme, targets have been set to cover the five year regulatory period to end of March 2020. Decisions on the pay of senior executives take into account information from independent reward surveys. The Managing Director and senior executives participate in the same pension schemes as other employees.

In respect of senior managers and employees throughout the business, South East Water's reward policy is to maintain a total reward package consisting of basic salary and additional benefits sufficient to attract, motivate and retain high quality personnel. Senior managers participate in the management performance bonus scheme. The intention is to be positioned around median market practice and we participate in reward surveys to benchmark our reward practices in order to ensure this outcome.

2018/19 Annual bonus performance criteria

At the end of the 2017/18 financial year the remuneration committee opted to retain the structure of the executive bonus scheme that commenced in April 2017 whilst allowing for a review of the scheme in order to take account of changes necessary in reflection of the company's planned exit from the non-household retail market.

These alterations did not impact the premise of the executive bonus scheme, whereby the bonus payable to each director is calculated by establishing multipliers for each performance category and applying the product of those multipliers to the relevant bonus level. The scheme did however see the number of operational objectives increase from five to six with the introduction of an objective relating to customer contacts regarding the discolouration of water supplied. In addition to this, no bonus becomes payable if three or more out of the six operational objectives are not met (i.e. the operational objectives multiplier becomes zero) and the reward progressively decreases if one or more operational objectives are not met. This was a shift from prior years where no bonus became payable if more than one of the then five operational objectives were not met and a reduced rate of 75 per cent was paid in circumstances where only one of the operational objectives was not met.

These changes were designed to ensure that focus is maintained on the other operational objectives in the event of the failure of one operational objective, whilst ensuring that the bonus scheme remains to prioritise the delivery of operational objectives above all else.

During the year the operational targets we set were not all met and the payments to Executive Directors under the scheme have been calculated reflecting this. The committee decided to use discretion in determining the awards. This was to recognise the overall operational and financial performance and the successful sale of the non-household retail business, the completion of the refinancing and the implementation of a single bill that joint customers of South East Water and Southern Water wanted but which had an impact on customer service measures.

We deemed the discolouration contacts to be met taking account of the significant improvements achieved, as actual performance was only just below the target we had set. This was done in the context of an exceptionally good overall water quality performance. We exercised discretion in relation to SIM, customer satisfaction and interruptions performance resulting in an overall operational performance multiplier of 63 per cent.

Operational objectives	· Customer satisfaction · Health and Safety · Leakage (Ml/d) · Interruptions · SIM score · Discolouration Contacts	Multiplier range 0% to 118% The H&S performance was below threshold. Leakage, interruptions, SIM and customer satisfaction were above threshold but below target. Therefore performance multiplier: 63%
Financial objectives	· Cash collection as a percentage of actual billing · Whole business totex	Multiplier range 0% to 140% Actual performance 100%
Personal objectives	· Set individually for each Executive Director	Multiplier range of 0% to 100%

2018/19 Bonus as a percentage of basic salary

Directors	Percentage of salary paid if 100% of target achieved	Awarded
Paul Butler	50.0%	30%
Andrew Farmer	30.0%	19%
David Hinton	30.0%	19%

The payments under the performance incentive scheme were made in July 2019 and are set out in the directors' emoluments section below.

Long-term Incentive Plan

A Long Term Incentive Plan (LTIP) was introduced at the beginning of the 2015/16 financial year. This incentive plan aligns the long-term interests of shareholders and the executive team, retains and rewards executive management of appropriate calibre as well as rewards Executive Directors for the performance over the regulatory period, including the impact of AMP6 performance on the final determination for the next regulatory period.

The LTIP has been constructed to give priority on delivering operational objectives, such that no bonus becomes payable if the overall performance on ODI's generates a penalty.

The LTIP grants cash awards at the beginning of the AMP6 period and vests over the six year period, 2015/16 to 2020/21, in increasing stages. Awards equivalent to one year's salary have been granted and will vest as detailed below.

Vesting of awards will be subject to three interdependent performance conditions as illustrated below:

		Multiplier 1		Multiplier 2		Multiplier 3	
Base award	x	Operational cash flow	x	ODI	x	SIM	= Final award vested

The criteria are as follows:

Operational cash flow*	Outcome delivery incentive	Service incentive mechanism ranking
Multiplier	Multiplier	Multiplier
0 x to 1.5 x (depending on outcome achieved)	0 x to 1.25 x (depending on outcome achieved)	1.35 x to 0.25 x (depending on position achieved)

* OCF is defined as the sum of cumulative net cash generated from operations less cumulative net cash flow over the 5 years of the AMP6 period as reported in the SEW Statutory accounts (adjusted for AMP7 Revenue and RCV penalties in respect of totex outperformance and revenue correction mechanism adjustments).

The awards are as follows:

	Base award £000	Corporate plan target £000	Maximum award £000	2017/18*	2018/19*	2019/20*
Paul Butler	240	360	607.5	20%	30%	50%
Andrew Farmer	180	270	455.6	20%	30%	50%
David Hinton	140	210	354.5	20%	30%	50%

* The remuneration committee will assess the level of award payable shortly after each of the financial years set out above.

As noted above the second vesting period for the Long Term Incentive Plan is 2018/19. The remuneration committee has considered the pre-audited performance in 2018/19 and the estimated performance in 2019/20 against the performance objectives of the directors and decided not to make the second payment of 30 per cent. As a result of this, the current cash awards vested under the scheme are as follows:

	2017/18 £000	2018/19 £000
Paul Butler	54	–
Andrew Farmer	41	–
David Hinton	32	–

Payments of the bonus awarded for the 2017/18 year were made in July 2018.

Directors' emoluments

	Salary and fees £000	Other £000	LTIP £000	Bonus £000	2018/19 Total £000	2017/18 Total £000
Directors						
Nick Salmon (Non-Executive Chairman)	102	–	–	–	102	100
Paul Butler (Managing Director)	252	68	–	75	395	415
Andrew Farmer (Finance Director)	191	19	–	36	246	263
David Hinton (Asset & Regulation Director)	149	24	–	28	201	213
Marissa Szczepaniak (Non-Executive Director) (R – 17 August 2018) (A – 30 January 2019)	–	–	–	–	–	–
Stephen Jordan (Non-Executive Director) (A – 17 August 2018)	–	–	–	–	–	–
Oliver Schubert (Non-Executive Director) (A – 03 May 2017) (R – 30 January 2019)	–	–	–	–	–	–
Peter Dixon (Non-Executive Director) (R – 27 April 2017)	–	–	–	–	–	–
Independent Non-Executive Directors						
John Barnes	36	–	–	–	36	41
Emma Gilthorpe	19	–	–	–	19	38
Chris Girling	41	1	–	–	42	42
Paul Rich (R – 3 July 2017)	–	–	–	–	–	10
Célia Pronto (A – 1 June 2018)	28	1	–	–	29	–

A – Appointed R – Resigned
- 2017/18 represents 3 months for P Rich
- 2018/19 represents 6 months for E Gilthorpe and 10 months for C Pronto

With effect from 1 April 2019 the salaries of the Executive Directors were increased in line with the company's pay award of 3.0 per cent. The executive bonus scheme for 2019/20 is unchanged.

In the year, Paul Butler was a member and David Hinton was a deferred member of a defined benefit pension scheme. For Paul Butler, the above table includes a cash supplement in lieu of the pension cap of £50,331 (2018: £49,248). David Hinton is a member of a stakeholder pension scheme and was not in receipt of a cash supplement in the lieu of the pension cap in the year (2018: £nil).

Other emoluments also comprise benefits-in-kind in the form of company car allowances, fuel costs and healthcare insurance.

The Executive Directors have employment contracts with notice periods not exceeding one year and have a performance related bonus included within their remuneration. The Independent Non-Executive Directors all have letters of appointment. As South East Water is a wholly-owned subsidiary, there are no listed shares and no directors are offered any share incentives in the company. The employment contracts and letters of appointment of the directors employed during the year include the following terms:

Executive Directors	Date of contract	Unexpired term (months)	Notice period (months)
Paul Butler	2 October 2006	N/A	12
Andrew Farmer	29 June 2015	N/A	6
David Hinton	1 June 2013	N/A	12
Independent Non-Executive Directors			
Nick Salmon	1 April 2015	24	3
Chris Girling	30 October 2014	19	3
John Barnes	28 January 2016	33	3
Célia Pronto	1 June 2018	26	3

The employment contract for John Barnes was extended in the year. His initial contract was due to expire on the 31 December 2018, however John Barnes has seen his contract extended until 31 December 2021.

Marissa Szczepaniak, Stephen Jordan and Oliver Schubert were nominated by South East Water's ultimate shareholders to sit on the board of South East Water and do not receive any remuneration for this service from South East Water.

Pension benefits earned

Approved contributory final salary pension scheme

One Executive Director was a member of the defined benefit pension scheme during the year. Their accrued entitlements under the scheme were as follows:

Accrued benefits	David Hinton
At March 2019	
Annual pension	29,127
Lump sum	87,283
At March 2018	
Annual pension	28,442
Lump sum	85,237
Increase in accrued benefits excluding inflation	
Annual pension	-
Lump sum	-
Increase in accrued benefits after allowing for inflation	
Annual pension	685
Lump sum	2,046

Paul Butler has exercised his right to draw a pension and as such there are no benefits accruing in the pension scheme as at 31 March 2019.

The defined benefit pension was closed to future accrual on 31 March 2015.

Approved defined contribution scheme

In the year to 31 March 2019 two Executive Directors were members of the defined contribution scheme.

The table below summarises the contributions that were made in the scheme as at 31 March 2019:

	Contributions in 2015/16	Contributions in 2016/17	Contributions in 2017/18	Contributions in 2018/19
Andrew Farmer	27,274	37,453	22,170	10,000
David Hinton	28,000	28,392	29,934	29,043

Approved by the board and signed on its behalf by:

John Barnes
Chair
15 July 2019

Act Responsibly

We think about how our actions today impact on tomorrow. Our education programme helps develop colleagues and customers of the future.

Group financial statements

Directors' report

The Directors have pleasure in presenting the group directors' report relating to South East Water Limited ("South East Water" or the "company") and its subsidiary South East Water (Finance) Limited (together referred to as the "group") for the year ended 31 March 2019, together with the audited financial statements.

Principal activities

The principal activities of the group comprise the supply of water to a population of 2.2 million in an area of 5,700 kms and the provision of certain ancillary services for customers, developers and other bodies within the constraints of the relevant legislation. The directors consider the performance of the business to be satisfactory and that this is expected to continue in the future.

Appointment as a water undertaker and the ring-fence

South East Water has been appointed as a water undertaker under the Water Industry Act 1991 and the duties and the obligations of the appointee are set out in that Act, in regulations created under that Act, and in its instrument of appointment. The conditions of the instrument of appointment cover a variety of areas including charges, accounts and requirements to produce information for customers.

Condition K of the instrument of appointment deals with ring-fencing and requires South East Water to ensure, so far as is reasonably practicable, that it retains at all times sufficient rights and assets (other than financial resources) for a special administrator, if appointed, to be able to manage the affairs of the business, which must be confirmed annually. Condition I requires South East Water to ensure that it has sufficient financial and managerial resources and adequate systems of planning and internal control to carry out the regulated activities and to certify this annually.

Condition I requires South East Water to conduct the appointed business as if it was substantially the company's sole business and it was a separate public limited company. The ultimate controllers of South East Water are bound by a binding undertaking required under Condition P to procure that their subsidiaries, other than South East Water, provide information required by South East Water to comply with its obligations under the Water Industry Act 1991 and the instrument of appointment and to refrain from any action that would cause the appointee to breach any of these obligations.

The effect of the relevant legislation and the terms of the instrument of appointment mean that our directors have an overriding responsibility to ensure the regulatory ring-fence is maintained. The directors remain mindful of these obligations along with their duties as directors set out in the Companies Act 2006. One of the ways the directors meet the ring-fencing obligations is by ensuring that all board level matters that affect the company are decided at the board of South East Water, rather than at a holding company level.

Group structure

South East Water is the main operating company in the group of companies headed by HDF. Further details of the structure of the HDF group are provided in the strategic report on page 45.

Capital structure

Details of the authorised and issued share capital are shown in note 30 of the financial statements. There have been no movements during the year. South East Water has one class of share which carries no right to fixed income. There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the Articles of Association and prevailing legislation.

Details of South East Water's immediate and ultimate controlling parties are provided in note 35 and in the strategic report.

Accounting framework

The financial information presented in these audited financial statements has been prepared in accordance with the disclosure and transparency rules of the Financial Services Authority and International Financial Reporting Standards (IFRS) as adopted for use in the European Union. The financial statements are presented in Sterling.

The results published in this report describe our performance for the year and incorporate the performance of South East Water Limited and South East Water (Finance) Limited.

Business review

The turnover of the group for the year ended 31 March 2019 was £238.3 million (2018: £221.5 million) and operating profit was £86.4 million for the year (2018: £75.0 million). Profit before taxation for the year was £36.4 million (2018: £23.8 million). The financial position at 31 March 2019 for the group and for the company is shown on pages 118 and 119 respectively. Further analysis of the performance of the business and future developments is included in the strategic report on page 20.

On 1 May 2018, the company sold its rights and interests in the trade and customer base of its non-household customers to its sister subsidiary, Invicta Water Limited, for a consideration of £10 million. This transfer was by virtue of a Statutory Transfer Scheme under the Water and Sewerage Undertakers (Exit from Non-household Retail Market) Regulations 2016. Under the transfer, no assets or liabilities of South East Water in respect of the customers transferred for the period prior to the transfer date were moved out of the group. Invicta Water Limited was subsequently sold from the wider HDF Group on 30 June 2018.

Research and development activities

South East Water is a member of UK Water Industry Research (UKWIR) and participates in their research programmes.

Dividends

The directors have approved dividends totalling £28.0 million (2018: £18.0 million) for the year, paid in equal instalments of £7.0 million per quarter. Further details are given in note 14 of the financial statements. South East Water's immediate parent company, South East Water (Holdings) Limited used £5.2 million of this dividend (2018: £4.5 million) to pay interest on an inter-company loan back to South East Water.

Capital expenditure

During the year the group's capital expenditure totalled £104.7 million (2018: £96.0 million). Further details are given in notes 16 and 17 of the financial statements.

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

Taxation

While the group makes profits, the extensive investment programme currently being undertaken by South East Water typically means that any taxable profits are exceeded by available capital allowances. As tax losses are available elsewhere in the HDF Group in practice we defer taking some capital allowances and purchase group relief to settle the resulting tax charge. The payment of group relief is made at the statutory rate for corporation tax so does not impact the effective tax rate. The effective rate after making allowance for the future rate change and prior year adjustments is 14.9 per cent. Additional information on taxation is provided in note 13.

Directors and their interests

The directors who at any time during the financial year and at the date of this report were directors of South East Water are set out on pages 68 to 70 and further details regarding their appointments are set out on page 72.

No director held any shares or loan stock in South East Water or other associated companies, which is required to be disclosed under the Companies Act 2006, during the financial year.

Directors' indemnities

South East Water has granted an indemnity to its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 2006. Such qualifying third party indemnity provision remains in force as at the date of approving this directors' report.

Principal risks and uncertainties

A description of the principal risks and uncertainties and an explanation of the steps the board takes to mitigate these risks are provided in the strategic report on page 50 to 59.

Environmental and corporate social responsibility

South East Water's approach to sustainable development of our business includes a strong commitment to the environment and corporate social responsibility. Details of our actions in this respect are given throughout the strategic report. We also report on our greenhouse gas emissions in our performance, people and planet report. Further details on our responsible business committee are set out in the corporate governance report at pages 16 to 17.

Employment policies

South East Water offers equal opportunities to all employees and applicants for employment. Our managers and officers are trained to ensure there is no unlawful discrimination on grounds of race, gender, age, religion, union membership, disability or sexual orientation. Employment policies are intended to confirm South East Water as an employer of choice through provision of a safe work environment, satisfying work, personal development and fair rewards. Further details are given in the strategic report on page 22.

South East Water gives full consideration to applications for employment from disabled persons where the candidate's particular aptitudes and abilities are consistent with meeting the requirements of the job. Opportunities are available to disabled employees for training, career development and promotion. Where existing employees become disabled it is South East Water's policy to provide continuing employment, wherever practicable, in the same position or in an alternative position and to provide appropriate training to achieve this aim.

Employee consultation

South East Water places considerable value on the involvement of our employees and has continued to keep them informed on matters affecting them as employees and on various factors affecting the performance of the company. This is achieved through formal and informal meetings, regular bulletins on the intranet and an employee magazine. Employee representatives are consulted regularly through the Staff Council on a wide range of matters affecting their current and future interest.

Financial instruments

Information about the use of financial instruments by South East Water and our subsidiary is given in note 27 of the financial statements.

In December 2018, the company entered into a £120 million, 7-year facility and in March 2019 two further agreements were entered into to raise £75 million and £100 million via US Private Placements (USPP). The two USPPs are for terms of 12 years and 23 years respectively. The new facilities will be utilised in September 2019 for the repayment of the existing £200 million bonds plus related indexation being repaid at that time.

Going concern

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the strategic report. The group finances its working capital requirements through cash generated from operations and committed facilities that can be called upon as required. The group's annual budget and forecasts, together with its five year plan and longer resources planning, all indicate that the group should be able to continue operating. Our longer term viability statement is set out on page 60.

Therefore, the directors believe that the South East Water and the group are well placed to manage their business risks successfully. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

Post balance sheet events

On 3 September 2018 South East Water submitted its plans for the five year price review period covering 2020 to 2025 to Ofwat. At the end of January Ofwat issued its initial assessment of the business plan and required the company to complete a number of actions and to provide further evidence. The draft determination from Ofwat will be published on 18 July 2019 followed by the final determination on December 2019 which will set the prices the company can charge customers for the new price review period.

On 30 September 2019 the group will repay £200 million of its long term funding. The maturing bond was originally issued at a fixed interest rate and swapped to an index linked rate via a derivative transaction. The total amount repayable on both the original loan and the derivative on 30 September is approximately £311.5 million.

The group has arranged new funding totalling £295 million which, together with the part repayment of £54 million of the group's parent company loan by South East Water (Holdings) Limited, will be used to finance the repayment of the above mentioned financial instruments. More details of the group's refinancing arrangements are provided in note 34 of these financial statements.

Directors' statement on audit information

The directors who were members of the board at the time of approving the directors' report are listed on page 7, further information regarding our directors is set out on pages 68 to 70. Having made enquiries of fellow directors, each of these directors confirms that:

- **so far as the director is aware, there is no relevant audit information of which the group's auditor is unaware**
- **each director has taken all the steps a director ought to have taken to be aware of relevant audit information and to establish that the group's auditor is aware of that information**

This confirmation is given and should be interpreted in accordance with provisions of s418 of the Companies Act 2006.

In the absence of a general meeting, Deloitte LLP has been re-appointed as auditor in accordance with the terms of their contract.

Political donations

No political donations were made by the group in either the current or prior period.

Approved by the board on 15 July 2019 and signed on its behalf by:

Nicolas Truillet
Company Secretary
15 July 2019

Directors’ responsibilities statement

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors are required to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and Article 4 of the IAS Regulation and have also elected to prepare the parent company financial statements in accordance with IFRS. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing the group and company financial statements, International Accounting Standard 1 requires that directors:

- properly select and apply accounting policies
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- provide additional disclosures when compliance with the specific requirements in IFRS’s are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance
- make an assessment of the company’s ability to continue as a going concern

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

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company’s website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole
- the strategic report includes a fair review of the development and performance of the business and the position of the company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the company’s position, performance, business model and strategy

Paul Butler
Managing Director
15 July 2019

Andrew Farmer
Finance Director
15 July 2019

Independent auditor's report to the members of South East Water Limited

Report on the audit of the financial statements

Opinion

In our opinion:

- the financial statements of South East Water Limited (the 'parent company') and its subsidiaries (together, the 'group') give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2019 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and IFRSs as issued by the International Accounting Standards Board (IASB);
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements which comprise:

- the group and parent income statement;
- the group and parent statement of comprehensive income;
- the group and parent company statement of financial position;
- the group and parent company statements of changes in equity;
- the group and parent company cash flow statement; and
- the related notes 1 to 35.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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 group and the parent 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 group or the parent 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: · Bad debt provisioning · Revenue recognition - estimating unbilled revenue · Classification of costs between operating and capital expenditure
Materiality	The materiality that we used for the group financial statements was £3.4m (2018: £3.5m) which was determined on the basis of 3% of EBITDA.
Scoping	The group comprises South East Water Limited (the regulated water business) and its only subsidiary company South East Water (Finance) Limited (which issues part of the group's debt). Both of these companies were subject to a financial statement audit by the group audit engagement team.
Significant changes in our approach	Our approach in the current year is substantially consistent with prior year.

Conclusions relating to going concern, principal risks and viability statement

Going concern

We have reviewed the directors' statement on page 63 about whether they considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and their identification of any material uncertainties to the group's and company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Principal risks and viability statement

Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the group's and the company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

- the disclosures on pages 53 to 59 that describe the principal risks and explain how they are being managed or mitigated
- the directors' confirmation on page 104 that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity
- the directors' explanation on pages 102 to 103 as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We confirm that we have nothing material to report, add or draw attention to 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.

Bad debt provisioning	
Key audit matter description	The bad debt provision is a key area of accounting judgement within the water business and an area of scrutiny by Ofwat. As a proportion of South East Water's customers do not or cannot pay their bills, there is the need for a provision to be made for non-payment of part of the accounts receivable balance. We identified a key audit matter in relation to the bad debt provision as significant judgement is involved in determining the provision. The provision is determined based on an analysis of historical cash collection and estimation of future cash collectability of the aged debt balance as at 31 March 2019. We identified a risk of fraud in relation to this audit matter due to its impact on key performance metrics. The value of the bad debt provision at 31 March 2019 is £25.9m (2018: £28.1m). The value of trade receivables net of the provision at 31 March 2019 is £38.6m (2018: £34.5m). The Board of Directors also considered this an area of significant judgement as discussed in the Corporate Governance Report on page 87. This is also reflected as a key source of estimation uncertainty in note 3 to the financial statements and the relevant accounting policy adopted is disclosed in note 4. The bad debt provision is outlined further in note 21.
How the scope of our audit responded to the key audit matter	We have: · evaluated the design and implementation of key management review controls and those relating to data integrity within the bad debt model. · assessed the accuracy of information within the aged debt report to ensure that customers are accurately categorised based on information contained within the HiAffinity billing system. · assessed that the final provision has been forecast in line with the policy of the group through testing the mechanical accuracy of the provision model. · assessed that the final provision has been calculated in line with IFRS 9. · reviewed management's bad debt policy, specifically challenging whether the recoverability assumptions are reflective of current cash collection rates. · assessed whether any discrepancies exist between the provision recognised and that supported by current cash collection ratios and other macroeconomic indicators that may impact the ability of customers to make payments.
Key observations	We are satisfied that the assumptions applied in assessing the impairment of trade receivables are reasonable and have been applied appropriately to compute the bad debt provision.

Revenue recognition - estimating unbilled revenue	
Key audit matter description	For customers with meters, the revenue recognised depends upon the volume used, including an estimate of the sales value of units supplied between the date of the last meter reading and the balance sheet date. The unbilled accrual at 31 March 2019 was £32.4m (2018: £34.7m). The risk is focused on the usage estimate, which is based on historical data and assumptions around consumption patterns upon which management then recognise unbilled revenue. Due to the level of management judgement, the estimation of unbilled household revenue has been identified as a key audit matter. We have identified a risk of fraud in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance. The Board of Directors also considered this an area of significant judgement as discussed in the Corporate Governance Report on page 87. This is also reflected as a key source of estimation uncertainty in note 3 to the financial statements and the relevant accounting policy adopted is disclosed in note 4. Revenue is disclosed in note 6.
How the scope of our audit responded to the key audit matter	We have: · evaluated the design and implementation and tested the operating effectiveness of key controls within the unbilled revenue estimation. · evaluated management's controls around the techniques used to estimate consumption and other key data inputs into the model. · challenged the appropriateness of management's consumption assumptions for a sample of individual customers. · audited the analysis of the prior year accrued revenue with trend analysis to assess whether we are satisfied with any adjustments included in the 2018/19 accrual. · performed retrospective analysis of the bills raised during 2018/2019 relating to the 2017/2018 accrual to evaluate the ability of management to accurately estimate unbilled revenue. · involved our IT audit specialists to test the accuracy of the reports utilised by management in determining the required accrual.
Key observations	We are satisfied that management's estimates in relation to the recognition of unbilled revenue are appropriate.

Classification of costs between operating and capital expenditure	
Key audit matter description	The group continues to invest significantly in infrastructure renewal and replacement, with property, plant and equipment and intangible asset additions of £101m (2018: £92m) in the period. Expenditure in relation to increasing the capacity or enhancing the network is treated as capital expenditure ("capex"). Expenditure incurred in maintaining the operating capability of the network is expensed in the year in which it is incurred ("opex"). Capital projects can contain a combination of enhancement and maintenance activity which are not distinct and hence the allocation of costs between capital and operating expenditure is inherently judgemental. This risk also includes the inappropriate capitalisation of labour overheads. We have identified a risk of fraud in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance. The Board of Directors also considered capital expenditure as an area of significant judgement as discussed in the Corporate Governance Report on page 87. This is reflected as a key source of estimation uncertainty in note 3 to the financial statement and the relevant accounting policy adopted is disclosed in note 4. Capital expenditure is disclosed in note 17.
How the scope of our audit responded to the key audit matter	We have: · assessed the design and implementation and tested the operating effectiveness of key controls surrounding the capitalisation of costs and the manual transfer process. · assessed the group's capitalisation policy to determine compliance with relevant accounting standards and tested the operating effectiveness of controls over the application of the policy to expenditure incurred on projects within the capital programme. · for a sample of capital projects, we assessed the application of the capitalisation policy to the costs incurred by agreement to third party invoices and obtain explanations and further support for any significant changes in capital expenditure from budget. · challenged the assumptions and judgements made in allocating overheads to capital projects, through understanding the nature of activities performed.
Key observations	Based on our audit of a sample of capital projects, the testing of controls, and our review of the project budgets, we consider that the classification of costs between operating and capital expenditure is appropriate.

Our application of materiality

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

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

	Group financial statements	Parent company financial statements
Materiality	£3.40m (2018: £3.50m)	£3.37m (2018: £3.46m)
Basis for determining materiality	Materiality has been determined at 3% (2018: 3.25%) of EBITDA	
Rationale for the benchmark applied	We have used EBITDA as the benchmark for materiality as this is deemed a key driver of business value and is a critical component of the financial statements and is a focus for users of those financial statements. The substantial majority of the group's operations are carried out by the parent company.	

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.2m (2018: £0.2m), 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 group audit was scoped by obtaining an understanding of the group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level.

South East Water Limited and South East Water (Finance) Limited were subject to full scope audits and together account for 100% (2018: 100%) of the group's turnover, net assets, profit before tax, gains/ losses on financial instruments and exceptional items.

All work was carried out directly by the group audit 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 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.

We have nothing to report in respect of these matters.

Other information continued

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.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- **Fair, balanced and understandable –** the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit committee reporting –** the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee.

We have nothing to report in respect of these matters.

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 group's and the parent 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 group or the parent 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 group'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, financial instruments valuations, pensions and IT 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:
  - Debt provision - ability of management not to sufficiently provide against debts, and therefore directly manipulating the financial statements by having a reduced provision and an increased EBITDA;
  - Revenue recognition – the influence the accrued income balance has on key metrics which management utilise to monitor and report business performance;
  - Property, plant and equipment – the ability of management to capitalise costs in order to improve EBITDA position.
- obtaining an understanding of the legal and regulatory frameworks that the group 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 group. The key laws and regulations we considered in this context included the UK Companies Act, tax legislation and pension legislation. In addition, compliance with terms of the group's operating licence and the regulatory solvency requirements are fundamental to the group's ability to continue as a going concern.

Audit response to risks identified

As a result of performing the above, we identified debt provision, revenue recognition - estimating unbilled household customer income 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.

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 Ofwat; 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 group and of the parent company and their 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 by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company 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 these matters.

Other matters

Auditor tenure

Following the recommendation of the audit committee, we were appointed by the company to audit the financial statements for the year ending 31 March 2011 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is nine years, covering the years ending 31 March 2011 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.

William Farren FCA

Senior Statutory Auditor

for and on behalf of
Deloitte LLP
Statutory Auditor
London, United Kingdom
15 July 2019

Group income statement

for the year ended 31 March 2019

	Notes	2019 £000	2018 £000
Continuing operations			
Revenue	6	**238,281**	221,492
Bad debt	21	**(1,584)**	(1,199)
Group net operating costs	8	**(163,257)**	(154,068)
Other income	6	**12,997**	8,816
Group operating profit		**86,437**	75,041
Finance costs	10	**(56,110)**	(56,017)
Finance income	11	**6,076**	4,803
Profit before taxation		**36,403**	23,827
Taxation	13	**(6,992)**	(7,590)
Profit for the year from continuing operations		**29,411**	16,237
Discontinued operations			
Profit/(Loss) on discontinued operations	12	**9,253**	(69)
Profit for the year		**38,664**	16,168
Earnings per share			
Basic and diluted	15	**78.41p**	32.79p

Group statement of comprehensive income

for the year ended 31 March 2019

	Notes	2019 £000	2018 £000
Profit for the year		**38,664**	16,168
Items that will not be reclassified subsequently to profit or loss:			
Remeasurement of defined benefit (deficit)/surplus	28	**(3,525)**	9,355
Deferred tax on defined benefit pension schemes	13	**600**	(1,590)
		(2,925)	7,765
Total comprehensive income for the year attributable to owners of the company		**35,739**	23,933

Company income statement

for the year ended 31 March 2019

	Notes	2019 £000	2018 £000
Continuing operations			
Revenue	6	**238,281**	221,492
Bad debt	21	**(1,584)**	(1,199)
Company net operating costs	8	**(163,253)**	(154,065)
Other income	6	**12,997**	8,816
Company operating profit		**86,441**	75,044
Finance costs	10	**(56,153)**	(56,060)
Finance income	11	**6,058**	4,792
Profit before taxation		**36,346**	23,776
Taxation	13	**(6,981)**	(7,580)
Profit for the year from continuing operations		**29,365**	16,196
Discontinued operations			
Profit/(Loss) on discontinued operations	12	**9,253**	(69)
Profit for the year		**38,618**	16,127
Earnings per share			
Basic and diluted	15	**78.31p**	32.70p

Company statement of comprehensive income

for the year ended 31 March 2019

	Notes	2019 £000	2018 £000
Profit for the year		**38,618**	16,127
Items that will not be reclassified subsequently to profit or loss:			
Remeasurement of defined benefit (deficit)/surplus	28	**(3,525)**	9,355
Deferred tax on defined benefit pension schemes	13	**600**	(1,590)
		(2,925)	7,765
Total comprehensive income for the year attributable to owners of the company		**35,693**	23,892

Group statement of financial position

as at 31 March 2019

	Notes	31 March 2019 £000	31 March 2018 £000
Non-current assets			
Intangible assets	16	**10,501**	10,758
Property, plant and equipment	17	**1,555,123**	1,501,707
Amount due from parent undertaking	19	**189,911**	190,013
Defined benefit pension surplus	28	**25,564**	24,510
		1,781,099	1,726,988
Current assets			
Inventories	20	**592**	236
Trade and other receivables	21	**86,190**	78,255
Cash and cash equivalents	22	**12,804**	6,528
		99,586	85,019
Total assets		**1,880,685**	1,812,007
Current liabilities			
Loans and borrowings	23/24	**(254,890)**	(20,000)
Derivative financial instruments	23/24	**(108,836)**	–
Trade and other payables	26	**(92,263)**	(94,379)
Deferred income	29	**(7,183)**	(7,593)
Provisions	25	**(3,972)**	(2,515)
		(467,144)	(124,487)
Non-current liabilities			
Loans and borrowings	23/24	**(717,604)**	(900,897)
Trade and other payables	23/24	**(5,379)**	(5,979)
Derivative financial instruments	23/24	**–**	(104,169)
Net deferred tax liabilities	13	**(145,395)**	(140,085)
Defined benefit pension liability	28	**(3,154)**	(3,281)
Deferred income	29	**(3,185)**	(74,471)
		(874,717)	(1,228,882)
Total liabilities		**(1,341,861)**	(1,353,369)
Net assets		**538,824**	458,638
Equity			
Ordinary share capital	30	**49,312**	49,312
Revaluation reserve		**251,259**	256,396
Retained earnings		**238,253**	152,930
Total equity		**538,824**	458,638

The notes on pages 124 to 177 are an integral part of these financial statements.

The consolidated financial statements of South East Water Limited (company number 02679874) on pages 116 to 177 were approved by the board of directors and authorised for issue on 15 July 2019 and were signed on its behalf by:

Paul Butler

Managing Director
15 July 2019

Andrew Farmer

Finance Director
15 July 2019

Company statement of financial position

as at 31 March 2019

	Notes	**31 March 2019 £000**	31 March 2018 £000
Non-current assets			
Intangible assets	16	**10,501**	10,758
Property, plant and equipment	17	**1,555,123**	1,501,707
Amount due from parent undertaking	19	**189,911**	190,013
Defined benefit pension surplus	28	**25,564**	24,510
		1,781,099	1,726,988
Current assets			
Inventories	20	**592**	236
Trade and other receivables	21	**85,634**	77,701
Cash and cash equivalents	22	**12,607**	6,310
		98,833	84,247
Total assets		**1,879,932**	1,811,235
Current liabilities			
Loans and borrowings	23/24	**(254,890)**	(20,000)
Derivative financial instruments	23/24	**(108,836)**	-
Trade and other payables	26	**(92,961)**	(95,012)
Deferred income	29	**(7,183)**	(7,593)
Provisions	25	**(3,972)**	(2,515)
		(467,842)	(125,120)
Non-current liabilities			
Loans and borrowings	23/24	**(717,604)**	(900,897)
Trade and other payables	23/24	**(5,379)**	(5,979)
Derivative financial instruments	23/24	**-**	(104,169)
Net deferred tax liabilities	13	**(145,395)**	(140,085)
Defined benefit pension liability	28	**(3,154)**	(3,281)
Deferred income	29	**(3,185)**	(74,471)
		(874,717)	(1,228,882)
Total liabilities		**(1,342,559)**	(1,354,002)
Net assets		**537,373**	457,233
Equity			
Ordinary share capital	30	**49,312**	49,312
Revaluation reserve		**251,259**	256,396
Retained earnings		**236,802**	151,525
Total equity		**537,373**	457,233

The notes on pages 124 to 177 are an integral part of these financial statements.

The consolidated financial statements of South East Water Limited (company number 02679874) on pages 116 to 177 were approved by the board of directors and authorised for issue on 15 July 2019 and were signed on its behalf by:

Paul Butler
Managing Director
15 July 2019

Andrew Farmer
Finance Director
15 July 2019

Group statement of changes in equity

for the year ended 31 March 2019

	Issued share capital £000	Revaluation reserve £000	Retained earnings £000	Total equity £000
Balance at 1 April 2017	49,312	261,549	141,845	452,706
Profit for the year	-	-	16,168	16,168
Other comprehensive income:				
Remeasurement of defined benefit surplus/(deficit)	-	-	9,355	9,355
Deferred tax on defined benefit pension schemes	-	-	(1,590)	(1,590)
Total other comprehensive income	-	-	7,765	7,765
Total comprehensive income			**23,933**	**23,933**
Dividends (see note 14)	-	-	(18,000)	(18,000)
Amortise revaluation reserve	-	(6,129)	6,129	-
Release revaluation on disposals	-	(70)	70	-
Deferred tax on revaluation and retained earnings transfer	-	1,046	(1,046)	-
Balance at 31 March 2018	**49,312**	**256,396**	**152,931**	**458,639**
Change in accounting policy IFRS 15 (see note 5)	-	-	72,548	72,548
Change in accounting policy IFRS 9 (see note 3)			(102)	(102)
At 1 April 2018	**49,312**	**256,396**	**225,377**	**531,085**
Profit for the year	-	-	38,664	38,664
Other comprehensive income:				
Remeasurement of defined benefit surplus/(deficit)	-	-	(3,525)	(3,525)
Deferred tax on defined benefit pension schemes	-	-	600	600
Total other comprehensive income	-	-	(2,925)	(2,925)
Total comprehensive income			**35,739**	**35,739**
Dividends (see note 14)	-	-	(28,000)	(28,000)
Amortise of revaluation reserve	-	(6,127)	6,127	-
Release of revaluation reserve on disposals	-	(51)	51	-
Deferred tax on revaluation and retained earnings transfer	-	1,041	(1,041)	-
Balance at 31 March 2019	**49,312**	**251,259**	**238,253**	**538,824**

All transactions relate to the equity holders of the company.

Company statement of changes in equity

for the year ended 31 March 2019

	Issued share capital £000	Revaluation reserve £000	Retained earnings £000	Total equity £000
Balance at 1 April 2017	49,312	261,549	140,480	451,341
Profit for the year	-	-	16,127	16,127
Other comprehensive income:				
Remeasurement of defined benefit surplus/(deficit)	-	-	9,355	9,355
Deferred tax on defined benefit pension schemes	-	-	(1,590)	(1,590)
Total other comprehensive income	-	-	7,765	7,765
Total comprehensive income			**23,892**	**23,892**
Dividends (see note 14)	-	-	(18,000)	(18,000)
Amortise revaluation reserve	-	(6,129)	6,129	-
Release revaluation on disposals	-	(70)	70	-
Deferred tax on revaluation and retained earnings transfer	-	1,046	(1,046)	-
Balance at 31 March 2018	**49,312**	**256,396**	**151,525**	**457,233**
Change in accounting policy IFRS 15 (see note 5)	-	-	72,548	72,548
Change in accounting policy IFRS 9 (see note 3)			(102)	(102)
At 1 April 2018	**49,312**	**256,396**	**223,971**	**529,679**
Profit for the year	-	-	38,618	38,618
Other comprehensive income:				
Remeasurement of defined benefit surplus/(deficit)	-	-	(3,525)	(3,525)
Deferred tax on defined benefit pension schemes	-	-	600	600
Total other comprehensive income	-	-	(2,925)	(2,925)
Total comprehensive income			**35,693**	**35,693**
Dividends (see note 14)	-	-	(28,000)	(28,000)
Amortise of revaluation reserve	-	(6,127)	6,127	-
Release of revaluation reserve on disposals	-	(51)	51	-
Deferred tax on revaluation and retained earnings transfer	-	1,041	(1,041)	-
Balance at 31 March 2019	**49,312**	**251,259**	**236,802**	**537,373**

All transactions relate to the equity holders of the company.

Group statement of cash flows

for the year ended 31 March 2019

	Notes	2019 £000	2018 £000
Operating activities			
Net cash flow from operating activities		**125,023**	123,172
Interest received		**5,437**	4,554
Interest paid		**(36,940)**	(35,617)
Group tax relief paid		**(1,314)**	(4,036)
Net cash flow before investing and financing activities		**92,206**	88,073
Investing activities			
Proceeds from the sale of property, plant and equipment		**736**	264
Purchase of property, plant and equipment		**(97,132)**	(93,763)
Proceeds from the sale of non-household customer base		**9,156**	(69)
Purchase of intangible assets		**(2,997)**	(3,106)
Fixed asset contributions received		**–**	1,758
Net cash flow used in investing activities		**(90,237)**	(94,916)
Financing activities			
New bank loans received		**35,000**	20,000
Issue cost of new debt		**(2,693)**	–
Dividends paid to shareholder	14	**(28,000)**	(18,000)
Net cash flow from financing activities		**4,307**	2,000
Increase/(Decrease) in cash and cash equivalents		**6,276**	(4,843)
Cash and cash equivalents at the beginning of the year		**6,528**	11,371
Cash and cash equivalents at the year end	22	**12,804**	6,528

Group cash flow from operating activities

for the year ended 31 March 2019

	2019 £000	2018 £000
Profit for the year	**38,664**	16,168
Adjustments for:		
Income tax charge	**6,992**	7,590
Finance income	**(6,076)**	(4,835)
Finance costs	**56,110**	56,049
Depreciation and impairment of property, plant and equipment	**48,046**	46,253
Amortisation and impairment of intangibles	**3,254**	3,405
Profit on disposal of fixed assets	**(377)**	(120)
Proceeds from the sale of non-household customer base	**(9,253)**	69
Difference between pension contributions paid and amounts recognised in the income statement	**(4,086)**	(3,861)
Changes in working capital:		
(Increase)/Decrease in trade and other receivables	**(5,451)**	(5,958)
(Increase)/Decrease in inventory	**(356)**	(22)
Increase/(Decrease) in trade and other payables	**(2,444)**	8,434
Net cash flow from operating activities	**125,023**	123,172

Company statement of cash flows

for the year ended 31 March 2019

	Notes	2019 £000	2018 £000
Operating activities			
Net cash flow from operating activities		**125,027**	123,178
Interest received		**5,414**	4,543
Interest paid		**(36,910)**	(35,233)
Group tax relief paid		**(1,304)**	(4,016)
Net cash flow before investing and financing activities		**92,227**	88,472
Investing activities			
Proceeds from the sale of property, plant and equipment		**736**	264
Purchase of property, plant and equipment		**(97,132)**	(93,763)
Proceeds from the sale of non-household customer base		**9,156**	(69)
Purchase of intangible assets		**(2,997)**	(3,106)
Fixed asset contributions received/(paid)		**–**	1,758
Net cash flow used in investing activities		**(90,237)**	(94,916)
Financing activities			
New bank loans received		**35,000**	20,000
Issue cost of listed debt		**(2,693)**	–
Dividends paid to shareholder	14	**(28,000)**	(18,000)
Net cash flow from financing activities		**4,307**	2,000
Increase/(Decrease) in cash and cash equivalents		**6,297**	(4,444)
Cash and cash equivalents at the beginning of the year		**6,310**	10,754
Cash and cash equivalents at the year end	22	**12,607**	6,310

Company cash flow from operating activities

for the year ended 31 March 2019

	2019 £000	2018 £000
Profit for the year	**38,618**	16,127
Adjustments for:		
Income tax charge/(credit)	**6,981**	7,580
Finance income	**(6,058)**	(4,792)
Finance costs	**56,153**	56,060
Depreciation and impairment of property, plant and equipment	**48,046**	46,253
Amortisation and impairment of intangibles	**3,254**	3,405
Profit on disposal of fixed assets	**(377)**	(120)
Proceeds from the sale of non-household customer base	**(9,253)**	69
Difference between pension contributions paid and amounts recognised in the income statement	**(4,086)**	(3,861)
Changes in working capital:		
Increase in trade and other receivables	**(5,451)**	(5,955)
Increase in inventory	**(356)**	(22)
Increase/(decrease) in trade and other payables	**(2,444)**	8,434
Net cash flow from operating activities	**125,027**	123,178

Notes to the financial statements

for the year ended 31 March 2019

1. Authorisation of financial statements and statement of compliance with IFRSs

The financial statements of South East Water and its subsidiary (the "group") for the year ended 31 March 2019 were authorised for issue by the board of Directors on 15 July 2019 and the Statement of Financial Position was signed on the board's behalf by Paul Butler and Andrew Farmer. South East Water is a private company that has limited liability by shares and is incorporated in the United Kingdom and domiciled in England and Wales.

2. Basis of preparation

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union and applied in accordance with the Companies Act 2006.

The financial statements are prepared under the historical cost convention except for pension assets and liabilities and certain financial instruments that have been measured at fair value and certain assets under property, plant and equipment which were recognised at the date of transition to IFRS at deemed cost by reference to fair value.

The group financial statements are presented in Sterling and all values are rounded to the nearest thousand pounds (£000) except where otherwise indicated.

Basis of consolidation

These financial statements incorporate the financial information of South East Water Limited and its subsidiary South East Water (Finance) Limited (together the "group").

Transactions and balances between the company and its subsidiary have been eliminated fully on consolidation. Subsidiaries are consolidated from the date on which control is transferred to the group and cease to be consolidated from the date on which control is transferred out of the group.

3. Key judgements and sources of estimation uncertainty

Key judgements

The preparation of financial statements requires the application of judgements and assumptions by management which affects the value of assets and liabilities at the balance sheet date and income and expenditure for the year. Actual results may differ from those arrived at based on management's judgements and assumptions.

The most significant judgements and assumptions for the group are set out below:

- *revenue:* The adoption of IFRS 15 has required an assessment of performance obligations in our contracts with customers for the new or diverted mains and new connections to our mains network. For contracts where contributions are made for the laying of new mains or the diversion of existing mains, the performance obligation is the completion of the mains project and the acceptance by the customer that the main is available for use and meets the required standards. For contracts with customers for connection to the mains network, the performance obligation is the completion of the connections of the relevant properties or housing development to the mains network and the successful testing and acceptance of the connections by the customer
- *the useful lives of infrastructure and non-infrastructure assets:* the group's asset lives, as detailed on page 132, represent a key judgement which impacts the value of depreciation charged to the income statement. The useful lives of the asset categories which determine the value of depreciation charged to the income statement are reviewed annually and are based on management's judgement and experience. An impairment review of assets is also undertaken annually to write down the value of assets where it is considered appropriate to do so

Notes to the financial statements

for the year ended 31 March 2019

3. Key judgements and sources of estimation uncertainty (continued)

- *the capitalisation of employee and other directly attributable costs:* the group determines employee costs directly attributable to capital projects based on the time spent on the projects. Other directly attributable costs are then assessed. The costs relating to capital projects are then capitalised into individual projects. During the year £11.7 million of employee and other directly attributable costs have been capitalised (2018: £11.8 million)

In considering the judgements above, we have assessed the impact of the prospect of the UK leaving the European Union and we do not consider the impact to be material.

Key sources of estimation uncertainty

Estimates are required to be made by management when preparing the financial statements. These estimates affect the value of assets and liabilities at the balance sheet date and income and expenditure for the year. The estimates and underlying assumptions are reviewed on an ongoing basis with any revisions to accounting estimates recognised in the period in which the estimate is revised and future periods where the revision affects both current and future periods. The actual results may differ from those arrived at based on management's estimates.

The most significant estimates included in the group's financial statements are set out below:

- *unbilled water income at the year-end (Household customers):* metered customers are billed on a six monthly cycle. This means that at the year-end there is a large volume of water which has been supplied but not billed to customers. The value of unbilled water income at 31 March 2019 is estimated to be £32.4 million (2018: £34.7 million).

  The methodology for arriving at the value of unbilled consumption incorporates estimates of water used based on historical consumption data and the relevant tariffs for customers. Previously billed consumption history provides a reliable basis for the estimate that is included in the financial statements. Our historical analysis of consumption indicates that billed revenue has been within two per cent of our previous estimates of the value of unbilled consumption.

  The sensitivity of the estimate of unbilled consumption is illustrated in the table below where the impact of fluctuations in estimated water consumption of one per cent and three per cent have been set out. These variants have been selected because, as stated above, our annual assessment of unbilled revenue is within 2 per cent of actual billed revenue.

	31 March 2019	Sensitivity			
		+1%	+3%	-1%	-3%
Unbilled water income	£32.4m	+£0.3m	+£1.0m	-£0.3m	-£1.0m

Unbilled water income at the year-end (Wholesale customers): Water revenue chargeable to wholesale customers is governed by the Market Settlement Process and information provided by the Central Market Operating System. System data is used to estimate the amount of unbilled revenue in respect of wholesale customers. As at 31 March 2019, the level of unbilled revenue was estimated to be £4.6 million.

	31 March 2019	Sensitivity			
		+1%	+3%	-1%	-3%
Unbilled water income	£4.6m	+£0.05m	+£0.14m	-£0.05m	-£0.14m

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

3. Key judgements and sources of estimation uncertainty (continued)

- *the provision for doubtful trade receivables:* management estimates the provision for doubtful debts or expected credit loss by applying expected recovery rates to aged debt. The value of the provision for doubtful debts as at 31 March 2019 was £25.9 million (2018: £28.1 million).

  The company employs the practical expedient allowed under IFRS 9 when calculating the lifetime expected credit loss for trade receivable. The methodology for determining the expected credit loss at the year-end incorporates the identifications of customer debt categories and the estimation of cash collection percentages for different customer categories. The estimated cash collection percentages take into account historical performance and current and expected future environmental and economic conditions. Debts over 4 years old are regarded as credit impaired and fully provided as, based on experience, our best estimate is that debt over four years old is not recoverable. Therefore, the estimated cash collection percentages are only applicable to debt which is less than four years old.

The sensitivity of the bad debt provision is illustrated in the table below where the impact of fluctuations in estimated future cash collections of one per cent and three per cent have been set out. The sensitivity analysis of one per cent and three per cent has been set based on commercial judgement and considers a range of economic, socio-economic, environmental and commercial factors.

	31 March 2019	Sensitivity			
		+1%	+3%	-1%	-3%
Bad debt provision estimate	£25.9m	+£0.3m	+£0.8m	-£0.3m	-£0.8m

- *Pension and other post-employment benefits:* there are a range of variables required to be determined to value the company's defined benefit pension schemes and the underlying costs of providing post-employment benefit.

  The costs of defined benefit pension schemes are determined using actuarial valuations. The actuarial valuations are determined by using certain assumptions for discount rates, mortality rates, expected return on assets and corporate bond performance projections as set out in note 28. Pension increases are based on expected future inflation rates. The net defined benefit pension scheme asset at 31 March 2019 is £22.4 million (2018: asset of £21.2 million). The Trust Deed provides South East Water with an unconditional right to a refund of surplus assets, assuming the full settlement of plan liabilities in the event of a plan winding-up. Furthermore, in the ordinary course of business the Trustee has no rights to unilaterally wind-up or otherwise augment the benefits due to members of the scheme. Based on these rights, any net surplus in the UK schemes is recognised in full.

  The sensitivity of the estimate of the surplus in the pension schemes is illustrated in the table below where the impact of fluctuations in prevailing market conditions on key assumptions of discount rate, inflation and life expectancy have been set out.

Sensitivities	Decrease in schemes' surplus	
0.1% decrease to the discount rate	£4.0m	1.5%
0.1% increase to inflation	£4.0m	1.5%
One year increase in life expectancy	£10.5m	3.8%

In considering the judgements above, we have assessed the impact of the prospect of the UK leaving the European Union and we do not consider the impact to be material.

Notes to the financial statements

for the year ended 31 March 2019

4. Accounting policies

The principal accounting policies adopted by the group are set out below. These policies have been consistently applied in both the current and prior years, except for those changes required due to the mandatory adoption of new reporting standards, specifically IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*.

New standards and interpretations adopted

In the current year, the group has applied a number of amendments to IFRS's issued by the International Accounting Standards Board ("IASB") that are mandatorily effective for accounting periods beginning on or after 1 January 2018. Their adoption has not had any material impact on the disclosures or on the amounts reported in these financial statements.

On 1 April 2018, the group adopted IFRS 9 *Financial Instruments* ("IFRS 9"). IFRS 9 specifies how the group should classify and measure financial assets and liabilities.

When considering the classification of financial instruments, IFRS 9 has three classifications for financial assets, being:

- amortised cost – an asset is measured at amortised cost if:
  - the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
  - the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
- fair value through other comprehensive income – financial assets are classified and measured at fair value through other comprehensive income if they are held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets
- fair value through profit or loss – any financial assets that are not held in one of the two business models mentioned are measured at fair value through profit or loss

IFRS 9 does not change the classifications of financial liabilities from the current IAS 39 requirements. IFRS 9 requires all financial liabilities to be measured at amortised costs, except for financial liabilities through profit or loss. Liabilities measured at fair value through profit or loss include:

- derivative financial instruments
- liabilities held for trading
- liabilities an entity designates as fair value through profit or loss

An entity may, at initial recognition, designate a liability at fair value through profit or loss if doing so would eliminate or substantially reduce a measurement or recognition inconsistency. After initial recognition, an entity cannot reclassify a financial liability.

When measuring a financial asset, any impairment of the asset should be recognised in stages:

- on initial recognition of a financial instrument, 12-month expected credit losses are recognised in profit or loss and a provision for the loss is established. This serves as a proxy for the initial expectations of credit losses. Interest revenue is calculated on the original amount of the asset
- where the credit risk significantly increases on an asset and is no longer considered low, full lifetime expected credit losses are recognised in profit or loss. Interest revenue is calculated on the original amount of the asset
- where the credit risk increases to the point that an asset is considered impaired, full lifetime expected credit losses are recognised in the profit or loss. Interest revenue is calculated on the amortised cost being the original value of the asset less the provision for expected credit losses

Notes to the financial statements

for the year ended 31 March 2019

4. Accounting policies (continued)

In adopting the Standard, the group has assessed the classification of its financial instruments and reclassified its financial assets as follows:

Financial asset	IAS 39 classification	IFRS 9 classification
Amount due from parent due in more than one year	Loans and receivables	Measured at amortised cost
Trade receivables	Loans and receivables	Measured at amortised cost
Accrued income	Loans and receivables	Measured at amortised cost
Amounts due from parent and fellow subsidiary undertakings due within one year	Loans and receivables	Measured at amortised cost

There were no changes to the classification of the company's financial liabilities.

The group has considered the credit risk of its financial assets and concluded that:

- the policy for provision for doubtful trade debts should be updated to include allowance for future environmental and economic conditions. In making this change management has concluded that no adjustment is required or has been recorded to the provision previously calculated under their old accounting policy following the adoption of IFRS 9; and
- the risk of non-recovery of the group's parent loan is considered very small. In accordance with the requirements of IFRS 9, management has assessed the risk and recognised an allowance on transition for credit loss of £102,000 in its opening retained earnings. A provision for this allowance has been created and offset against the carrying value of the relevant asset in the group statement of financial position.

Also on 1 April 2018, the group adopted IFRS 15 ***Revenue from Contracts with Customers*** ("IFRS 15"). IFRS 15 establishes the principles the group applies when reporting information about revenue and the cash flows arising from contracts with customers. In adopting the standard the group has applied the steps for recognising revenue from customers. IFRS 15 has been adopted using the modified retrospective method which has led to the accumulated historical adjustments being made to the opening balances at 1 April 2018. A detailed explanation of the adoption of IFRS 15 and the impact on the financial statements is provided in note 5.

New standards and interpretations not applied

As the group prepares their financial statements in accordance with IFRS as adopted by the European Union, the application of new standards and interpretations will be subject to their having been endorsed for use in the EU via the EU Endorsement mechanism. In the majority of cases this will result in an effective date consistent with that given in the original standard or interpretation but the need for endorsement restricts the group's discretion regarding early adoption of the standards.

Notes to the financial statements

for the year ended 31 March 2019

4. Accounting policies (continued)

At the date of these financial statements, the following Standards and Interpretations were in issue but not yet effective (and in some cases had not yet been adopted by the EU) and have not been applied to these Financial Statements:

IFRS 3 (amended)	Business Combinations
IFRS 9 (amended)	Financial Instruments
IFRS 16	Leases
IFRS 17	Insurance contracts (replaces IFRS 4)
IAS 1 (amended)	Presentation of Financial Statements
IAS 19 (amended)	Employee Benefits
IAS 28 (amended)	Investments in Associates and Joint ventures
IFRIC 23	Uncertainty over Income Tax Treatments

The directors do not expect that the adoption of the standards listed above will have a material impact on the financial statements of the group in future periods with the exception of IFRS 16 Leases, the impact of which is explained below.

IFRS 16 Leases

IFRS 16 is effective for periods commencing on or after 1 January 2019 and therefore will first be adopted by the Group for the year ending 31 March 2020. For lessees, IFRS 16 removes the distinction between operating and finance leases and requires the recognition of a right of use asset and corresponding liability, equating to the present value of the future lease payments. The Group currently holds the following operating leases under IAS 17 which meet the criteria under IFRS 16 for such recognition.

Leased asset	Start date	End date	Annual rent £000	Values of assets and liabilities on adoption £000
Laboratory at Farnborough	22 May 2015	21 May 2035	195	2,467
Unit at Brooke House, Larkfield	8 Aug 2018	7 Aug 2021	19	43
Water Tower at Blackhill, Camberley	19 Jan 2004	14 Jun 2022	17	206
Offices at Leithrim House, Larkfield	4 Apr 2018	4 Apr 2028	67	536
			298	3,252

The annual rents for these leases are currently charged to the income statement as operating costs under IAS 17. On adoption of IFRS 16, rights of use assets will be recognised under property, plant and equipment at an initial value of £3.3 million and the corresponding lease liabilities will be recognised as financial liabilities of the same value.

The initial values of the right of use assets and corresponding liabilities on adoption of IFRS 16 equate to the present value of future lease payments under the relevant lease contracts. Under the modified approach adopted by the group, the discount rates used reflect the interest rates at which the group would currently be able to borrow in order to finance similar assets to those under the leases affected by transition (the incremental borrowing rate).

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

4. Accounting policies (continued)

The company has recently entered into loan facilities at fixed rates and with weighted average repayment maturities comparable with the lengths of the leases affected by transition. It was, therefore, decided that the interest rates attached to the new facilities were appropriate proxies for the incremental borrowing rates to be applied in calculating the present value of the future leases liabilities, as follows:

- lease length of zero to ten years remaining on transition – 2.94 per cent
- lease length of ten to twenty years remaining on transition – 3.22 per cent

Revenue

Revenue is recognised by applying the five criteria detailed in IFRS 15 Revenue from Contracts with Customers. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the group, the performance obligations in the contracts with "named" customers have been met and the revenue can be reliably measured. All revenue arises within the United Kingdom and is recorded net of VAT. The company only recognises revenue in respect of "named" customers.

Metered and unmetered income

The performance obligation of the company for metered and unmetered income is the supply of potable water to each named customer in the period under review.

Metered water income is recognised when water has been delivered to the customer and the performance obligation has been satisfied for the period. This income includes an estimation of the volume of mains water supplied but unbilled at the year end. This is estimated using a defined methodology as detailed under key sources of estimation uncertainty above.

Unmetered water income was invoiced in full for the financial year 2018/19 on 1 April 2018 and is recognised over the year as water is supplied to the named customer and the performance obligation is satisfied.

Cash received in advance from customers is not treated as current year revenue, being recognised as payments received in advance within creditors.

Infrastructure charges

Infrastructure charges represent the fees charged to property developers and others for connecting new properties and water outlets to the group's network. The performance obligation within these contracts is the completed connection of the relevant properties and outlets to the mains supply. These fees are recognised in the income statement upon completion of the performance obligation.

Grants and contributions

Grants and contributions are received in respect of both infrastructure and non-infrastructure assets and are usually received in advance of the work being undertaken by the company. The receipts are recognised as deferred income on the balance sheet upon receipt. The performance obligations for this income stream is the completion of the work to which contributions relate. The income is recognised in the income statement upon completion of the specific performance obligations.

Other income

Other income includes rechargeable works' charges and charges for engineering, scientific, laboratory, billing and cash collection services.

The performance obligations for rechargeable works are the installation of meters and the connection to new property developments to the mains supply. The income for rechargeable works is recognised when the performance obligations are completed.

Notes to the financial statements

for the year ended 31 March 2019

4. Accounting policies (continued)

The performance obligations for the remaining other income is for the supply of services as detailed in the specific contracts with customers and is recognised in the income statement when the work to which it relates is complete.

Finance income

Finance income is recognised using the effective interest rate method.

Taxation

Current tax, being UK Corporation Tax, is provided at amounts expected to be paid (or recovered) using tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Tax relating to items recognised directly in equity is also recognised directly in equity and not in the income statement.

Deferred tax is provided using the liability method on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred tax liabilities are recognised for all taxable temporary differences except where the deferred tax liability arises from goodwill amortisation or the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets are recognised for all deductible temporary differences and the carry forward of unused tax assets and losses to the extent that it is probable that taxable profits will be available against which the deductible temporary differences and the carry forward of unused tax assets and losses can be utilised.

Deferred tax assets are recognised for the deductible temporary differences arising from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction affects neither the accounting profit nor taxable profit or loss.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date. In accordance with IAS 12 ***Income Taxes***, deferred taxes are not discounted.

Dividends

Dividends are recorded in the financial statements in the year in which they are approved by the board.

Investments in subsidiaries

Investments are recorded at historical cost. Where the directors are of the opinion that there has been a permanent diminution in the value of investments, the carrying amount of such investments is written down to the recoverable amount.

Intangible assets

Software

Software intangible assets externally acquired are recognised at cost. They have finite useful lives and are amortised over three to five years on a straight-line basis. Residual values and useful lives of all assets are re-assessed annually and, where necessary, changes are accounted for prospectively.

Employee and other costs directly attributable to intangible asset projects are capitalised in the financial statements as part of the cost of the intangible asset to which they relate. Training costs, administration and other general overhead costs including interest are not capitalised.

Notes to the financial statements

for the year ended 31 March 2019

4. Accounting policies (continued)

Derecognition

An intangible asset is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset, calculated as the difference between the net disposal proceeds and the carrying amount of the item, is included in the income statement in the year in which the item is derecognised.

Property, plant and equipment

Infrastructure assets

Infrastructure assets comprise a network of systems relating to water distribution. Infrastructure assets in the course of construction are depreciated from the time they are brought into use and are stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the assets, being between 20 years and 100 years for all infrastructure assets, except surface reservoirs, which have useful economic lives of 250 years.

Non - infrastructure assets

Freehold land is not depreciated. Assets in the course of construction are depreciated from the time they are brought into use. All other non-infrastructure assets are stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

	Years
Freehold buildings	80
Operational structures	50-80
Fixed plant and machinery	10-35
Meters, vehicles, mobile plant, computers, furniture and office equipment	3-10

Derecognition

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year the item is derecognised.

Residual values and useful lives

Residual values and useful lives of all assets are re-assessed annually and, where necessary, changes are accounted for prospectively.

Capitalisation of employee and other directly attributable costs

Employee and other costs, including borrowing costs, directly attributable to capital projects are capitalised in the financial statements as part of the cost of the property, plant and equipment to which they relate. Training costs, administration and other general overhead costs are not capitalised.

Leased assets

Property, plant and equipment held under finance leases are capitalised at the lower of the fair value of the leased asset and the present value of the minimum lease payments. These assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Notes to the financial statements

for the year ended 31 March 2019

4. Accounting policies (continued)

Impairment of property, plant and equipment, investments and intangible assets

At each reporting date an assessment is carried out to determine whether there is any indication that property, plant and equipment, investments and software intangible assets may be impaired. If there is an indication of impairment, the recoverable amount of the asset or respective cash-generating unit is compared to the carrying amount. Where the recoverable amount is less than the carrying amount, the asset value is reduced to the recoverable amount with an impairment loss recognised as an operating cost in the income statement in the year in which the respective assessment takes place.

Borrowing costs

Borrowing costs are incurred on the group's general borrowings. Where appropriate borrowing costs are attributed to qualifying assets in line with IAS 23 Borrowing Costs. Otherwise borrowing costs are expensed as incurred. See note 10 for further details.

Inventory

Inventory is valued at the lower of average cost or net realisable value. The stocks of treated water held by the group are valued at £nil. Consumable chemical purchases are recognised as an expense in the income statement at the point they received on site for use, either from central stores or from suppliers direct.

Work-in-progress for chargeable services is valued at the lower of cost and net realisable value.

Short-term trade and other receivables

Short-term trade receivables are initially measured at their transaction price in line with the provisions of IFRS 9. The carrying value for trade receivables includes an allowance for the lifetime expected credit loss (doubtful debts) of the outstanding debts. An estimate for the expected credit loss is calculated by the group's management in accordance with the defined methodology detailed under key sources of estimation uncertainty above.

Cash and cash equivalents

Cash and cash equivalents in the statement of financial position comprise cash at bank and in hand and short term deposits with an original maturity of three months or less.

Included within cash and cash equivalents are amounts that are held in designated bank accounts as short-term deposits in order to meet the interest and associated swap payments falling due in respect of listed debt and other long-term borrowings.

Trade payables

Trade payables are measured at fair value and subsequently measured at amortised cost.

Financial instruments

The group's financial instruments comprise fixed and variable rate borrowings, index linked loans, fixed rate debentures, an interest rate swap, finance leases, a loan to its parent undertaking, cash, short-term and medium-term bank deposits, trade receivables and trade and other payables.

Recognition

Financial instruments are recognised on the statement of financial position when the group becomes party to the contractual provisions of the instrument. The group determines the classification of its financial liabilities at initial recognition.

Notes to the financial statements

for the year ended 31 March 2019

4. Accounting policies (continued)

Impairment of financial assets

A provision for twelve month expected credit loss on new financial assets is recognised in the income statement to establish a loss allowance on initial recognition in line with the impairment requirements of IFRS 9.

At each reporting date an assessment is carried out to determine whether there is any indication that the credit risk on financial assets has increased significantly. If this is considered to be the case, full life-time expected credit loss is recognised in the income statement.

Where there is objective evidence that an impairment loss has arisen, the loss is recognised in the income statement in the year in which the respective assessment takes place. Impaired debts are derecognised when they are assessed as irrecoverable.

Derecognition

Financial liabilities are removed from the statement of financial position when the related obligation is discharged, cancelled or it expires.

Financial assets are removed from the statement of financial position when the rights to the cash flows from the asset expire, or when the risks and rewards of ownership of the asset are transferred or when control of the asset is transferred.

Embedded derivatives

Financial instruments that are not carried at fair value through the income statement are reviewed to determine if they contain embedded derivatives. Embedded derivatives are accounted for separately as derivative financial instruments when the economic characteristics and risks are not closely related to the respective host financial instrument.

Derivative financial instruments

The group uses an interest rate swap to hedge its risks associated with certain interest rate fluctuations. This use does not qualify for hedge accounting. Derivative financial instruments are recognised initially and subsequently in the statement of financial position at fair value through profit or loss with any movements during the year charged or credited to the income statement. The fair value is determined by reference to market values for similar instruments.

Interest bearing loans and borrowings

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

Interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Revaluation reserve

The revaluation reserve was created on the adoption of IFRS when company took the option to treat the revalued amounts as deemed cost. This reserve, is released over the life of the underlying assets to which it relates in line with the depreciation of the revalued assets and transferred to retained earnings. The revaluation uplift remaining on any assets that are disposed of is also transferred to retained earnings at the time of the disposal.

Notes to the financial statements

for the year ended 31 March 2019

4. Accounting policies (continued)

Leases

Finance leases, which substantially transfer to the group all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease with a corresponding liability being recognised, at the lower of the fair value of the leased asset and the present value of the minimum lease payments.

Lease payments are apportioned between the finance charges and reduction of the lease liability to achieve a constant rate of interest on the remaining balance of the liability.

Provisions

A provision is recognised when the group has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are measured at management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. Where the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects the risks specific to the liability.

Research and development

Research costs are charged to the income statement in the year in which they are incurred.

Development costs are capitalised based on management's judgement that the technological and economic feasibility of a project is confirmed, usually when a project has reached a defined milestone according to an established project management model. In determining the amounts to be capitalised management makes assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits.

Pension and other post-employment benefits

The group accounts for pensions and other post-employment benefits under IAS 19(R). The group operates both defined benefit and defined contribution pension schemes. Defined benefits are provided using both funded and unfunded pension plans.

Defined contribution plans

Contributions to defined contribution plans are recognised as an expense in the income statement when the contributions fall due.

Defined benefit plans

The pension scheme asset or liability in the statement of financial position represents the net present value of the defined benefit obligation and the fair value of scheme assets at the balance sheet date. The present value of the defined benefit obligation is analysed between the funded and unfunded pension plans.

The present value of the defined benefit obligation and the cost of providing benefits under defined benefit plans is determined on a triennial basis, and updated to each year end by an independent qualified actuary using the Projected Unit Credit actuarial valuation method, discounted at an interest rate equivalent at measurement date to the rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities.

Notes to the financial statements

for the year ended 31 March 2019

4. Accounting policies (continued)

The pension cost in the income statement includes current and past service cost and the effect of any settlements and curtailments. A net finance charge or credit is recognised within finance costs in the income statement and comprises the net of the expected return on pension scheme assets and the interest on pension scheme liabilities.

All actuarial gains and losses and the related current and deferred taxation are recognised in the statement of recognised income and expense.

5. Adoption of IFRS 15

The group adopted IFRS 15 on 1 April 2018 using the modified retrospective method. IFRS 15 delivers its core principles of revenue recognition in a five step framework as follows:

1 Identify the contracts with customers.
2 Identify the performance obligations in the contract.
3 Determine the transaction price.
4 Allocate the transaction price to the performance obligations in the contract.
5 Recognise revenue as and when performance obligations are met.

The group has a number of different income streams that need to be considered in the context of IFRS 15.

Income from the supply of water services is currently recognised as the service is supplied. Under IFRS 15 there is no significant judgment required in identifying the customer in these contracts with customers. The performance obligations are the supply of the water services and revenue is recognised as these obligations are satisfied over time. The adoption of the new standard has had no material impact on the timing and amount of revenue recognised in these services.

Other income, including billing and collections services and laboratory services, involve similarly readily identifiable contracts with customers with clearly defined performance obligations to which prices are allocated.

The performance obligations on contracts for the billing and collection services are:

- **to produce bills for mutual customers of both parties to the contract, either monthly, six monthly or annually, as required, which includes the potable water charges levied by the company and the sewerage charges levied by the other party to the contract;**
- **to collect payment for the joint bills from customers in line with the company's collection processes and to pay the cash collected in respect of the sewerage element of the joint bills to the other parties on agreed terms**

The performance obligations for the laboratory services contracts are the completion of scientific analysis of samples provided by the third party to ensure their compliance with their regulatory responsibilities.

Revenue is recognised as the contracts are completed and the performance obligations satisfied. This is in line with the existing accounting policies for these income streams under IAS 18 Revenue.

Income from transactions relating to the group's network assets in providing a network connection and on-going access to the network ("capital income") requires significantly more judgment in identifying contracts with customers and the related performance obligations.

Notes to the financial statements

for the year ended 31 March 2019

5. Adoption of IFRS 15 (continued)

Capital income can be categorised under the following headings:

- infrastructure charges
- new connections income
- developer contributions to new mains and mains diversions

Infrastructure charges were previously recognised in the income statement when access to the mains supply is granted. This treatment is consistent with the principles of IFRS 15 and no change is required for this income stream.

New connections income, to the extent it relates to the cost of the new connection, and developer contributions were previously held as deferred income on the statement of financial position and released to the income statement over the life of the underlying assets.

These activities relate to the establishing a connection to the water network and are performed for developers. Each of these activities are performed as separate contracts with the developers as required and on request from developers. Not all developments require all of these activities to be performed. The overall result from these contracts is that properties are allowed access to the network prior to the properties being sold. These activities are part of the group's ordinary activities associated with the operation, maintenance and expansion of a water network and, because they are deemed to result in an exchange transaction, we have determined that they fall within the scope of IFRS 15 as transactions arising from contracts with customers, i.e. the developers who request the services.

The performance obligations in contracts for the different capital related income streams are recognised as:

- infrastructure charges – the provision of access to the network
- new connections income – the connection of individual properties via a communication pipe to the mains supplying the development
- developer contributions to new mains and mains diversions – the completion of the laying of a new main or replacement main, as defined by the contract

The prices attaching to these contracts and relating to these performance obligations are set in line with the guidance provided by Ofwat. In the case of infrastructure charges and new connections a number of properties are aggregated together in determining when performance obligations are completed and the price relating to the obligation.

Revenue is recognised on each of these capital income streams on completion of the performance as described above.

Applying IFRS 15 has resulted in a significant change to the accounting policy for new connections income and developer contributions to new and diverted mains.

At the date of adoption of IFRS 15, the group had £75.7 million of deferred income in respect of infrastructure charges, new connection charges and developer contributions to new and diverted mains. Of this amount, £71.9 million related to contracts that have been completed and where the assets are in current use. An adjustment has been made to deferred income upon adoption of IFRS 15 for the contributions on completed jobs and retained earnings has increased by £71.9 million accordingly.

In addition, non-current trade and other payables includes amounts received from developers for self-lay, discounted aggregate deficit and relevant deficit schemes of £5.4 million at 1 April 2018. Of this amount, £0.5 million related to projects that have been completed in prior years and are not refundable to the developers. An adjustment has been made to non-current trade and other payable for the amounts received in respect of completed jobs and retained earnings has increased by £0.5 million accordingly.

Notes to the financial statements

for the year ended 31 March 2019

5. Adoption of IFRS 15 (continued)

The remaining amounts received from developers at 1 April 2018, being £3.8 million in respect of contributions and £4.9 million in respect of self-lay and similar schemes, relate to contracts where the performance obligations have not yet been satisfied. These will be recognised in the income statement on completion of the respective performance obligation under each contract.

	£000
Non-current trade and other payables	543
Deferred Tax	107
Non-current deferred income	71,898
Increase in net assets	72,548
Increase in retained earnings	72,548

The adjustments to non-current trade and other payables and non-current deferred income reflect the release of deposits and contributions from developers for contracts that have been completed in prior years. The revenue from these contracts has previously been amortised over the lives of the assets to which they relate.

The impact of the adoption of IFRS 15 on the Group's income statement and statement of financial position in the year are disclosed in the following table together with an explanation of each adjustment value.

Group income statement	**31 March 2019 pre IFRS 15 £000**	**Adoption of IFRS 15 £000**	**31 March 2019 Post IFRS 15 £000**
Revenue			
Water income	224,229	–	224,229
Other sales	7,610	6,442	14,052
Total revenue	**231,839**	**6,442**	**238,281**
Bad debt	(1,584)	–	(1,584)
Group net operating costs	(161,318)	(1,939)	(163,257)
Other income	12,997	–	12,997
Group operating profit	**81,934**	**4,503**	**86,437**
Net finance costs	(50,034)	–	(50,034)
Profit before taxation	**31,900**	**4,503**	**36,403**
Taxation	(6,992)	–	(6,992)
Profit for the year from continued operation	**24,908**	**4,503**	**29,411**
Profit on discontinued operation	9,253	–	9,253
Profit for the year	**34,161**	**4,503**	**38,664**

Notes to the financial statements

for the year ended 31 March 2019

5. Adoption of IFRS 15 (continued)

- Other sales have increased by £6.4 million. The increase is due to the deposits and contributions received from developers for completed contracts in the year being released to the income statement. Previously, only an amount for the amortisation of contributions would have been released and the overhead recovery would have been offset against operating costs.
  The adjustment is made up as follows:

	£000
Release of contributions	805
Release of new connections income	6,710
Release of deposits	154
Total deferred income released	**7,669**
Reduction in amortisation of contributions	(1,227)
Net increase in profit for the year	**6,442**

- Group net operating costs have increased by £1.9 million. The increase reflects the overhead recovery on new connections that was previously offset against operating costs and is now included in other sales above.
- The adjustment to taxation reflects the additional tax charged on the above adjustments. The additional tax has been relieved against losses in other companies in the HDF group of companies.

Notes to the financial statements

for the year ended 31 March 2019

5. Adoption of IFRS 15 (continued)

Group statement of financial position	**31 March 2019 pre IFRS 15 £000**	**Adoption of IFRS 15 £000**	**31 March 2019 Post IFRS 15 £000**
Non-current assets	**1,781,099**	**–**	**1,781,099**
Current assets	**99,586**	**–**	**99,586**
Total assets	**1,880,685**	**–**	**1,880,685**
Current liabilities			
Loans and borrowings	(254,890)	–	(254,890)
Derivative financial instruments	(108,836)	–	(108,836)
Trade and other payables	(92,263)	–	(92,263)
Deferred income	(7,183)	–	(7,183)
Provisions	(3,972)	–	(3,972)
Non-current liabilities			
Loans and borrowings	(717,604)	–	(717,604)
Trade and other payables	(6,076)	697	(5,379)
Net deferred tax liabilities	(145,502)	107	(145,395)
Defined benefit pension liability	(3,154)	–	(3,154)
Deferred income	(79,432)	76,247	(3,185)
Total liabilities	**(1,418,912)**	**77,051**	**(1,341,861)**
Net assets	**461,773**	**77,051**	**538,824**
Equity			
Ordinary share capital	49,312	–	49,312
Revaluation reserve	251,259	–	251,259
Retained earnings	161,202	77,051	238,253
Total equity	**461,773**	**77,051**	**538,824**

- Current and non-current deferred income has decreased by £76.2 million reflecting the release of historical contribution to the opening balance of retained earnings and the additional release of contributions and new connections income over the amortisation of contributions
- Non-current trade and other payables has reduced by £0.7 million being the release of deposits to other sales.

The adoption of IFRS 15 has had no impact on the group statement of changes in equity in the year other than to adjust the opening balances on retained earnings and total equity and those changes to retained earnings and total equity for the year as detailed in this note.

The adoption of IFRS 15 has had no impact on the group statement of cash flows.

Notes to the financial statements

for the year ended 31 March 2019

6. Total income

Group and company	**2019 £000**	2018 £000
Revenue		
Unmetered water income	**24,966**	34,868
Metered water income	**199,278**	180,363
Unmetered sewerage income	**–**	–
Metered sewerage income	**(15)**	–
Other sales	**14,052**	6,261
Total revenue	**238,281**	221,492
Other income		
Rental income	**1,233**	1,178
Sundry income	**11,764**	7,638
Total other income	**12,997**	8,816
Total income	**251,278**	230,308

All revenue is from customers within the United Kingdom.

Other sales includes new connections income of £7.7 million (2018: £nil), infrastructure income of £5.2 million (2018: £4.1 million) and capital contributions of £1.0 million (2018: £nil).

Sundry income includes charges for billing and cash collection services amounting to £8.1 million (2018: £4.8 million), and laboratory income of £2.3 million (2018: £2.0 million).

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

7. Segmental analysis

The group's revenue mainly arises from the supply of water and related activities. The activities of the group, for management purposes, fall into three operating areas being the supply of potable water on a wholesale and retail basis, both of which are governed by the Water Act 2014, and related non-regulated activities.

Year ended 31 March 2019	Wholesale activities £000	Retail activities £000	Other activities £000	Total £000
Total income	217,705	21,379	12,194	251,278
Operating profit	76,996	4,901	4,540	86,437
Finance costs				(56,110)
Finance income				6,076
Profit before taxation				36,403
Taxation				(6,992)
Profit from continued operation				29,411
Profit from discontinued operation				9,253
Profit for the year				**38,664**
Year ended 31 March 2018				
Total income	200,438	21,986	7,884	230,308
Operating profit	66,903	6,061	2,077	75,041
Finance costs				(56,017)
Finance income				4,803
Profit before taxation				23,827
Taxation				(7,590)
Profit from continued operation				16,237
Loss from discontinued operation				(69)
Profit for the year				16,168

The group analyses results by segment to operating profits only, so no segmental statement of financial position or statement of cash flows are presented.

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

8. Net operating costs

	Notes	Group		Company	
		2019 £000	2018 £000	**2019 £000**	2018 £000
Employee benefits expense (see note 9)		**30,078**	28,490	**30,078**	28,490
Asset expense/(income):					
Depreciation – owned assets		**47,456**	45,655	**47,456**	45,655
Depreciation – leased assets		**579**	579	**579**	579
Impairment of fixed assets		**10**	19	**10**	19
Amortisation of intangible assets		**3,129**	3,399	**3,129**	3,399
Impairment of intangible assets		**126**	6	**126**	6
(Profit)/loss on disposal of non-current assets		**(377)**	(120)	**(377)**	(120)
		50,923	49,538	**50,923**	49,538
Other operating expenses:					
Operating lease rentals:					
vehicles and office equipment		**211**	116	**211**	116
land and buildings		**287**	286	**287**	286
Fees payable to the group's auditor (see below)		**279**	230	**279**	230
Other expenses (see below)		**87,190**	86,684	**87,186**	80,681
Other operating expenses charged to capital projects		**(5,711)**	(5,276)	**(5,711)**	(5,276)
		82,256	76,040	**82,252**	76,037
Total operating costs		**163,257**	154,068	**163,253**	154,065
Fees payable to the group's auditor in respect of:					
Audit of the group and company financial statements		**203**	168	**203**	168
Audit of subsidiary		**1**	1	**1**	1
Total audit		**204**	169	**204**	169
Regulatory accounts		**50**	36	**50**	36
Other assurance services		**15**	15	**15**	15
		65	51	**65**	51
Services relating to taxation		**10**	10	**10**	10
Total non-audit services		**75**	61	**75**	61
Total fees payable to the group's auditor		**279**	230	**279**	230
Other expenses comprise:					
Energy costs		**16,440**	15,474	**16,440**	15,474
Rates		**17,770**	17,244	**17,770**	17,244
Contractors		**23,768**	19,726	**23,768**	19,726
Bulk water supplies and abstraction licences		**9,195**	8,666	**9,195**	8,666
Chemicals		**3,300**	3,077	**3,300**	3,077
Insurance and related costs		**3,083**	2,803	**3,083**	2,803
Other		**13,634**	13,694	**13,630**	13,691
Total other expenses		**87,190**	80,684	**87,186**	80,681

Notes to the financial statements

for the year ended 31 March 2019

9. Directors and employees

The average monthly number of employees, including salaried directors, of the group in the year was:

Group and company	**2019 Number**	2018 Number
Operations	**440**	515
Management and administration	**510**	460
	950	975

	Notes	**2019 £000**	2018 £000
The aggregate payroll costs of these persons were:			
Wages and salaries		**30,193**	28,556
Social security costs		**3,049**	2,866
Pension costs for defined benefit schemes	28	**1,067**	1,090
Pension costs for unfunded pensions		**266**	521
Pension costs for defined contribution schemes	28	**2,143**	1,931
		36,718	34,964
Less: direct salary costs charged to capital projects		**(6,640)**	(6,474)
		30,078	28,490

Emoluments of the directors, who are the group's key management, were:

	2019 £000	2018 £000
Aggregate emoluments including bonuses	**1,071**	1,122
Company contributions to defined contribution scheme	**39**	52
	1,110	1,174
Emoluments of the highest paid director were:		
Aggregate emoluments including bonuses	**395**	415

Retirement benefits are accruing to one directors (2018: one) under the defined benefit pension schemes and two directors (2018: two) under a defined contribution scheme. Further disclosures in respect of directors' emoluments are set out in the remuneration report on page 91.

Notes to the financial statements

for the year ended 31 March 2019

10. Finance costs

	Group		Company	
	2019 £000	2018 £000	**2019 £000**	2018 £000
Debenture interest	**42**	42	**42**	42
Interest payable to subsidiary	**–**	–	**25,684**	25,160
Indexation payable to subsidiary	**–**	–	**7,671**	9,274
Effective interest on listed debt	**22,842**	22,401	**–**	–
Fair value movements on interest rate swap	**4,668**	3,253	**4,668**	3,253
Indexation on variable rate bonds	**4,564**	5,680	**–**	–
Bank interest and other finance charges	**975**	650	**975**	650
Financing guarantee fees	**1,289**	1,158	**1,289**	1,158
Interest payable on index linked loans	**12,174**	11,767	**9,375**	9,051
Indexation on index linked loans	**11,487**	12,644	**8,380**	9,050
Amortisation of loan issue costs	**546**	548	**546**	548
Interest and related fees payable	**58,587**	58,143	**58,630**	58,186
Interest capitalised	**(2,477)**	(2,126)	**(2,477)**	(2,126)
	56,110	56,017	**56,153**	56,060

Interest capitalised during the year amounted to £2.4 million (2018: £2.1 million) and is calculated using the weighted average interest rate of the group's long-term lending of 4.44 per cent (2018: 4.43 per cent).

11. Finance income

		Group		Company	
	Notes	**2019 £000**	2018 £000	**2019 £000**	2018 £000
Interest receivable on bank balances and short term deposits		**135**	51	**117**	40
Interest receivable from group undertakings		**5,305**	4,504	**5,305**	4,504
Pension fund finance income	28	**636**	248	**636**	248
		6,076	4,803	**6,058**	4,792

Notes to the financial statements

for the year ended 31 March 2019

12. Discontinued operations

On 1 May 2018, the group sold its rights to the non-household customer base to its fellow wholly owned subsidiary, Invicta Water Limited, for a consideration of £10.0 million which has resulted in a profit on disposal of £9.2 million. The rights to the non-household customer base are an internally generated intangible asset and, as per IAS 38, these were not recognised on the group's statement of financial position.

Group and company	**2019 £000**	2018 £000
Revenue	**354**	3,363
Operating expenses	**(361)**	(3,446)
Finance costs	**–**	(2)
Profit before tax	**(7)**	(85)
Proceeds from disposal of intangible asset	**10,000**	–
Legal fee	**(244)**	–
Consultancy	**(91)**	–
Bad debt provision	**(502)**	–
Taxation	**97**	16
Profit/(loss) attributable to discontinued operation	**9,253**	(69)

13. Taxation

Major components of the group's tax expense for the years ended 31 March 2019 and 2018 are:

	Group		Company	
	2019 £000	2018 £000	**2019 £000**	2018 £000
Group income statement				
Current tax:				
Current UK tax charge	**878**	1,975	**867**	1,965
Amounts over provided in previous years	**–**	(1)	**–**	(1)
	878	1,974	**867**	1,964
Deferred tax:				
Relating to origination and reversal of temporary differences	**6,017**	5,600	**6,017**	5,600
	6,017	5,600	**6,017**	5,600
Tax charge/(credit) reported in the group income statement	**6,895**	7,574	**6,884**	7,564
Tax charge/(credit) to equity				
Deferred tax on defined benefit pension schemes	**(600)**	1,590	**(600)**	1,590
Tax reported in comprehensive income statement	**(600)**	1,590	**(600)**	1,590

Notes to the financial statements

for the year ended 31 March 2019

13. Taxation (continued)

Factors affecting the tax charge for the year

The tax for the year is lower than the standard rate of corporation tax in the UK. The differences are explained below:

	Group		Company	
	2019 £000	2018 £000	**2019 £000**	2018 £000
Profit before tax on Continued operation	**36,403**	23,827	**36,346**	23,776
Profit multiplied by the rate of corporation tax in the UK of 19% (2018: 19%)	**6,917**	4,527	**6,906**	4,517
Effects of:				
Adjustments to current tax charge in respect of previous years	**–**	(1)	**–**	(1)
Adjustments to deferred tax charge in respect of previous years	**(451)**	2,523	**(451)**	2,523
Expenses not deductible for tax purposes	**594**	541	**594**	541
Tax effect of income not taxable in determining taxable profit	**(68)**	–	**(68)**	–
Total tax charge reported in the group income statement	**6,992**	7,590	**6,981**	7,580

The adjustments to deferred tax in respect of previous years represents the changes between the year end and submitted computations and, in respect of the prior year, a revision of the tax treatment of the amortisation of the revaluation reserve. The expenses not deductible for tax purposes are made up of the movement on general provisions, entertainment expenses and depreciation on non-qualifying capital expenditure.

Group and company	**2019 £000**	2018 £000
Profit/(Loss) for the year on discontinued operation	**9,156**	(85)
Profit multiplied by the rate of corporation tax in the UK of 19% (2018: 19%)	**1,739**	(16)
Effects of:		
Tax effect of income not taxable in determining taxable profit	**(1,836)**	–
Total tax charge reported in the group income statement	**(97)**	(16)

Notes to the financial statements

for the year ended 31 March 2019

13. Taxation (continued)

Deferred tax

The movement on the net deferred tax liability is as shown below:

Group and company	2019 £000	2018 £000
At 1 April	**140,085**	132,895
(Credit)/Charge to the income statement	**6,017**	5,600
(Credit)/Charge to equity	**(600)**	1,590
Impact of IFRS taken to Reserves	**(107)**	–
At 31 March	**145,395**	140,085

Deferred tax assets have been recognised in respect of all tax losses and other temporary differences giving rise to deferred tax assets because it is probable that these assets will be recovered by giving relief against future taxable profits.

The movements in deferred tax assets and liabilities during the year are shown below:

Group and company	Accelerated tax depreciation £000	Pension provision £000	Total £000
Deferred tax liabilities			
At 1 April 2017	134,373	1,318	135,691
(Credit)/Charge to the income statement	3,866	699	4,565
Charge to equity	–	1,590	1,590
Impact of rate change on deferred taxation on the revaluation reserve	–	–	–
At 1 April 2018	138,239	3,607	141,846
(Credit)/charge to the income statement	4,034	800	4,834
Charge to equity	–	(600)	(600)
At 31 March 2019	**142,273**	**3,807**	**146,080**

Group and company	Fair value swap £000	Other provision £000	Total £000
Deferred tax assets			
At 1 April 2017	2,547	249	2,796
(Charge)/credit to the income statement	(1,045)	10	(1,035)
At 1 April 2018	1,502	259	1,761
Credit/(charge) to the income statement	(1,100)	24	(1,076)
At 31 March 2019	**402**	**283**	**685**

Notes to the financial statements

for the year ended 31 March 2019

13. Taxation (continued)

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net. All of the deferred tax assets were available for offset against deferred tax liabilities and hence the net deferred tax liability at 31 March 2019 was £145.4 million (2018: £135.9 million).

Capital investment is expected to remain at similar levels and the group expects to be able to claim capital allowances in excess of depreciation in future years, allowing for any group relief arrangements within the HDF (UK) Holdings Ltd group of companies.

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 19 per cent, changing to 17 per cent from 1 April 2020. (2018: 19 per cent changing to 17 per cent from 1 April 2020).

For the year ended 31 March 2019 a UK corporation tax rate of 19 per cent has been used as enacted by Finance Act 2013. A reduction in the UK corporation tax rate to 17 per cent (effective 1 April 2020) was substantively enacted in September 2016. The deferred tax on temporary differences as at 31 March 2019 has been calculated at the rate applicable to the year in which the temporary differences are expected to reverse.

We have assessed the impact of the prospect of the UK leaving the European Union on our current tax charge and our deferred tax assets and liabilities and we do not consider the impact to be material.

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

14. Dividends

Group and company	2019 £000	2018 £000
Equity dividends paid during the year:		
First interim dividend of 14.20p per ordinary share (2018: 9.13p per ordinary share)	**7,000**	4,500
Second interim dividend of 14.20p per ordinary share (2018: 9.13p per ordinary share)	**7,000**	4,500
Third interim dividend of 14.20p per ordinary share (2018: 9.13p per ordinary share)	**7,000**	4,500
Final dividend of 14.20p per ordinary share (2018: 9.13p per ordinary share)	**7,000**	4,500
	28,000	18,000

There were no dividends proposed for approval as at 31 March 2019 and 31 March 2018.

15. Earnings per ordinary share

Basic earnings per share amounts are calculated by dividing profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year. The following reflects the income and shares data used in the basic and diluted earnings per share computations:

	Group		Company	
	2019 £000	2018 £000	**2019 £000**	2018 £000
Profit for the year from continuing operations	**29,411**	16,237	**29,365**	16,196
Profit/(loss) for the year from discontinued operations	**9,253**	(69)	**9,253**	(69)
	2019 Number	2018 Number	**2019 Number**	2018 Number
Basic and diluted weighted average number of shares	**49,312,354**	49,312,354	**49,312,354**	49,312,354
Basic and diluted earnings per share from continuing operations	**59.64p**	32.93p	**59.55p**	32.84p
Basic and diluted earnings per share from discontinued operations	**18.77p**	(0.14)p	**18.76p**	(0.14)p

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements.

Notes to the financial statements

for the year ended 31 March 2019

16. Intangible assets

Group and company	**Computer software £000**	**Assets in the course of construction £000**	**Total £000**
Cost	22,406	296	22,702
At 1 April 2018			
Additions	–	4,067	4,067
Transfers	2,619	(2,619)	–
Reclassifications	(573)	(496)	(1,069)
Disposals	(365)	–	(365)
At 31 March 2019	**24,087**	**1,248**	**25,335**
Accumulated amortisation and impairment			
At 1 April 2018	(11,944)	–	(11,944)
Charge for the year	(3,129)	–	(3,129)
Eliminated on disposals	365	–	365
Impairment	(126)	–	(126)
At 31 March 2019	**(14,834)**	**–**	**(14,834)**
Net book amount at 31 March 2019	**9,253**	**1,248**	**10,501**
Cost			
At 1 April 2017	16,842	3,067	19,909
Additions	–	3,554	3,554
Transfers	5,710	(5,710)	–
Reclassifications	167	(615)	(448)
Disposals	(313)	–	(313)
At 31 March 2018	22,406	296	22,702
Accumulated amortisation and impairment			
At 1 April 2017	(8,851)	–	(8,851)
Charge for the year	(3,399)	–	(3,399)
Eliminated on disposals	312	–	312
Impairment	(6)	–	(6)
At 31 March 2018	(11,944)	–	(11,944)
Net book amount at 31 March 2018	10,462	296	10,758

The impairment loss on computer software in the year relates to website and internet software which has become obsolete. There is no recoverable value on this asset.

We have assessed the impact of the prospect of the UK leaving the European Union on our intangible assets and we do not consider the impact to be material.

Notes to the financial statements

for the year ended 31 March 2019

17. Property, plant and equipment

Group and company	Land, wells, reservoirs and buildings £000	Mains £000	Plant, equipment and vehicles £000	Assets in the course of construction £000	Total £000
Deemed cost					
At 1 April 2018	231,158	1,048,217	332,818	59,908	1,672,101
Additions	–	–	–	100,621	100,621
Transfers	8,004	48,140	62,188	(118,332)	–
Reclassifications	–	–	573	496	1,069
Disposals	(106)	(1,474)	(878)	–	(2,458)
At 31 March 2019	**239,056**	**1,094,883**	**394,701**	**42,693**	**1,771,333**
Accumulated depreciation and impairment					
At 1 April 2018	(16,123)	(69,128)	(85,143)	–	(170,394)
Charge for the year	(4,313)	(19,963)	(23,759)	–	(48,035)
Eliminated on disposals	8	1,357	865	–	2,230
Impairment	–	–	(11)	–	(11)
At 31 March 2019	**(20,428)**	**(87,734)**	**(108,048)**	**–**	**(216,210)**
Net book amount at 31 March 2019	**218,628**	**1,007,149**	**286,653**	**42,693**	**1,555,123**
Net book amount of leased assets included above	4,095	–	5,038	–	9,133
Assets under construction	752	18,385	23,920	–	43,057
Deemed cost					
At 1 April 2017	227,272	998,456	293,430	61,021	1,580,179
Additions	–	–	–	92,410	92,410
Transfers	3,957	49,966	40,215	(94,138)	-
Reclassifications	–	–	(167)	615	448
Disposals	(71)	(205)	(660)	–	(936)
At 31 March 2018	231,158	1,048,217	332,818	59,908	1,672,101
Accumulated depreciation and impairment					
At 1 April 2017	(11,862)	(50,651)	(62,286)	–	(124,799)
Charge for the year	(4,267)	(18,487)	(23,479)	–	(46,233)
Eliminated on disposals	6	10	641	–	657
Impairment	–	–	(19)	–	(19)
At 31 March 2018	(16,123)	(69,128)	(85,143)	–	(170,394)
Net book amount at 31 March 2018	215,035	979,089	247,675	59,908	1,501,707
Net book amount of leased assets included above	4,255	–	5,457	–	9,712
Assets under construction	4,807	19,362	35,739	–	59,908

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

17. Property, plant and equipment (continued)

Plant, equipment and vehicles have been impaired in respect of sampling equipment in our laboratory which is obsolete. There is no recoverable value on any of these impaired assets.

The group's index linked loans and listed bonds are secured on certain assets of the group (see note 23).

We have assessed the impact of the prospect of the UK leaving the European Union on our intangible assets and we do not consider the impact to be material.

18. Investments in subsidiaries

Details of the company's subsidiary, the results of which are included in the group financial statements at 31 March 2019 and 31 March 2018 are as follows:

Company Name of subsidiary	Place of incorporation	Principal activity	Ordinary share ownership interest %	Voting rights held %
South East Water (Finance) Limited	Cayman Islands	Finance company	100	100

South East Water (Finance) Limited's principal purpose is to raise debt on behalf of South East Water and any proceeds from such issues are lent on to South East Water. South East Water (Finance) Limited is a company registered in the Cayman Islands but the company does not gain any tax benefit from this as the company is resident for tax purposes in the UK.

South East Water (Finance) Limited is wholly-owned by South East Water Limited, which owns 100 per cent of the voting rights. Its registered address is P O Box 309GT, Ugland House, South Church Street, Georgetown, Grand Cayman, Cayman Islands.

19. Amount due from parent undertaking

Group and company	**2019** **£000**	2018 £000
Non-current assets		
Measured at amortised cost		
Amount due from parent due in more than one year	**190,013**	190,013
Expected credit loss	**(102)**	–
	189,911	190,013

The amount due from parent undertaking falls due for repayment on 27 July 2034 and bears interest at the rate of LIBOR plus two per cent. The carrying value has been adjusted to reflect the expected credit loss in line with the requirements of IFRS 9 (see note 4).

We have assessed the impact of the prospect of the UK leaving the European Union on our intangible assets and we do not consider the impact to be material.

Notes to the financial statements

for the year ended 31 March 2019

20. Inventories

Group and company	2019 £000	2018 £000
Consumables	**531**	201
Work-in-progress	**61**	35
	592	236

In preparation for the UK leaving the European Union, we have increased chemical stocks and are working with other water companies to closely manage critical chemical reserves.

21. Trade and other receivables

	Group		Company	
	2019 £000	2018 £000	**2019 £000**	2018 £000
Financial asset receivables				
Trade receivables	**38,562**	34,463	**38,562**	34,463
Accrued income	**37,835**	35,506	**37,835**	35,506
Amounts due from parent and fellow subsidiary undertakings due within one year	**4**	26	**4**	26
	76,401	69,995	**76,401**	69,995
Non-financial asset receivables				
Prepayments and accrued income	**3,856**	5,132	**3,300**	4,578
Other receivables	**5,933**	3,128	**5,933**	3,128
	9,789	8,260	**9,233**	7,706
Total trade and other receivables	**86,190**	78,255	**85,634**	77,701

Group and company

All trade receivables at 31 March 2019 and 31 March 2018 are denominated in sterling.

Trade receivables are stated after provision for doubtful debts of £25.9 million (2018: £28.1 million). They are non-interest bearing and generally for immediate settlement. Receivables are determined to be impaired where there is a poor payment history or insolvency of the debtor and are fully or partially provided for.

Movements in the provision for impairment of receivables were as follows:

	2019 £000	2018 £000
Provision brought forward	**28,054**	28,443
Charge for the year from continued operation	**1,584**	1,199
Charge for the year from discontinued operation	**43**	751
Provision for legacy debt	**502**	–
Amounts utilised	**(4,246)**	(2,339)
Provision carried forward	**25,937**	28,054

As at 31 March, the analysis of trade receivables past due but not impaired is as follows:

	Total £000	Current £000	<30 days £000	30-60 days £000	60-90 days £000	90-120 days £000	120-365 days £000	>365 days £000
2019	**38,562**	**9,368**	**3,863**	**2,702**	**1,610**	**1,683**	**9,930**	**9,406**
2018	34,463	7,372	4,581	2,698	1,647	1,480	9,455	7,230

Notes to the financial statements

for the year ended 31 March 2019

22. Cash and cash equivalents

Cash and cash equivalents comprise the following at 31 March:

	Group		Company	
	2019 £000	2018 £000	**2019 £000**	2018 £000
Cash at bank and in hand	**12,804**	6,528	**12,607**	6,310
	12,804	6,528	**12,607**	6,310

Included in the group and company cash at bank and in hand balance at 31 March 2019 was £11.6 million (2018: £4.1 million) held on an on demand deposit account.

At 31 March 2019, £0.2 million (2018: £nil) of restricted cash was held for the group in designated bank accounts and £nil million (2018: £nil million) of restricted cash was held for the company in designated bank accounts in order to meet interest and associated swap payments falling due in respect of the listed debt and interest payments on index linked loans (note 10).

23. Non-current financial liabilities

Group		**2019 £000**	2018 £000
Loans and borrowings	(i)	**717,604**	900,897
Trade and other payables	(ii)	**5,379**	5,979
Derivative financial instruments – Inflation swap	(iii)	**–**	104,169
		722,983	1,011,045
(i) Loans and borrowings:			
Irredeemable debenture stock	(a)	**991**	991
Listed bonds	(b)	**334,387**	529,337
Index linked loans	(c)	**382,226**	370,569
		717,604	900,897

	2019 £000	2018 £000
(a) Irredeemable debenture stock		
3% perpetual stock	**25**	25
3½% perpetual stock	**384**	384
4% perpetual stock	**178**	178
5% perpetual stock	**366**	366
5½% perpetual stock	**1**	1
6% perpetual stock	**37**	37
	991	991

Interest on irredeemable debenture stock is payable six monthly.

Notes to the financial statements

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23. Non-current financial liabilities (continued)

(b) Listed bonds

The group holds bonds listed on the London Stock Exchange with an original value of £296 million (2018: £496 million), with effective terms, having taken account of a related interest rate swap, as follows:

- **£166 million at a fixed rate of 5.5834 per cent, falling due for repayment on 29 March 2029 (or earlier at the option of the group)**
- **£130 million at a variable rate linked to inflation, falling due for repayment on 3 June 2041 (or earlier at the option of the group)**

Issue costs incurred by the group in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

New issue costs has been incurred in securing the new loans to repay the £200m bond maturing on 30 September 2019.

Indexation accrues on the bond repayable in 2041 under the terms of the bond.

Listed bonds are stated at the original consideration received plus accrued indexation less issue costs unamortised at the balance sheet date as follows:

	Loan due 2019 £000	Loan due 2029 £000	Loan due 2041 £000	Total £000
2019				
Original loan consideration	–	166,000	130,000	296,000
Indexation on bonds	–	–	40,608	40,608
Less: unamortised issue costs	–	(1,106)	(1,115)	(2,221)
Listed bonds	**–**	**164,894**	**169,493**	**334,387**
2018				
Original loan consideration	200,000	166,000	130,000	496,000
Indexation on bonds	–	–	36,045	36,045
Less: unamortised issue costs	(326)	(1,217)	(1,165)	(2,708)
Listed bonds	199,674	164,783	164,880	529,337

(c) Index linked loans

The group holds index linked loans with an original value of £269 million and with effective terms as follows:

- **£135 million at a variable rate linked to inflation, falling due for repayment on 30 September 2032 (or earlier at the option of the group)**
- **£34 million at a variable rate linked to inflation, falling due for repayment on 30 September 2033 (or earlier at the option of the group)**
- **£100 million at a variable rate linked to inflation, falling due for repayment on 1 December 2037 (or earlier at the option of the group)**

Indexation on the loans accrues under the terms of the loans. Issue costs incurred by the group in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

Notes to the financial statements

for the year ended 31 March 2019

23. Non-current financial liabilities (continued)

Index linked loans are stated after the uplift for accrued indexation and the deduction of issue costs to be amortised at the balance sheet date as follows:

	Loan due 2032 £000	Loan due 2033 £000	Loan due 2037 £000	Total £000
2019				
Original loan amounts	135,000	34,000	100,000	269,000
Indexation on bonds	82,508	16,809	16,638	115,955
Less: unamortised issue costs	(1,116)	(209)	(1,404)	(2,729)
Loans	**216,392**	**50,600**	**115,234**	**382,226**
2018				
Original loan amounts	135,000	34,000	100,000	269,000
Indexation on bonds	75,714	15,223	13,530	104,467
Less: unamortised issue costs	(1,197)	(222)	(1,479)	(2,898)
Loans	209,517	49,001	112,051	370,569

The irredeemable debentures, listed bonds and index linked loans detailed in a, b and c above respectively are secured on the assets of South East Water (Holdings) Limited, South East Water Limited and South East Water (Finance) Limited (the South East Water (Holdings) Limited group) as far as allowed by the Water Industry Act 1991 and South East Water's licence. The agreements for the bonds and loans contain a number of covenants that the group is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Strategic Report.

(ii) Trade and other payables

Trade and other payables comprise financing guarantee fees of £nil (2018: £20,000) and deposits payable to developers of £5.8 million (2018: £6.0 million).

Deposits payable to developers has been adjusted at 1 April 2018 upon the adoption of IFRS 15 using the modified retrospective method (see note 3). This has given rise to a transfer of £0.5 million from trade and other payables to retained earnings for the balance of deposits received where the performance obligations in the contracts have been completed and there is no requirement to refund the deposits.

(iii) Derivative financial instruments – interest rate swap

The group has entered into an interest rate swap arrangement in respect of the £200 million listed bonds with Deutsche Bank AG. This arrangement swaps the fixed rate of interest on the bond for a variable rate of interest which is linked to inflation as reported by the Retail Price Index.

As at 31 March 2018 the interest rate swap is stated at its fair value of a liability of £104.2 million. The principle and interest swap is due to be paid on maturity of the bond on 30 September 2019. (See note 23)

Company		**2019 £000**	2018 £000
Loans and borrowings	(i)	**717,604**	900,897
Trade and other payables	(ii)	**5,379**	5,979
Derivative financial instruments	(iii)	**–**	104,169
		722,983	1,011,045

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23. Non-current financial liabilities (continued)

Company		**2019 £000**	2018 £000
(i) Loans and borrowings			
Irredeemable debenture stock	(a)	**991**	991
Amounts due to subsidiary undertakings	(b)	**449,621**	641,388
Index linked loans	(c)	**266,992**	258,518
		717,604	900,897

	2019 £000	2018 £000
(a) Irredeemable debenture stock		
3% perpetual stock	**25**	25
3½% perpetual stock	**384**	384
4% perpetual stock	**178**	178
5% perpetual stock	**366**	366
5½% perpetual stock	**1**	1
6% perpetual stock	**37**	37
	991	991

(b) Amounts due to subsidiary undertakings

The company's subsidiary undertaking, South East Water (Finance) Limited, has debt with an original consideration of £396 million (2018: £596 million), of which £296 million (2018: £496 million) is listed on the London Stock Exchange. The funds raised are lent to the company under loan agreements between the company and its subsidiary. An annual fee of £43,000 (2018: £43,000) is charged by South East Water (Finance) Limited.

The effective terms of the £396 million loans due to South East Water (Finance) Limited are as follows:

- **£166 million at a fixed rate of 5.5834 per cent, falling due for repayment on 29 March 2029 (or earlier at the option of the company)**
- **£130 million at a variable rate linked to inflation, falling due for repayment on 3 June 2041 (or earlier at the option of the company)**
- **£100 million at a variable rate linked to inflation, falling due for repayment on 1 December 2037 (or earlier at the option of the company)**

Issue costs incurred by the company in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

New issue cost has been incurred in securing the new loans to repay the £200m bond maturing on 30 September 2019.

Indexation accrues on the loan repayable in 2041 under the terms of the loan.

The amounts due to subsidiary undertakings and the indexed loans are secured on the assets of South East Water (Holdings) Limited Group as far as allowed by the Water Industry Act 1991 and South East Water's licence.

The agreements for the bonds and loan contain a number of covenants that the company is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Strategic Report.

Notes to the financial statements

for the year ended 31 March 2019

23. Non-current financial liabilities (continued)

The amounts due to group undertakings are stated at the original consideration plus accrued indexation and less issue costs unamortised at the balance sheet date as follows:

	Loan due 2019 £000	Loan due 2029 £000	Loan due 2041 £000	Loan due 2037 £000	Total £000
2019					
Original loan consideration	–	166,000	130,000	100,000	396,000
Indexation on bonds	–	-	40,608	16,638	57,246
Less: unamortised issue costs	–	(1,106)	(1,115)	(1,404)	(3,625)
Loans	**–**	**164,894**	**169,493**	**115,234**	**449,621**
2018					
Original loan amounts	200,000	166,000	130,000	100,000	596,000
Indexation on bonds	–	–	36,045	13,530	49,575
Less: unamortised issue costs	(326)	(1,217)	(1,165)	(1,479)	(4,187)
Loans	199,674	164,783	164,880	112,051	641,388

(c) Index linked loans

The company holds index linked loans with an original consideration of £169 million and effective terms as follows:

- **£135 million at a variable rate linked to inflation, falling due for repayment on 30 September 2032 (or earlier at the option of the company)**
- **£34 million at a variable rate linked to inflation, falling due for repayment on 30 September 2033 (or earlier at the option of the company)**

Indexation on the loans accrues under the terms of the loans. Issue costs incurred by the company in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate. Index linked loans are stated after the uplift for accrued indexation and the deduction of issue costs to be amortised at the balance sheet date. The issue costs for this debt were borne by the company on behalf of its subsidiary company.

The listed bonds and unlisted loan are secured on the assets of South East Water (Holdings) Limited Group as far as allowed by the Water Industry Act 1991 and South East Water's licence.

The agreements for the loans contain a number of covenants that the company is required to meet to safeguard the interests of the lenders. The current position of the covenants and the required targets are detailed in the Strategic Report.

Notes to the financial statements

for the year ended 31 March 2019

23. Non-current financial liabilities (continued)

	Loan due 2032 £000	Loan due 2033 £000	Total £000
2019			
Original loan consideration	135,000	34,000	169,000
Indexation on bonds	82,508	16,809	99,317
Less: unamortised issue costs	(1,116)	(209)	(1,325)
Index-linked loans	**216,392**	**50,600**	**266,992**
2018			
Original loan amounts	135,000	34,000	169,000
Indexation on bonds	75,714	15,223	90,937
Less: unamortised issue costs	(1,197)	(222)	(1,419)
Index-linked loans	209,517	49,001	258,518

(ii) Trade and other payables

Trade and other payables comprise financing guarantee fees of £nil (2018: £20,000) and deposits payable to developers of £5.8 million (2018: £6.0 million).

Deposits payable to developers have been adjusted at 1 April 2018 upon the adoption of IFRS 15 using the modified retrospective method (see note 5). This has given rise to a transfer of £0.5 million from trade and other payables to retained earnings for the balance of deposits received where the performance obligations in the contracts have been completed and there is no requirement to refund the deposits.

(iii) Derivative financial instruments

The company has entered into an interest rate swap arrangement in respect of the £200 million intercompany loan with its subsidiary company. This mirrors the South East Water (Finance) Limited's arrangement with Deutsche Bank AG. This arrangement swaps the fixed rate of interest on the bond for a variable rate of interest which is linked to inflation as reported by the Retail Price Index.

As at 31 March 2018 the interest rate swap is stated at its fair value of a liability of £104.2 million (2017: £100.9 million), as detailed in the above table. The increase in the fair value of the liability of £3.3 million (2017: increase of £13.7 million) during the year has been recognised in the income statement in finance costs (see note 27).

	2019 £000	2018 £000
Amounts due to subsidiary undertakings	**–**	104,169

24. Current loans and borrowings

Group and company	**2019 £000**	2018 £000
Bank loans	**55,000**	20,000
Index linked Bond	**200,000**	–
Less: unamortised issue cost	**(110)**	–
Loan	**254,890**	20,000

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for the year ended 31 March 2019

24. Current loans and borrowings (continued)

During the year, the group utilised its committed borrowing facilities by further drawing down a total of £35.0 million (2018: £20.0 million) of loans. The loan facilities are secured on the assets of the group, as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence, and against the assets of the immediate parent company, South East Water (Holdings) Limited, at a variable interest rate of LIBOR plus 0.45 per cent.

The company has entered into an interest rate swap arrangement in respect of the £200 million intercompany loan with its subsidiary company. This mirrors South East Water (Finance) Limited's arrangement with Deutsche Bank AG. This arrangement swaps the fixed rate of interest on the bond for a variable rate of interest which is linked to inflation as reported by the Retail Price Index.

As at 31 March 2019 the interest rate swap is stated at its fair value of a liability of £108.8 million. This was shown as non-current liabilities at 31 March 2018. The principle and interest swap is due to be paid on maturity of the bond on 30 September 2019. (see note 31)

	2019 £000	2018 £000
Amounts due to subsidiary undertakings	**108,836**	–

25. Provisions

Group and company	Third party damage claims £000	Leak allowance £000	Other provisions £000	Total £000
As at 1 April 2018	**1,988**	**527**	**–**	**2,515**
Additional provisions	**1,406**	**3,825**	**–**	**5,231**
Amounts utilised	**(1,250)**	**(2,524)**	**–**	**(3,774)**
31 March 2019	**2,144**	**1,828**	**–**	**3,972**
As at 1 April 2017	1,789	553	130	2,472
Additional provisions	1,004	2,252	–	3,256
Amounts utilised	(805)	(2,278)	(130)	(3,213)
31 March 2018	1,988	527	–	2,515

It is anticipated that all provisions will be utilised within the next year.

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

26. Trade and other payables

	Group		Company	
	2019 £000	2018 £000	**2019 £000**	2018 £000
Financial liability payables				
Trade payables	**13,890**	13,610	**13,890**	13,610
Amounts due to parent and fellow subsidiary undertakings	**8,786**	9,217	**16,670**	16,838
Other payables	**2,303**	1,866	**2,303**	1,866
Accruals	**33,553**	32,556	**26,367**	25,568
	58,532	57,249	**59,230**	57,882
Non-financial liability payables				
Payments received in advance	**32,724**	36,118	**32,724**	36,118
Other taxes and social security	**1,007**	1,012	**1,007**	1,012
	33,731	37,130	**33,731**	37,130
	92,263	94,379	**92,961**	95,012

As at 31 March 2019 and 2018, amounts due to parent and fellow subsidiary undertakings represent unsecured non-interest bearing balances relating to the surrender of group tax relief in respect of the group and the surrender of group tax relief and interest due on debt with the subsidiary company in respect of the company.

27. Group financial instruments

Financial risk management objectives and policies

The group's financial instruments comprise index linked loans, fixed rate debentures, variable rate bank loans, an interest rate swap, a variable rate loan to its parent undertaking, cash, short-term and medium-term deposits, trade receivables and trade and other payables. The main purpose of the group's financial instruments, other than the interest rate swap, is to raise finance for the group's operations.

Derivative activity is undertaken as determined by the board of Directors. The board considers the overall risk profile of the group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. The group does not use derivative financial instruments for speculative purposes.

The group's treasury operations are managed within parameters defined by the board and its parent undertaking. It is the group's policy to minimise liquidity risk within an acceptable range of interest rates. The group does not use foreign currency financial instruments. The main risks arising from the group's financial instruments are interest rate and liquidity risk. There are no regulatory capital requirements placed on the group.

Notes to the financial statements

for the year ended 31 March 2019

27. Group financial instruments (continued)

Interest rate and cash flow risk

The group finances its activities through a mixture of cash generated from operations, debenture loans, long-term bonds and long-term index linked loans. Debentures are long-term fixed rate loans. Bonds comprise long-term fixed rate loans and long-term variable rate loans which have been linked to inflation, partly through the use of an interest rate swap. The interest rate swap is used in order to reflect movements in the expected future income of the group. Long-term index linked loans comprise loans linked to inflation.

The group's policy is to manage short term interest rate risk by using short term fixed rate drawdowns under a committed facility. During the year to 31 March 2019 there was a net inflow of £35.0 million from financing activities within the group (excluding dividend payments) (2018: £20.0 million). It is the view of the group that long-term fluctuations in interest rates will be within the parameters that are considered acceptable by the group.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, on the group's profit before tax (through the impact on floating rate borrowings). The sensitivity analysis excludes all non-derivative fixed rate financial instruments carried at amortised cost but includes those recognised at fair value as well as all non-derivative floating rate financial instruments.

	Increase/ decrease in basis points	Effect on profit before tax £000	Effect on Shareholders' equity £000
2019			
Sterling	+300	(13,920)	(11,136)
Sterling	-100	4,640	(3,712)
2018			
Sterling	+300	(12,870)	(10,296)
Sterling	-100	4,290	3,432

Liquidity risk

The group aims to maintain a balance between continuity of funding and flexibility. Continuity of funding has been guaranteed throughout the period by the existence of long-term funding facilities. Short-term flexibility is achieved by varying the drawdown amounts under these facilities. Further details are given below. Cash is put on deposit with variable maturity dates so as to mitigate liquidity risk.

Inflation risk

The group manages its inflation risk on its financial liabilities through the use of an interest rate swap and other index linked bonds and loans (note 23). The group considers that the inflation rate risk is effectively managed as Ofwat allows revenues to be increased in line with inflation.

Notes to the financial statements

for the year ended 31 March 2019

27. Group financial instruments (continued)

Credit risk

The group's financial assets include a loan due from its parent undertaking, short-term and medium-term bank deposits and trade receivables, which represent the group's maximum exposure to credit risk in relation to financial assets. The group's credit risk is primarily attributable to its trade receivables, which are stated in the statement of financial position at original invoice amount less an allowance for any doubtful debts (see note 3). An estimate for the provision for doubtful debts is calculated by the group's management based on expected recovery rates of the aged debt profile and an assessment of current socio-economic conditions (see note 21). The group has no significant concentration of credit risk, with exposure spread over a large number of domestic and commercial customers.

Capital management risk

The objectives and management of the group's capital management risk are discussed in the strategic report.

Fair values of financial assets and financial liabilities

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties. In the opinion of the directors, the fair values of the financial assets and liabilities of the group (apart from the specific items shown in the fair value table below) are not materially different from the book values.

The following tables provide a comparison by category of the carrying amount and the fair values of the group's financial assets and financial liabilities at 31 March 2019.

	Notes	**Book Value 2019 £000**	**Fair Value 2019 £000**	Book Value 2018 £000	Fair Value 2018 £000
Financial assets at amortised cost					
Trade and other receivables	21	**83,499**	**83,499**	69,246	69,246
Cash	22	**12,804**	**12,804**	6,528	6,528
Amounts due from parent undertaking	19	**189,918**	**148,811**	190,013	142,573
		286,221	**245,114**	265,787	218,347
Financial liabilities at amortised cost					
Trade and other payables	26	**41,862**	**41,632**	48,031	47,608
Irredeemable debentures	23	**991**	**861**	991	862
Listed bonds	23/24	**534,277**	**633,509**	529,337	672,137
Index linked loans	23	**382,226**	**499,694**	370,569	494,338
Bank loans	24	**55,000**	**55,000**	20,000	20,000
Amounts due to parent and group undertakings	26	**16,670**	**16,578**	9,217	9,136
		1,031,026	**1,247,274**	978,145	1,244,081
Financial liabilities at fair value through profit and loss					
Interest rate swap	24	**108,836**	**108,836**	104,169	104,169

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27. Group financial instruments (continued)

The net book value is considered to equate to the fair value for trade receivables due to the short maturity of the amounts receivable. The fair value of trade and other payables and amounts due to parent and group undertakings have been adjusted for the appropriate credit risk. The fair values of amounts due from parent and irredeemable debentures have been calculated using the discounted cash flow method. The calculation includes all future capital and interest payments discounted by an amount representing credit risk and a further amount representing future inflation.

Index-linked loans have been calculated by discounted cash flow method, taking into account future capital and interest payments based on estimated interest and inflation rates appropriate to the loans. These amounts have been similarly discounted for credit risk and inflation using appropriate discount rates in effect at the balance sheet dates. The fair values of listed bonds are based on market prices. The book value of the interest rate swap has been adjusted to reflect its fair value.

The fair value of the interest rate swap attributable to credit risk for the year is £0.2 million (2018: £0.2 million) and for the life to date of the swap is £3.3 million (2018: £3.1 million). The difference between the carrying value of the swap, above, and the amount payable at maturity is £2.9 million (2018: £7.1 million).

The movement in the value attributable to credit risk is calculated as the movement in fair value less that movement attributable to market factors for the year and the life to date of the swap.

Fair value hierarchy

The group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities
- Level 2: other techniques for which all inputs with a significant effect on the recorded fair value are observable, either directly or indirectly
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data

Notes to the financial statements

for the year ended 31 March 2019

27. Group financial instruments (continued)

The group held the following financial instruments measured at fair value:

	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
31 March 2019				
Financial liabilities at fair value through the income statement				
Interest rate swap	**(108,836)**	**–**	**(108,836)**	**–**
31 March 2018				
Financial liabilities at fair value through the income statement				
Interest rate swap	(104,169)	–	(104,169)	–

The group held the following financial instruments which are not measured at fair value but fair value disclosures are required:

	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
31 March 2019				
Fair value of financial assets at amortised cost				
Amounts due from parent undertaking	148,811	–	148,811	–
Fair value of financial liabilities at amortised cost				
Trade and other payables	(41,632)	–	(41,632)	–
Irredeemable debentures	(861)	–	(861)	–
Listed bonds	(633,509)	(633,509)	–	–
Index linked loans	(499,694)	–	(499,694)	–
Bank loans	(55,000)	–	(55,000)	–
Amounts due to parent and group undertakings	(16,578)	–	(16,578)	–
Total fair value of financial liabilities at amortised cost	**(1,247,274)**	**(633,509)**	**(613,765)**	**–**
31 March 2018				
Fair value of financial assets at amortised cost				
Amounts due from parent undertaking	142,573	–	142,573	-
Fair value of financial liabilities at amortised cost				
Trade and other payables	(47,608)	–	(47,608)	–
Irredeemable debentures	(862)	–	(862)	–
Listed bonds	(672,137)	(672,137)	–	–
Index linked loans	(494,338)	–	(494,338)	–
Bank loans	(20,000)	–	(20,000)	–
Amounts due to parent and group undertakings	(9,136)	–	(9,136)	–
Total fair value of financial liabilities at amortised cost	(1,244,081)	(672,137)	(571,944)	–

During the reporting years ended 31 March 2019 and 2018, there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into and out of Level 3 fair value measurements.

Notes to the financial statements

for the year ended 31 March 2019

27. Group financial instruments (continued)

Maturity of financial instruments

The table below summarises the maturity profile of the group's financial assets and liabilities based on contractual undiscounted payments:

Year ended 31 March 2019	Within 1 year £000	1 – 2 years £000	2 – 5 years £000	Over 5 years £000	Total £000
Fixed rate					
Fixed rate financial liabilities:					
Irredeemable debentures	42	42	126	1,087	1,297
Listed bond	9,268	9,268	27,805	240,149	286,490
Total fixed rate financial liabilities	**9,310**	**9,310**	**27,931**	**241,236**	**287,787**
Floating rate					
Floating rate financial assets:					
Short term financial assets	83,499	–	–	–	83,499
Long-term financial assets	5,199	5,199	15,596	247,200	273,194
Total floating rate financial assets	**88,698**	**5,199**	**15,596**	**247,200**	**356,693**
Floating rate financial liabilities:					
Short term financial liabilities	58,532	–	–	–	58,532
Listed bond	13,730	4,414	323,100	235,737	576,981
Index-linked loans	12,322	12,589	39,371	670,378	734,660
Total floating rate financial liabilities	**84,584**	**17,003**	**362,471**	**906,115**	**1,370,173**
Year ended 31 March 2018					
Fixed rate					
Fixed rate financial liabilities:					
Irredeemable debentures	42	42	126	1,088	1,298
Listed bond	9,268	9,268	27,805	249,416	295,757
Total fixed rate financial liabilities	9,310	9,310	27,931	250,504	297,055
Floating rate					
Floating rate financial assets:					
Short term financial assets	69,246	–	–	–	69,246
Long-term financial assets	4,843	4,843	14,529	248,131	272,346
Total floating rate financial assets	74,089	4,843	14,529	248,131	341,592
Floating rate financial liabilities:					
Short term financial liabilities	57,248	–	–	–	57,248
Listed bond	13,302	13,744	326,503	235,410	588,959
Index-linked loans	11,958	12,225	38,280	680,244	742,707
Total floating rate financial liabilities	82,508	25,969	364,783	915,654	1,388,914

The £200 million fixed rate instrument is classified as a floating rate financial liability due to the associated interest rate swap arrangement.

Notes to the financial statements

for the year ended 31 March 2019

27. Group financial instruments (continued)

Borrowing facilities

The group has committed borrowing facilities of £147.0 million (2018: £147.0 million), of which £55.0 million (2018: £20.0 million) was drawn down. Any drawdowns under these facilities are repayable in less than one year.

The capital and working capital facility of £90.0 million (2018: £90.0 million) expires in June 2020. The DSR Liquidity Facility of £38.0 million (2018: £36.0 million) and the O&M Reserve Facility of £19.0 million (2018: £18.0 million) expire in June 2019.

Items of income, expense, gains and losses

The net gains or losses of the different classes of financial instruments on the income statement are:

	Notes	**2019 £000**	2018 £000
Financial assets at amortised cost	11	**6,076**	4,803
Financial liabilities at amortised cost	10	**(51,441)**	(52,766)
Financial liabilities at fair value through profit or loss	10	**(4,470)**	(3,253)
Financial assets due to impairment	21	**(2,178)**	(1,950)

28. Retirement benefit schemes

Group and company (hereafter referred to as "group" in this note)

The South East Water pension scheme provides benefits to group and former group employees. From 17 June 2011 onwards, benefits from the South East Water pension scheme have been provided solely on a defined contribution basis.

The scheme was originally contracted-out under the Guaranteed Minimum Pension Test. From 6 April 1997, after taking independent actuarial advice, the group decided to contract-out via the Protected Rights Test. With effect from 6 April 2012, the Government have removed the option for schemes to contract-out via a Protected Rights basis. From 6 April 2012, the group has decided to contract-out via a salary related basis.

The final salary defined benefit section of the scheme was closed to new entrants with effect from July 2002.

The last full actuarial valuation of the scheme took place as at 31 March 2017.

The group contribution rate was nil (2018: nil) of pensionable remuneration during the year plus an annual contribution of £3.8 million (2018: £3.8 million). The group's future annual contribution is expected to be £3.7 million.

As a result of the merger of South East Water and Mid Kent Water Limited in October 2006, the group acquired the Mid Kent Group Pension Scheme, which is a defined benefit scheme in the UK.

The last full actuarial valuation of the scheme took place as at 31 March 2017.

The group contributed nil (2018: nil) of pensionable remuneration plus £1.27 million (2018: £1.25 million) in respect of the deficit as at 31 March 2018 to the scheme during the year. The group's future annual contribution is expected to be £1.3 million.

Notes to the financial statements

for the year ended 31 March 2019

28. Retirement benefit schemes (continued)

On 31 March 2015 both of the group's defined benefit schemes closed to further benefit accrual. This was advised to the schemes' members on 13 December 2012. From 31 March 2015 all active members became deferred members and their accrued benefits will increase in line with statutory deferred revaluation. All members were invited to join the group's defined contribution scheme from 1 April 2015.

The group also has obligations to pay a number of former employees' pensions on a defined benefit basis which are not included in either of the pension schemes. These pensions are paid by the group and charged directly to the income statement each year. The value of future obligations has been valued and the liability is recognised on the statement of financial position.

On 26 October 2018, the High Court issued a judgment involving the Lloyds Banking Group's defined benefit pension schemes in relation to Guaranteed Minimum Pension (GMP) benefits being calculated differently for men and women. The judgment concluded that the schemes should be amended to equalise pension benefits for men and women in relation to GMP benefits. The issues determined by the judgment arise in relation to many other defined benefit pension schemes. This issue has been treated as a plan amendment and the impact has been recognised as a past service cost in these accounts.

Pension costs recognised in the income statement for the defined contribution scheme were as follows:

	2019 £000	2018 £000
Defined contribution scheme	**2,149**	2,007

The major assumptions used for the actuarial valuations were:

	SEW Pensions 2019 %	SEW Pensions 2018 %	**MKW Pensions 2019 %**	MKW Pensions 2018 %
Main assumptions:				
Rate of increase in pensions in payment	**2.25**	2.15	**2.25**	2.15
Rate of increase in deferred pensions	**2.25**	2.15	**2.25**	2.15
Discount rate	**2.55**	2.70	**2.55**	2.70
RPI assumption	**3.25**	3.15	**3.25**	3.15
CPI assumption	**2.25**	2.15	**2.25**	2.15
Post-retirement mortality (in years)				
Current pensioners at 65 – male	**21.5**	21.6	**21.5**	21.6
Current pensioners at 65 – female	**23.3**	23.4	**23.3**	23.4
Future pensioners at 65 – male	**22.6**	22.8	**22.6**	22.8
Future pensioners at 65 – female	**25.4**	25.5	**25.4**	25.5

Notes to the financial statements

for the year ended 31 March 2019

28. Retirement benefit schemes (continued)

The following table demonstrates the sensitivity to a reasonably possible change in the above key assumptions, with all other variables held constant, on the schemes' liabilities:

	(Decrease)/ increase in liabilities £000	(Decrease)/ increase %
0.1% increase to the discount rate	4,000	1.5
0.1% decrease to inflation	4,000	1.4
One year increase in life expectancy	10,500	3.8

The fair value of the assets in the schemes and the present value of the liabilities in the schemes were:

	SEW Pensions £000	MKW Pensions £000	Total £000
2019			
Equities	32,111	15,675	47,786
Corporate bonds	87,219	64,426	151,645
Government bonds	42,630	34,622	77,252
Property	–	–	–
Cash	4,608	5,044	9,652
Insured persons	5,326	4,850	10,176
Total fair value of assets	171,894	124,617	296,511
Present value of funded obligations	(161,451)	(109,496)	(270,947)
Surplus in the schemes	10,443	15,121	25,564
Unfunded obligation 2019			
Present value of unfunded obligations			**(3,154)**
2018			
Equities	35,890	25,064	60,954
Corporate bonds	76,571	50,154	126,725
Government bonds	41,508	32,906	74,414
Property	8,458	6,071	14,529
Cash	1,746	3,901	5,647
Insured persons	5,296	4,827	10,123
Total fair value of assets	169,469	122,923	292,392
Present value of funded obligations	(160,169)	(107,713)	(267,882)
Surplus in the schemes	9,300	15,210	24,510
Unfunded obligation 2018			
Present value of unfunded obligations			(3,281)

Equity investments include Global Tactical Asset Allocation, Private Equity Fund and Absolute Return investments.

Notes to the financial statements

for the year ended 31 March 2019

28. Retirement benefit schemes (continued)

Analysis of amounts charged/(credited) to income statement:

	SEW Pensions £000	MKW Pensions £000	Total £000
2019			
Net interest on defined asset	(212)	(424)	(636)
Past service costs	164	109	273
Administrative expenses	423	371	794
Total amount charged to income statement	**375**	**56**	**431**
2018			
Net interest on defined liability/(asset)	8	(256)	(248)
Administrative expenses	642	448	1,090
Total amount charged to income statement	650	192	842

Analysis of amounts recognised in the statement of comprehensive income:

	SEW Pensions £000	MKW Pensions £000	Unfunded pensions £000	Total £000
2019				
Return on schemes' assets excluding interest income	2,343	2,084	–	4,427
Actuarial (losses)/gains due to changes in financial assumptions	(5,732)	(4,170)	140	(9,762)
Actuarial gains due to changes in demographic assumptions	1,092	731	–	1,823
Experience loss on obligation	–	–	(13)	(13)
Actuarial (losses)/gains recognised in the statement of comprehensive income	**(2,297)**	**(1,355)**	**127**	**(3,525)**
Cumulative actuarial losses	**(6,114)**	**(13,435)**	**(3,154)**	**(22,703)**
2018				
Return on schemes' assets excluding interest income	(1,544)	(1,536)	–	(3,080)
Actuarial gains due to changes in financial assumptions	3,811	5,186	–	8,997
Actuarial losses due to changes in demographic assumptions	(967)	(338)	–	(1,305)
Experience gains/(losses) on obligation	4,782	1,200	(1,239)	4,743
Actuarial gains/(losses) recognised in the statement of comprehensive income	4,843	4,512	(1,239)	9,355
Cumulative actuarial losses	(3,817)	(12,080)	(3,281)	(19,178)

Notes to the financial statements

for the year ended 31 March 2019

28. Retirement benefit schemes (continued)

Reconciliation of defined benefit obligations:

	SEW Pensions £000	MKW Pensions £000	Unfunded pensions £000	Total £000
2019				
Opening defined benefit obligations	160,169	107,713	3,281	271,163
Interest cost	4,304	2,846	–	7,150
Actuarial losses/(gains)	4,640	3,439	(127)	7,952
Past service cost	164	109	–	273
Benefits paid	(7,826)	(4,611)	–	(12,437)
Closing defined benefit obligations	**161,451**	**109,496**	**3,154**	**274,101**
2018				
Opening defined benefit obligations	170,485	116,436	4,520	291,441
Interest cost	4,341	2,898	–	7,239
Actuarial gains	(5,148)	(6,048)	(1,239)	(12,435)
Benefits paid	(9,509)	(5,573)	–	(15,082)
Closing defined benefit obligations	160,169	107,713	3,281	271,163

Reconciliation of fair value of plans' assets:

	SEW Pensions £000	MKW Pensions £000	Total £000
2019			
Opening fair values of schemes' assets	169,469	122,923	292,392
Interest income on assets	4,516	3,270	7,786
Return on schemes' assets excluding interest income	2,343	2,084	4,427
Contributions by employer	3,815	1,322	5,137
Administrative expenses	(423)	(371)	(794)
Benefits paid	(7,826)	(4,611)	(12,437)
Closing fair values of schemes' assets	**171,894**	**124,617**	**296,511**
2018			
Opening fair values of schemes' assets	173,154	126,052	299,206
Interest income on assets	4,333	3,154	7,487
Return on schemes' assets excluding interest income	(1,544)	(1,536)	(3,080)
Contributions by employer	3,677	1,274	4,951
Administrative expenses	(642)	(448)	(1,090)
Benefits paid	(9,509)	(5,573)	(15,082)
Closing fair values of schemes' assets	169,469	122,923	292,392

Notes to the financial statements

for the year ended 31 March 2019

28. Retirement benefit schemes (continued)

The five year history of the schemes is as follows:

	2019 £000	2018 £000	2017 £000	2016 £000	2015 £000
SEW Pensions					
Fair value of scheme's assets	**171,894**	169,469	173,154	152,659	156,844
Present value of defined benefit obligation	**(161,451)**	(160,169)	(175,005)	(154,125)	(166,627)
Surplus/(deficit) in the scheme	**10,443**	9,300	(1,851)	(1,466)	(9,783)
Experience adjustment on scheme's assets:					
Amount	**6,859**	2,789	25,464	1,558	18,108
Percentage of scheme's assets (%)	**4.0%**	1.6%	14.7%	1.0%	11.5%
Experience adjustments on scheme's liabilities:					
Amount	**(4,513)**	6,387	(23,734)	(8,928)	1,400
Percentage of the scheme's liabilities (%)	**(2.8)%**	4.0%	(13.6)%	(5.8)%	0.8%
MKW Pensions					
Fair value of scheme's assets	**124,617**	122,923	126,052	111,558	113,948
Present value of defined benefit obligation	**(109,496)**	(107,713)	(116,436)	(102,555)	(111,154)
Surplus/(deficit) in the scheme	**15,121**	15,210	9,616	9,003	2,794
Experience adjustment on scheme's assets:					
Amount	**5,354**	1,618	19,165	2,477	14,813
Percentage of scheme's assets (%)	**4.3%**	1.3%	15.2%	2.2%	13.0%
Experience adjustments on scheme's liabilities:					
Amount	**(3,439)**	6,048	(16,008)	(6,521)	(2,903)
Percentage of the scheme's liabilities (%)	**(3.1)%**	5.6%	(13.7)%	(6.4)%	(2.6)%

The Trust Deed provides South East Water with an unconditional right to a refund of surplus assets assuming the full settlement of plan liabilities in the event of a plan wind-up. Furthermore, in the ordinary course of business the Trustee has no rights to unilaterally wind up or otherwise augment the benefits due to members of the scheme. Based on these rights, any net surplus in the UK scheme is recognised in full.

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

29. Deferred income

The group adopted IFRS 15 on 1 April 2018 using the modified retrospective method. This has given rise to accumulated historic adjustments being made to the opening balances at 1 April 2018 as detailed below.

Group and company	Notes	**2019 £000**	2018 £000
As at 1 April		**82,064**	76,511
Transfer to retained earnings on adoption of IFRS 15	5	**(71,898)**	–
As at 1 April adjusted		**10,166**	76,511
Received in the year		**9,099**	14,676
Released during the year		**(8,897)**	(9,123)
As at 31 March		**10,368**	82,064
Non-current		**3,185**	74,471
Current		**7,183**	7,593
		10,368	82,064

Contributions received towards below ground assets are released to the income statement on completion of the performance obligations within the contracts with customers.

30. Issued share capital

Group and company	**2019 £000**	2018 £000
Allotted, issued, called up and fully paid		
49,312,354 ordinary shares of £1 each (2018: 49,312,354)	**49,312**	49,312

There is one class of ordinary share which carries no right of fixed income and no restrictions on dividends or capital repayment. The authorised share capital was £100 million at 31 March 2019 (2018: £100 million).

Notes to the financial statements

for the year ended 31 March 2019

31. Movement in liabilities arising from financing activities

Group non-current loans and borrowings	Irredeemable debenture stock £000	Listed bonds £000	Indexed linked loans £000	Non-current loans and borrowing £000
Balance 1 April 2017	991	523,281	357,752	882,024
Changes from other financing activities:				
Indexation on index linked instruments	-	5,680	12,645	18,325
Movement in fair value of interest rate swap	-	-	-	-
Amortisation of issue costs	-	376	172	548
Balance at 31 March 2018	991	529,337	370,569	900,897
Balance 1 April 2018	991	529,337	370,569	900,897
Changes from other financing activities:				
Indexation on index linked instruments	-	**4,564**	**11,487**	**16,051**
Movement in fair value of interest rate swap	-	**-**	**-**	**-**
Loan transfer to current liabilities	-	**(199,890)**	**-**	**(199,890)**
Amortisation of issue costs	-	**376**	**170**	**546**
Balance at 31 March 2019	**991**	**334,387**	**382,226**	**717,604**

Company non-current loans and borrowings	Irredeemable debenture stock £000	Amounts due to subsidiary undertakings £000	Indexed linked loans £000	Non-current loans and borrowing £000
Balance 1 April 2017	991	631,662	249,371	882,024
Changes from other financing activities:				
Indexation on index linked instruments	-	9,274	9,051	18,325
Movement in fair value of interest rate swap	-	-	-	-
Amortisation of issue costs	-	452	96	548
Balance at 31 March 2018	991	641,388	258,518	900,897
Balance 1 April 2018	991	641,388	258,518	900,897
Changes from other financing activities:				
Indexation on index linked instruments	-	**7,672**	**8,379**	**16,051**
Movement in fair value of interest rate swap	-	**-**	**-**	**-**
Loan transfer to current liabilities	-	**(199,890)**	**-**	**(199,890)**
Amortisation of issue costs	-	**451**	**95**	**546**
Balance at 31 March 2019	**991**	**449,621**	**266,992**	**717.604**

Notes to the financial statements

for the year ended 31 March 2019

31. Movement in liabilities arising from financing activities (continued)

Group and company current loans and borrowings	**2019 £000**	2018 £000
Balance 1 April	**20,000**	-
Changes from financing cash flows:		
New loans received during the period	**35,000**	20,000
Listed Loan	**200,000**	-
Expected Credit Loss IFRS 9	**(102)**	-
Balance 31 March	**254,898**	20,000

Group and company derivative financial instruments	**2019 £000**	2018 £000
Balance 1 April	**104,169**	100,916
Changes in fair values:		
Movement in fair value of interest rate swap	**4,667**	3,253
Balance 31 March	**108,836**	104,169

32. Capital commitments

Group and company	**2019 £000**	2018 £000
Contracts placed for future capital expenditure not provided in the financial statements	**33,780**	47,288

All of the above capital commitments relate to property, plant and equipment.

33. Obligations under operating leases

Group and company	Notes	**2019 £000**	2018 £000
Minimum lease payments under operating leases recognised as an expense in the year	8	**498**	408

Future minimum lease payments under non-cancellable operating leases are as follows:

Group and company	**Land and buildings 2019 £000**	Land and buildings 2018 £000
Amounts for the following periods:		
- within one year	**195**	195
- in the first to second	**195**	195
- in the second to fifth years	**585**	585
- after five years	**2,145**	2,340
	3,120	3,315

Notes to the financial statements

for the year ended 31 March 2019

34. Events after the balance sheet date

The group is due to repay part of its long term funding on 30 September 2019 with the maturity of its £200 million listed bond. The bond was originally issued at a fixed interest rate and swapped to an index linked rate via a derivative transaction, also maturing on 30 September 2019. The total amount repayable on both the original loan and the derivative is approximately £311.5 million.

The group has arranged new funding to finance the repayment of the above financial instruments by way of:

- A fixed rate loan of £75 million to be drawn down on 16 September 2019. The Interest rate applicable to this loan is 2.94 per cent, being LIBOR plus a margin of 1.34 per cent. This loan matures on 16 September 2031
- A fixed rate loan of £100 million to be drawn down on 16 September 2019. The Interest rate applicable to this loan is 3.22 per cent, being LIBOR plus a margin of 1.52 per cent. This loan matures on 16 September 2042
- A variable rate loan of £120 million to be drawn down on 30 September 2019. Interest on this loan, which varies annually in line with LIBOR, has been budgeted at 2.2429 per cent for the initial year, being LIBOR plus a margin plus a margin of 1.2 per cent. This loan matures on 19 December 2025

Additionally, the group's immediate parent company, South East Water (Holdings) Limited will repay £54 million of the £190 million parent company loan.

In September 2018 the group submitted its business plan to Ofwat for the forthcoming five-year regulatory period. The ambitious plan would see investment of a further £472 million to improve the local water infrastructure between 2020 and 2025.

While Ofwat praised the plan overall, the group was requested to review some specific aspects and asked to re-submit the plan by 1 April 2019, which was duly completed. Ofwat will publish their draft determination in July 2019 and final determination in December 2019. This will set the backdrop for the prices the group are allowed to charge for the period between 2020 and 2025.

The political and economic situation with regards to the UK leaving the European Union continues to evolve and the company has prepared for this eventuality. We continue to monitor the situation and will respond to developments as they progress.

35. Group related party transactions

The group's ultimate holding company is Utilities of Australia Pty Ltd as Trustee for the Utilities Trust of Australia, which is resident in Australia.

The group of companies into which results of the group are consolidated is that headed by HDF, a company registered in England and Wales. The consolidated financial statements of HDF may be obtained from the Company Secretary, Rocfort Road, Snodland, Kent ME6 5AH.

Transactions with the group's parent company

An unsecured loan to the immediate parent company SEWH of £190 million (2018: £190 million) is disclosed in note 19 under non-current assets. Loan interest receivable during the year was £5.3 million (2018: £4.5 million). There was no interest outstanding as at 31 March 2019 (2018: £nil) included under trade and other receivables in note 21.

Also, as at 31 March 2019 the group has a current account debt due to its parent company of £5.4 million (2018: £5.8 million) in respect of group tax relief payable.

Transactions with other related parties

As at 31 March 2019 the group has net current account balances due to other related parties totalling £3.2 million (2018: £3.2 million) all relating to group tax relief payable.

The company has received loans totalling £761.9 million (2018: £749.7 million) on various terms from its subsidiary company as disclosed in note 23. Interest of £25.7 million (2018: £25.2 million) has been charged on these loans during the year. Interest outstanding on the loans at 31 March 2019 totalled £7.9 million (2018: £7.6 million).

On 1 May 2018, the company sold its rights and interests in the trade and customer base of its non-household customers to its sister subsidiary, Invicta Water Limited, for a consideration of £10 million. Subsequently, following the sale of Invicta Water Limited by its parent, Swan Group, the company bought the outstanding debtors at 30 June 2019 from Swan Group on that date for £6.4 million, including a discount on the book value of £0.5 million.

Key management compensation is disclosed in note 9 and discussed further in the remuneration report. Contributions to retirement benefit schemes are disclosed in note 28.

Care for our community

Throughout the business we've put customer satisfaction at the heart. Ensuring our customers whatever their circumstances receive a great service they deserve.

Annual Performance

Disclosures and statements by directors

This annual performance report has been prepared in accordance with Condition F of South East Water Ltd's ("SEW") instrument of appointment ("Licence") and in accordance with the latest regulatory accounting guidelines ("RAGs") issued by Ofwat.

In instances where there are differences between international financial reporting standards ("IFRS") as adopted for use in the European Union and the RAGs, the RAGs take precedence.

These disclosures and statements should be read in conjunction with the information set out in the financial statements of South East Water Ltd for the year ended 31 March 2019.

Directors' remuneration and standards of performance

The directors' remuneration report in the company's annual report and financial statements sets out the remuneration paid or due for the financial year to the directors under arrangements linking the remuneration of directors to standards of performance in connection with the carrying out by South East Water of its functions as a relevant undertaker. It provides details of these arrangements and of the relevant remuneration. The relevant information provided in the directors' remuneration report is incorporated by reference into this annual performance report as the statement required under section 35A of the Water Industry Act 1991. The report from the Remuneration Committee in the corporate governance report also provides information on the arrangements in place for the remuneration of directors and how they have been reviewed by the Committee.

Disclosure to auditor

The directors who were members of the board at the time of approving the annual performance report are listed in the company's financial statements. Having made enquiries of fellow directors, and exercising reasonable care, skill and diligence, each of these directors confirms that:

- so far as the director is aware, there is no relevant audit information of which South East Water Ltd's auditor is unaware
- each director has taken all the steps that a director ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that South East Water Ltd's auditor is aware of that information

Dividend policy

Dividends are authorised in accordance with the Companies Act 2006 and our dividend policy, having due regard to Condition I12 and I26.6 of the Licence which state that dividends paid must be in accordance with the dividend policy, must not impair the ability of South East Water Ltd to finance the appointed business and that, under a system of incentive regulation, the dividend would be expected to reward efficiency and the management of economic risks. Dividends are paid as declared and are recognised as a distribution when paid. No unpaid dividends exist at the year end. Additional information on our dividend policy is set out in the Strategic Report.

Dividends paid in the year amounted to £28.0 million, of which £5.3 million was used by our parent company, South East Water (Holdings) Ltd, to pay interest on a loan from South East Water Ltd.

Accounting policies

Price control segments

Operating costs are directly attributed to price control units, where possible, based on the activities that cause the cost to be incurred. Costs are attributed based on the guidelines set out in RAG 2.07. Where costs cover more than one price control unit, an appropriate basis of allocation consistent with the activities that cause the costs is used in order to allocate the costs to the relevant price control units.

In the majority of cases, assets and their associated depreciation are directly attributed to price control units that solely use the assets. However, where assets are used by more than one price control unit, the assets are initially allocated to the price control unit where the principal use occurs with a recharge being made to other price control units using the assets in proportion to the use of the assets.

There have been no significant changes in the methodology of allocating costs to price segments in the year. For further information on the allocations of costs and assets, see South East Water Ltd's accounting methodology statement which is available on our website.

Revenue recognition

The revenue recognition policy is the same in the regulatory accounts as in the statutory accounts. Additional charges added to a customer's account as a result of debt recovery activity, such as court costs or solicitors fees, are recognised as a credit within operating costs in both the statutory and regulatory accounts and as such do not affect turnover.

There have been no changes made to the procedure followed in calculating the measured income accrual in the year. A review was undertaken of the measured income accrual for the year 2017/18 and there were no significant differences between the accrual and the amounts billed in the year.

The following applies in relation to our policy on billing:

- if supply is not required, charges on an unoccupied or void property will normally be waived from the date we are informed. When informed of the vacation of a property, we may choose to turn off or disconnect the water supply at the stopcock. If we are requested not to turn off or disconnect the water supply either by the outgoing or incoming occupier they must undertake to pay all water charges arising until we are otherwise notified
- we do not send a bill to "the occupier" for premises where the name of the customer is not known. At the point that the occupier's details are known we will issue a bill as appropriate
- where we have donated to a charitable trust/ assistance fund in relation to assisting customers with payment of water debt, any associated billing is included within water turnover
- when a new property is connected to our network, billing commences upon meter installation

When a property is identified as unoccupied on the billing system it will then proceed into our void property process to verify with as much certainty as possible whether the property is truly empty or not. As part of this process we will send out letters along with an application form to properties that are recorded as being empty for over 21 days. If there is no response a further letter is then sent. If there is still no response, we will review the account and take a range of additional steps including further written communication, meter reader visits to the property and enquiries to view the land registry to confirm the owner of the property whom we then contact.

Capitalisation

We determine employee costs directly attributable to capital projects based on the time spent on each project recorded on timesheets completed by employees. Other directly attributable costs are then assessed and any costs relating to capital projects are capitalised into individual projects. Training costs, administration and other general overhead costs are not capitalised. Over the past year our policies on the capitalisation of costs have not changed.

Bad debt

The bad debt policy is the same in the regulatory accounts as in the statutory accounts and has been adjusted to reflect the adoption of IFRS 9.

Debt is written off in only a limited number of scenarios when all collection avenues have been fully exhausted. Examples include where a debtor is not a current customer and all procedures to trace their whereabouts have been undertaken or where a customer is insolvent and we have been advised that no payment will be forthcoming.

An estimate for the provision for doubtful debts is calculated by our management based on applying expected recovery rates to an aged debt profile. We have no significant concentration of credit risk with exposure spread over a large number of domestic and commercial customers.

Sufficiency of non-financial resources – Certificate under Condition K

The directors of South East Water Ltd confirm that, in their opinion, the company was in compliance with sub-paragraph 3.1 of Condition K of its Licence at the 31 March 2019 and would have available sufficient rights and assets, other than financial resources, to enable a special administrator to manage the affairs, business and property of the company.

Sufficiency of financial resources and facilities – Certificate of Adequacy under Condition I

Under Condition I of the Licence, sub-paragraph I17 – Certificate of Adequacy, the directors of the company are required to provide a certificate in relation to the wholesale and household retail business (referred to as the Residual Business in the Condition) including, in respect of the wholesale business only, a statement on any contracts entered into with any associated company. The following certificate is set out below in accordance with the requirements of this Condition.

Certificate of adequacy in relation to the wholesale and household retail business (Residual Business)

- in the opinion of the directors, the company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least 12 months from the date of signing the accounts, the regulated activities as defined in the Licence (including the investment programme necessary to fulfil its obligations under the Licence)
- in the opinion of the directors, the company will, for at least 12 months from the date of signing of the accounts, have available management resources and systems of planning and internal control which are sufficient to enable it to carry out the regulated activities
- in respect of the wholesale business only, in the opinion of the directors, all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the company, to ensure that it is able to meet all its obligations as a water undertaker

South East Water exited the non-household retail market on 1 May 2018 and transferred its non-household retail business to Invicta Water Ltd as the acquiring licensee pursuant a transfer scheme made under the Water and Sewerage Undertakers (Exit from Non-Household Retail Market) Regulations 2016. In accordance with the provision of Condition I sub-paragraphs I17 and I18, the requirement under that Condition to provide a separate certificate of adequacy in relation to the non-household retail business ceased to apply on 1 May 2018.

Main factors taken into account by the directors

In providing the certificate set out above, the directors have taken into account the following:

- our financial statements, which have been prepared on the going concern basis
- the outcome of the 2014 price review for the five years from 1 April 2015 to 31 March 2020
- the outcome of the 2016 non-household price review
- the updates provided at each board meeting on the financial performance of the company
- that we have complied with our financial covenants and have maintained our investment grade rating of BBB
- borrowing facilities which include significant undrawn bank facilities
- our formal risk management process which reviews, monitors and reports on the company's risks and mitigating controls and assesses the potential impact of risks
- the processes we put in place under the company monitoring framework
- our PR19 business plan that was submitted to Ofwat in September 2018
- the long term viability statement set out in the strategic report and the going concern statement set out in the company's financial statements
- the results from the stress testing and examinations as requested to be performed by Ofwat to improve the robustness of the viability statement
- the completion of our refinancing in 2019

The independent auditor's report is also relevant to the certificates set out above and can be found on page 196 of this annual performance report.

Long term viability statement

Our long term viability statement is set out on page 60 of the Strategic Report. Details of our risk management process and of our principal risks may be found on pages 53 to 59 of the Strategic Report.

Explaining company direction and performance

Our 2015 to 2020 business plan is based around outcomes which, in the broadest sense, set out what we want to achieve in all areas of our performance, as opposed to just meeting a set of prescribed targets. This approach enables our ambition to become a more customer-centric business – which measures our customers' satisfaction with how well we delivered those outcomes – to flourish. Those outcomes included a suite of innovative customer satisfaction metrics that measure all aspects of our service delivery, as well as a comprehensive set of targets around the quality, reliability and management of supplying drinking water. This renewed focus on customer satisfaction has led to a shift in our company culture and how we run the business – one that ensures that customers are at the centre of our decision making and planning.

As a provider of a service that is essential for our society to thrive now and in the future our board is focused on delivering a great level of service to our customers today as well as setting the strategic direction over the longer term. Our business planning process for 2015 to 2020 was an important step along our board's continuing journey to develop the strategic direction of our business; this was translated into our vision and objectives, the 2015 to 2020 corporate plan and the annual reporting and governance associated with meeting our strategic objectives.

Our experience to date has shown us that having a strong focus on customer satisfaction ensures that we are constantly listening to our customers and stakeholders so that we can adapt and improve our services to their changing needs and requirements. In our plans for 2020 to 25 we are taking this approach even further to ensure that the voice of all of our customers' is heard and acted on.

Being a responsible business

Over the past year we have developed a responsible business strategy by listening to our customers, stakeholders, employees and Board. This has resulted in the creation of 10 new responsible business commitments to reflect the actions and behaviours that our customers and stakeholders expect a responsible business to display; and, in conjunction with great service, have the potential to create a stepchange in trust of the water sector.

Being a business that understands our customers

Our plan for 2020 to 2025 is built around customer satisfaction. We have evolved our approach to measuring customer satisfaction that we introduced in 2015, and have developed an innovative approach to measuring satisfaction based on attitudinal segments. This will help us understand the needs of all our customers and make sure we go beyond delivery what the 'average' customer wants.

Being a responsible business that supports our customers

We have stretched our performance and ambitions for our future plans with six new performance commitments specifically around vulnerability. These have been co-created with our customers, stakeholders, employees and our CCG; so too has the strategy that underpins these performance commitments. A key focus during the year has been developing our vulnerability strategy. An example of our ambition to ensure all customers receive the service they desire this year we became the first water company to achieve the British Standard BS 18477, demonstrating that the organisation provides an inclusive service for customers with vulnerable circumstances.

Being a business that enhances the environment

Operating in an environmentally diverse yet water-stressed area we need to make the right choices for our local communities and the environment. We have developed a suite of six new performance commitments that recognise the influence we can, and should, have on landowners, other water users and abstractors to make water catchments more resilient to drought, while also ensuring we enhance habitats to give wildlife an opportunity to thrive.

We intend to build on the partnership approach we have developed over the last five years to achieve these ambitions as we know our shared experience and knowledge of the environment is key.

Being a business that drives innovation

We have developed a focused innovation strategy which targets our customers' and stakeholders' priorities; and where we can make the most difference. We have developed a number of innovation toolboxes to help us deliver our stretching performance commitments for the next five years and beyond.

The relationship between business performance and executive rewards

Our executive rewards policy is designed to recognise and reward performance that customers have told us are most important to them. Priority is given to the delivery of six key operational objectives.

Operational targets include improving our customers' satisfaction, service incentive mechanism scores and health and safety performance, in addition to performance measures such as leakage, interruptions and discoloration. In 2018/19, in line with our Board's responsible business commitments, we also included personal objectives for the Executive Directors to improve diversity and inclusion, and develop our environment, social and governance framework and customer engagement strategy beyond PR19. This inclusion reflects how we have responded to customers' wishes to see a greater focus on responsible business attributes and adapted the approach accordingly.

We will increase our focus on our responsible business commitments in the next five years and our targets and decision on reward will include broader stakeholder considerations including employee engagement, community impacts, environmental performance etc.

Financial performance targets are focussed on "totex" costs and cash collection efficiency.

Our aim is to ensure our performance incentives encourage the achievement of stretching operational, financial and personal targets. We want to motivate a strong commitment to achieving the goals we have set, as well as to establish a close link between overall rewards, corporate performance and the benefits delivered to our customers.

Our remuneration committee is responsible for designing, monitoring and reporting executive pay in accordance with its terms of reference. It reviews the ongoing appropriateness and relevance of the remuneration policy. The committee set annual bonus and longer term targets and decides the performance bonus payment to each member of the executive team based on an assessment of their performance. This is part of the ongoing monitoring of performance against the company's commitments.

Board leadership, transparency and governance

We set out in our corporate governance report how we have met corporate governance requirements including those set out in the 2014 board leadership, transparency and governance principles. Please read our corporate governance report starting at page 66.

We explain below the steps we are taking to transition to the new 2019 board leadership, transparency and governance principles and more generally how we intend to develop and improve our corporate governance framework.

Updating our corporate governance framework

We are updating our overall corporate governance framework to incorporate the most recent requirements of the UK Corporate Governance Code 2018 and associated guidance, the 2019 board leadership, transparency and governance principles and new reporting requirements under the Companies (Miscellaneous Reporting) Regulations 2018.

Our aim is to develop a cohesive, consistent and integrated approach to transparency, governance, environmental and social matters which is continuously reviewed to incorporate best practice and innovation and which is guided by:

- understanding our role as a provider of an essential public service
- our business plan responsible business commitments and in particular our commitment to develop a trusted corporate governance
- our engagement with customers and stakeholders and the insight from our new customer insight team

We established our responsible business committee on 7 March 2019 and its terms of reference were approved by the board.

The main purpose of the responsible business committee is to assist the board in defining its strategy relating to environmental, social and governance ("ESG") matters and in reviewing the practices and initiatives of the company relating to the ESG matters ensuring they remain effective and up-to-date.

The responsible business committee will also oversee the execution of our ESG strategy and initiatives and will monitor performance against the responsible business commitments adopted by the board in our business plan. The responsible business committee will ensure that the board maintains a primary focus on customer engagement, our commitments and the environment.

The first key work streams of our action plan to improve our corporate governance framework are:

- to review the SEW corporate governance code and make consequential changes to the terms of reference of committees and other corporate governance documents and policies
- to formalise our wider CRS/ESG framework in line with our business plan and corporate plan responsible business commitments through the responsible business committee
- to implement a new reporting framework to meet our obligations under the Companies (Miscellaneous Reporting) Regulations 2018

We have reviewed our current practices against the requirements of the new board leadership, transparency and governance principles and our current practices are substantially in line with the principles. We have identified areas where we wish to go further to meet the intent of the objectives of the January 2019 principles which are summarised below and are not limitative.

Purpose, values and culture

During the current regulatory period, we have defined our company's vision and values and implemented a number of initiatives to promote a culture that supports our approach to customer satisfaction and our role as a provider of an essential public service.

The board has also been reviewing regular updates in monthly performance reports on our cultural change initiatives and on environmental, social and governance matters allowing the board to monitor the progress made in implementing these initiatives which are also closely linked to our approach to customer satisfaction. We will be enhancing this regular reporting to the board as we implement our responsible business commitments from 2019/20 onward.

This year, our board evaluation questionnaire also incorporated questions from the Sustainability First "Check-list for energy and water board effectiveness" in line with our responsible business commitments. The questions identified in the Sustainability First check-list relate to three key challenges faced by water and energy companies:
(i) How to demonstrate that total returns are acceptable?
(ii) What can boards do to build better regulator / company relationships?
(iii) The important role of Non-Executive Directors in energy and water.

The board agreed to consider further the Sustainability First themes in its strategic sessions in 2019.

We will define the company purpose and develop our work on cultural change using our engagement with customers and other stakeholders as a basis, building on the existing work described above to help deliver our responsible business commitments. Our responsible business committee supported by the responsible business steering group will play a central role in making sure that behaviour is aligned with our purpose and aspirations.

Board leadership and transparency

One of our key responsible business commitments is to have a trusted corporate governance. We will use the principles of integrated reporting for the continuous improvement of our corporate governance and reporting framework.

We will expand our reporting to cover our responsible business commitments and wider ESG matters. Our aim is to make it more accessible, understandable and relevant to our customers, the communities we serve and other stakeholders.

Our goal is also to keep our reporting focused and concise. For example, we believe there is convergence between the objectives Ofwat's principles on board leadership and transparency and the three new statements required under the miscellaneous reporting regulations on
(i) section 172(1) and how the directors have had regard to relevant matters when performing their duty under that section,
(ii) on engagement with employees and
(iii) on engagement with suppliers, customers and others in a business relationship with the company.

We will also review our reporting to improve transparency in key areas highlighted by Ofwat in the principles or elsewhere on executive pay, financial flows and structure, risk and viability and the management of conflicts of interest.

Statement of directors' responsibilities

The directors are responsible under Conditions F and I of the Licence for:

- ensuring that proper accounting records are maintained by the appointee to enable compliance with the requirements of Condition F and to prepare a set of regulatory accounting statements, in respect of the twelve months ending on 31 March in each charging year, which are in accordance with the Regulatory Accounting Guidelines
- ensuring that South East Water maintains an investment grade credit rating (license Condition I30)
- ensuring that South East Water has adequate resources to continue as a going concern for the foreseeable future

Differences between statutory and RAG definitions

Material differences between the statutory financial statements and the RAG definitions are:

- in the income statement, the difference of £2.6 million in profit before tax includes capitalised interest of £2.5 million, the removal of depreciation on capitalised interest of £0.2 million and pension costs adjustments of £0.3 million
- in the statement of financial position, cumulative capitalised interest less depreciation of £17.7 million has been excluded from fixed assets

Transactions with associate companies

Disposal of intangible assets

Associate	Transaction	2019 £000
Invicta Water Limited	Sale of the rights to non-household customer book	10,000

Acquisition of debt

Associate	Transaction	2019 £000
Invicta Water Limited	Purchase of residual non-household debtors	6,126

Loans from associate companies

Associate	Interest	Loan period	2019 £000
South East Water (Finance) Limited	Index linked plus 0.01% margin fee Indexation	Repayable in September 2019	200,000 108,639
South East Water (Finance) Limited	Fixed rate	Repayable in March 2029	166,000
South East Water (Finance) Limited	Index linked plus 0.01% margin fee Indexation	Repayable in December 2041	130,000 40,608
South East Water (Finance) Limited	Index linked plus 0.01% margin fee Indexation	Repayable in December 2037	100,000 16,638

Interest and related fees payable to associate companies

Associate	Nature of transaction	Terms of supply	2019 £000
South East Water (Finance) Limited	Interest, RPI indexation and margin fees on intercompany loans (see below)	(See above)	37,825
South East Water (Finance) Limited	Ambac fees on both £166 million and £200 million loans	Monoline fees	749
South East Water (Finance) Limited	Facility fees	Commitment fees on loan facilities	189

Loans to associate companies

Associate	Nature of transaction	Terms of supply	2019 £000
South East Water (Holdings) Limited	Interest on intercompany loans of £190 million	LIBOR plus 2%	5,305

Fees payable to associate companies

Associate	Nature of transaction	Terms of supply	2019 £000
Invicta Water Limited	Fees for the cash collections services	Market values	385

In the regulatory accounts for the previous year a provision was charged to the income statement for meter reading services provided by Invicta Water Limited of £52,000. These fees were cancelled in the current year and the full provision was released back to the income statement.

Fees receivable from associate companies

Associate	Nature of transaction	Terms of supply	2019 £000
Invicta Water Limited	Fees for the provision of support services	Market values	141

To the best of the directors' knowledge, all appropriate transactions with associated companies have been disclosed in compliance with Condition I and RAGs 3.11 and 5.07.

Tax strategy and current tax reconciliation

South East Water Ltd is committed to the effective, sustainable and active management of our tax affairs in support of our overall business performance and, as with all other aspects of our business, to maximise shareholder value and minimise customer bills as any tax payable is required to be funded via the prices set by Ofwat.

We are committed to pay tax according to the law and conducting our tax affairs according to clear principles. We seek to maintain good working relationships with tax authorities, sharing our views either directly or through trade associations.

South East Water believes it is important to state our views on tax in the context of corporate responsibility. We believe our obligation is to pay the amount of tax legally due and observe all applicable rules and regulations relating to tax compliance. However, at the same time we also have an obligation to maximise shareholder value, minimise customer bills and to manage financial and reputational risk. This includes controlling our overall liability to taxation.

We do not condone either personal or corporate tax evasion under any circumstances and were such issues to be identified, full disclosure of the activities undertaken would be required to be made to the tax authorities.

Our aim is to have a constructive relationship with the tax authorities on an on-going basis. Nevertheless we recognise that there may be some areas that are not free from doubt or differing legal interpretations may be possible. Where disputes arise with the tax authorities with regard to interpretation and application of tax law, we are committed to addressing the matter promptly and seek resolutions in a responsible manner. A more detailed explanation of our tax policy is available on our website.

For the year ended 31 March 2019 a UK corporation rate of 19 per cent has been used as enacted on 26 October 2015 by Finance Act 2013. A reduction in the UK corporation tax rate to 18 per cent (effective 1 April 2020) was also enacted 26 October 2015, however an additional reduction to 17 per cent (effective 1 April 2020) was substantively enacted on 6 September 2016.

The deferred tax on temporary differences as at 31 March 2019 have been calculated in full under the liability method at the rate applicable to the year in which the temporary differences are expected to reverse.

The following table shows a comparison between the amount funded within the final determination (FD) and the tax charge within the regulatory accounts.

Wholesale tax reconciliation:

	2018/19 Prices £000
Final determination (2012/13 prices)	1,580
Indexation	249
Final determination	1,829
Actual in regulatory accounts	(321)
Retail tax	(717)
Wholesale tax	(1,038)

The reconciliation of wholesale taxation to funded taxation is as follows:

	2018/19 Prices £000
Wholesale tax	
Contributions and Infrastructure charges	(814)
Capital allowances	3,160
Variance in operating profit	248
Corporation tax reduction	91
Other	182
Final determination	1,829

The reconciliation of current appointed tax is as follows:

	2018/19 Prices £000
Profit before tax	45,502
Taxation at 19%	8,645
Expenses not deductible	594
Capital allowance exceed depreciation	(1,904)
Prior year adjustment	(4,005)
Fair value of swap	(1,100)
Pension movements	(892)
Allocated to non-appointed activities	(1,188)
Other	(471)
Current tax charge for the year	(321)

Data assurance summary

Our internal controls and board oversight

In 2015/16 Ofwat issued new reporting requirements for the annual performance report which would incorporate a number of tables and information previously contained in the regulatory accounts. Further changes to reporting requirements were issued by Ofwat in 2017/18, with the introduction of the financial flows metric and additional cost assessment tables. 2018/19 has seen the financial flows incorporated into the annual performance report. We have included these changes into our annual reporting and have chosen to publish the cost assessment tables (4J to 4W) as a separate document alongside our annual performance report.

The internal data assurance that we have undertaken for the contents of the annual performance report section of the annual report also covers all contents in our performance, people and planet (PPP) report.

Our governance and assurance process for the preparation of our annual performance report and PPP report were based on our well-established systems of internal control for all regulatory and performance reporting and incorporated oversight by the board and scrutiny by the audit and risk committee following reviews by the executive directors, and the requirement for heads of department and/or manager level sign off.

The assurance methodology that we have adopted is in line with our approach set out in our company monitoring framework with the three levels of assurance as described below:

Level 1

- peer review – data and information must be checked by a separate individual
- manager review/sign off – data and information is required to be checked by the line manager responsible for the individual completing the submission

Level 2

Internal review

- data and process audit – data validity is tested through taking a sample and verifying the data for critical data such as PCs, ODIs and 'C' grade areas
- the methodology document is reviewed to ensure that the process and internal controls are complete and being followed

External review

- data, process and submission audit – this process is undertaken by an external assurance partner
- a review of methodology, data sampling and internal controls is undertaken
- meetings undertaken with senior managers and those who produce the data to ensure a thorough understanding is obtained. The external auditors attend the pre audit meetings to review preparations for the audits and any potential issue that may arise

Level 3

- director/executive approval – final review of submission information
- audit and risk committee review
- board approval – overall review of assurance and auditing undertaken
- discussion and approval of external assurance partner findings

Additional assurance has been added as part of our ongoing drive to publish highly robust and accurate information as described below:

Level 1

- independent review is undertaken of the reporting requirements to ensure all required changes and actions are identified
- the changes identified are circulated and assigned to an owner
- formal review of last year's Ofwat queries and audit issues are circulated to the owners to ensure required actions are adopted
- data owners are required to complete pre audit check lists which cover all areas of compliance including, Ofwat's reporting requirements

Level 2

- any required changes are controlled by the Regulatory Assurance Manager. A log has been maintained to track sign off at all the assurance stages and provide an audit trail to the source data
- the process for areas of high risk and importance are reviewed and additional assurance added. For example, all interruption events are separately reviewed and signed off by the manager
- internal consistency checks have been undertaken on the data within the annual performance report and against other published documents
- external consistency checks have been carried out on our APR tables, by Jacobs
- A master set of APR tables is linked to our source data to provide an audit trail. This is separately managed and controlled
- independent review is undertaken to check the tables are populated with the audited data
- the master set of data tables and submission version is checked manually cell by cell by an independent reviewer and by an automatic electronic lookup. These are used to try to eliminate any input errors arising from the manual entry process required for the submission version of the tables
- independent check to ensure all the formatting requirements have been met
- internal consistency checks on the APR tables with APR commentary

Annual reporting has a clear ownership structure with relevant managers and head of departments taking ownership of sections of the reporting and supporting material. Each data table has data providers assigned for each line and each section and table has an overarching table owner who is a head of department, reporting to an executive director. The data providers are responsible for collecting, compiling and reporting the data to the table owner and the table owner is responsible for reviewing such data.

The board considered and approved the final processes used for the generation of the 2018/19 annual reporting. The audit and risk committee also scrutinised the annual performance report and related narrative, the risk and compliance statement and PPP report. This committee reported to the board before the board approved the annual reports.

A summary of the performance by the company in 2018/19 against our performance targets including comments and recommendations received from our independent assurance partner, Jacobs, were reviewed by the committee. The committee and board also reviewed the annual performance report, the risk and compliance statement and PPP report. Our annual performance tables have been prepared under the scrutiny of our audit and risk committee, which also considered the declarations to be provided under Conditions I and K of the Licence, and have been approved by the board.

Our external assurance

As the processes and associated data items are complex and detailed, the board focuses on the process followed to prepare and review data, the robustness and clarity of the reported information, and obtains additional information and analysis from the executive directors. In addition, the board assures itself of the robustness of data by gaining assurance from Jacobs.

Jacobs are our independent assurance partners whose role is to assist the board to ensure, completeness of the annual reporting, compliance with relevant duties and obligations, and to ensure that the information we provide to demonstrate compliance with our relevant duties and obligations is consistent, comparable, reliable and robust. They presented their summary report and findings to the audit and risk committee.

During 2018/19 Jacobs undertook a half year review of some of our performance commitments providing feedback on any potential improvements identified.

Details of the work performed by Deloitte on our annual performance report are provided in the Independent Auditor Report on page 196.

For the current reporting period Jacobs have reviewed all of our performance commitments. This is done through separate audits for each of the PCs, ODIs and sub measures, enabling additional information to be reviewed on a yearly basis and enabling the auditors to provide a more robust challenge. Final audits of the APR tables are then undertaken (Tables 3A, 3B, 3C, 3D and 3S). The following annual performance report tables are also audited by Jacobs:

- 2B – Totex analysis – wholesale water and wastewater
- 2C – Operating cost analysis – retail
- 3A – Outcome performance table
- 3C – AIM table
- 3D – SIM table
- 4A – Non-financial information
- 4B – Wholesale totex analysis
- 4C – Impact of AMP performance to date on RCV
- 4D – Wholesale totex analysis – water
- 4F – Cost analysis – household retail

Jacobs also reviewed the following tables not included within the annual performance report, but which are included in the annual performance report tables:

- 3S – Shadow reporting of new definition data
- 4J – Atypical expenditure by business unit – wholesale water
- 4P – Non-financial data for WR, WT and WD – wholesale water
- 4Q – Non-financial data – Properties, population and other – wholesale water
- 4V – Operating cost analysis – water resources

Deloitte, our financial auditors have audited:

- Section 1, including the new additional table 1F
- Section 2, except 2B and 2C noted above but includes the new additional table 2K

Deloitte also reviewed the following tables audited by Jacobs:

- 4B – Wholesale totex analysis
- 4C – Impact of AMP performance to date on RCV
- 4D – Wholesale totex analysis – water
- 4F – Cost analysis – household retail

Deloitte also review the following tables:

- 4G – Wholesale current cost financial performance
- 4H – Financial metrics
- 4I – Financial derivatives

The findings from annual audits will be incorporated into the process of updating our company monitoring framework which will be published in autumn 2019.

Our company monitoring framework

In June 2015 Ofwat published guidance on its company monitoring framework. In which it stated:

"The company monitoring framework is a tool to challenge all companies to provide information for customers and stakeholders that is reliable, timely, appropriate to the audience, and for companies to be transparent with customers and stakeholders about the data assurance they put in place."

Each autumn we publish our company monitoring framework which sets out what we do to ensure that the data and information we publish is reliable, transparent, timely and appropriate to the audience. We publish our strengths, risks and weaknesses statement and the subsequent draft assurance plan we have developed in order to address any risks that have been identified. In March each year we publish our final assurance plan for the year which takes into account any feedback we have received as a result of the publication of our draft assurance plan.

Ofwat's 2018 assessment

In January 2019 Ofwat published its Company Monitoring Framework Assessment in which we were commended for the quality of the performance information we publish for some areas, but identified as having some minor concerns in some of the other areas.

The report is an annual assessment on the quality of information and assurance all water companies provide to customers about their performance and is intended to challenge them to publish information that can be trusted by their customers.

The conclusion of this report saw us drop from the highest category of self-assured, which we earned in 2016, to the targeted category.

Our plans for publishing our future company monitoring frameworks

In their assessment, Ofwat said: "The company met our expectations in many areas and exceeded our expectations in two areas, the assurance plan and water resources management plan (WRMP) and market information. However, we had minor concerns in four areas; the financial monitoring framework, changes engagement, PR19 business plan data consistency and PR19 business plan data quality. Given the number of concerns we consider that the company has not consistently met the high standards expected in order to be assessed as self-assurance".

This status means that we are required to publish a full analysis of the strengths, risks and issues in relation to data and information provision and we need to publish a summary of the outcome of the assurance that has been carried out. In practice we have always published this for these elements, while self-assured (though not required to), and as such the format of our company monitoring framework remains unchanged.

All companies in the targeted assurance band were required to:

- identify the risks, strengths and weaknesses in providing the quality of information that stakeholders want and trust
- carry out an exercise with stakeholders to target issues to address
- consult on our draft assurance plans to ensure that they are sufficient to address the issues identified
- publish a statement on this in the autumn of each year

We will be producing a new company monitoring framework and assurance plan for 2019/20 and publishing this in autumn 2019. The findings from our annual audits for 2018/19 will be incorporated into the process of updating our risk assessments and assurance plans. In particular, we will be reviewing our risks and the minor concerns identified by Ofwat.

Risk and compliance statement

As directors of South East Water, we have relied on the established systems of internal control the company operates to ensure that it delivers its statutory, regulatory and Licence obligations and manages its risks in order to prepare this statement, the regulatory accounts, the annual performance report and all related narrative.

We have also relied on comprehensive and transparent controls and assurance mechanisms which set out clear accountability for data collection, analysis and verification following the approach defined in our company monitoring framework. The data and control processes themselves have been thoroughly reviewed by external financial and technical auditors to ensure that the information we publish is robust and of high quality. This enables us to have a high degree of confidence in the information presented in this year's regulatory reporting and supporting data on which the declarations of compliance set out at the end of this statement are based.

We describe our risk management systems and our principal risks in our strategic report. We describe our governance and how we comply with the principles of our corporate governance code including on transparency and accountability in our corporate governance report. Our company monitoring framework describes our approach to reporting and assurance of information and a summary of the process we followed to assure the quality of our reporting is set out in our data assurance summary. We have also set out our assessment of the prospects and viability of the company in our long term viability statement.

In addition to regular reporting during the year, compliance with our obligations under sector specific legislation or regulation and under our Licence was reviewed for our annual reporting on several of our outcome delivery incentives. This identified one deviation from or non-compliance with these obligations in 2018/19.

Following a site audit by the Drinking Water Inspectorate ("DWI") in May 2018, we received a Notice under regulation 28(4) of the Water Supply (Water Quality) Regulations 2016 relating to our Barcombe Water Treatment Works. The Notice required a pre-emptive suspension of transfers of water between Barcombe WTW and Arlington WTW over concerns that they might potentially affect the disinfection process. We immediately complied with the conditions of the Notice to avoid any risk to the wholesomeness of water at the consumer's tap and have met all required timescales for activity in relation to that Notice.

Following a further review by the DWI and the progress made to date, the prohibition Notice was lifted in May 2019 and a revised Notice issued setting out additional measures and in particular monitoring that would provide sufficient information to demonstrate the transfers do not have a detrimental impact on disinfection.

Our innovative approach on outcomes is based on customer satisfaction. For further information about our customer satisfaction outcomes and the approach we have taken in 2018/19 to improve our customers' experience please see our performance, people and planet report.

For the preparation of this statement we have considered compliance with our statutory, regulatory and Licence obligations, particularly those considered by our annual reviews as set out above. We have also specifically considered compliance with our statutory, regulatory and licence obligations that have not been confirmed by other processes and for which Ofwat is the enforcement authority.

Having regard to the progress made in responding to the issues raised by the DWI at our Barcombe Water Treatment Works, our annual reviews have not identified any material deviation from or non-compliance with these obligations and to the best of the board's knowledge after reasonable enquiries South East Water has complied in all material respects with these obligations and is taking appropriate steps to manage and/or mitigate the risks it faces.

This statement is published alongside our annual report and financial statements, and annual performance report for the year ended 31 March 2019, and in making this statement we have taken account of the other statements made in compliance with our obligations under Conditions F, I and K of our Licence and under section 35A of the Water Industry Act 1991 (which are set out in the directors' remuneration report).

Based on the scope and outcome of the review processes detailed in this statement and in our annual financial and regulatory reporting the board is able to confirm that South East Water:

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

Approved by the Board and signed on its behalf by:

Paul Butler
Managing Director
15 July 2019

Andrew Farmer
Finance Director
15 July 2019

Independent auditor's report

To the Water Services Regulation Authority (the WSRA) and the Directors of South East Water Limited

Report on the audit of the Regulatory Accounting Statements

Opinion

We have audited certain tables within South East Water Limited("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
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water 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 East Water Limited'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, as defined in RAG 3.11, appendix 2).

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, 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 International Financial Reporting Standards as adopted by the European Union ("IFRSs"). Financial information other than that prepared on the basis of IFRSs 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 199 to 232 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from IFRSs. 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 186, the directors are responsible for the preparation of the Regulatory Accounting Statements in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement, as defined in RAG 3.11, 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 of timing of the audit and significant audit findings, including 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 undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the WSRA, for our audit work, for this report or for the opinions we have formed.

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

Deloitte LLP

Statutory Auditor
London, United Kingdom
15 July 2019

The following tables are set out following the order defined in Appendix 1 of the regulatory accounting guidance 3.11. Where the tables include line items which do not require a data entry, the line has been omitted from the table.

Additional tables have been included under each of the tables in section 1 to provide a reconciliation of the differences in applying RAGs and IFRS.

As detailed earlier, we have opted to not include tables 3S and 4J to 4W within the annual performance report and these will instead be published separately.

1A- Income statement

for the 12 months ended 31 March 2019

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Non-appointed £000	Total adjustments £000	Total appointed activities £000
Revenue	238,281	(65)	12,447	(12,512)	225,769
Operating costs	(164,837)	(843)	(6,055)	5,212	(159,625)
Other operating income	12,997	(12,621)	-	(12,621)	376
Operating profit	86,441	(13,529)	6,392	(19,921)	66,520
Other income	9,253	13,325	-	13,325	22,578
Interest income	6,058	(637)	-	(637)	5,421
Interest expense	(56,153)	2,193	(138)	2,331	(53,822)
Other interest expense	-	636	-	636	636
Profit before tax and fair value movements	45,599	1,988	6,254	(4,266)	41,333
Fair value gains/(losses) on financial instruments	-	(4,668)	-	(4,668)	(4,668)
Profit before tax	45,599	(2,680)	6,254	(8,934)	36,665
UK Corporation tax	(964)	97	(1,188)	1,285	321
Deferred tax	(6,017)	-	-	-	(6,017)
Profit for the year	**38,618**	**(2,583)**	**5,066**	**(7,649)**	**30,969**
Dividends	(28,000)	-	(5,066)	5,066	(22,934)

		Adjustments			
Tax analysis	Statutory £000	Differences between statutory and RAG definitions £000	Non-appointed £000	Total adjustments £000	Total appointed activities £000
UK Corporation tax – current year	964	(97)	1,188	(1,285)	(321)

Analysis of non-appointed revenue	Non-appointed £000
Other non-appointed revenue	12,447

1A- Income statement

for the 12 months ended 31 March 2019

Differences between statutory and RAG definitions	Revenue £000	Operating costs £000	Other operating income £000	Operating profit £000
Movement of Contributions Income	(960)	-	-	(960)
Movement of Infrastructure Income	(5,229)	-	-	(5,229)
Movement of New Connections Income	(6,710)	-	-	(6,710)
Movement of Laboratory Income	2,285	-	(2,285)	-
Movement of Thames Water Billing Commission	2,308	-	(2,308)	-
Movement of Southern Water Billing Commission	5,759	-	(5,759)	-
Movement of Other Sundry Income	2,145	-	(2,145)	-
Removal of Depreciation on Capitalised Interest	-	162	-	162
Adjust Pension Contributions	-	(268)	-	(268)
Movement of Profit/(Loss) on Disposal of Fixed Assets	-	(377)	377	-
Movement of Rental Income	-	-	(516)	(516)
Movement of Return Made on Pensions	-	-	-	-
Movement of Fair Value Gains/(Losses)	-	-	-	-
Movement of transactions relating to Discontinued Operations	337	(360)	15	(8)
Removal of Interest Capitalised	-	-	-	-
Total differences	**(65)**	**(843)**	**(12,621)**	**(13,529)**

	Other income £000	Interest income £000	Interest expense £000	Other interest expense £000	Profit before tax and fair value movements £000
Movement of Contributions Income	960	-	-	-	-
Movement of Infrastructure Income	5,229	-	-	-	-
Movement of New Connections Income	6,710	-	-	-	-
Movement of Laboratory Income	-	-	-	-	-
Movement of Thames Water Billing Commission	-	-	-	-	-
Movement of Southern Water Billing Commission	-	-	-	-	-
Movement of Other Sundry Income	-	-	-	-	-
Removal of Depreciation on Capitalised Interest	-	-	-	-	162
Adjust Pension Contributions	-	-	-	-	(268)
Movement of Profit/(Loss) on Disposal of Fixed Assets	-	-	-	-	-
Movement of Rental Income	516	-	-	-	-
Movement of Return Made on Pensions	-	(636)	-	636	-
Movement of Fair Value Gains/(Losses)	-	-	4,668	-	4,668
Movement of transactions relating to Discontinued Operations	(90)	(1)	2	-	(97)
Removal of Interest Capitalised	-	-	(2,477)	-	(2,477)
Total differences	**13,325**	**(637)**	**2,193**	**636**	**1,988**

1A- Income statement

for the 12 months ended 31 March 2019

Differences between statutory and RAG definitions continued	Fair value gains/(losses) on financial instruments	Profit before tax	Current tax	Profit for the year
Movement of Contributions Income	-	-	-	-
Movement of Infrastructure Income	-	-	-	-
Movement of New Connections Income	-	-	-	-
Movement of Laboratory Income	-	-	-	-
Movement of Thames Water Billing Commission	-	-	-	-
Movement of Southern Water Billing Commission	-	-	-	-
Movement of Other Sundry Income	-	-	-	-
Removal of Depreciation on Capitalised Interest	-	162	-	162
Adjust Pension Contributions	-	(268)	-	(268)
Movement of Profit/(Loss) on Disposal of Fixed Assets	-	-	-	-
Movement of Rental Income	-	-	-	-
Movement of Return Made on Pensions	-	-	-	-
Movement of Fair Value Gains/(Losses)	(4,668)	-	-	-
Movement of transactions relating to Discontinued Operations	-	(97)	97	-
Removal of Interest Capitalised	-	(2,477)	-	(2,477)
Total differences	**(4,668)**	**(2,680)**	**97**	**(2,583)**

1B - Statement of comprehensive income

for the 12 months ended 31 March 2019

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Non-appointed £000	Total adjustments £000	Total appointed activities £000
Profit for the year	38,618	(2,583)	5,066	(7,649)	30,969
Actuarial gains/(losses) on post-employment plans	(2,925)	-	-	-	(2,925)
Total comprehensive income for the year	**35,693**	**(2,583)**	**5,066**	**(7,649)**	**28,044**

1C - Statement of financial position

for the 12 months ended 31 March 2019

	Statutory £000	Adjustments: Differences between statutory and RAG definitions £000	Adjustments: Non-appointed £000	Adjustments: Total adjustments £000	Total appointed activities £000
Non-current assets					
Fixed assets	1,555,123	(7,177)	-	(7,177)	1,547,946
Intangible assets	10,501	(10,501)	-	(10,501)	-
Investments - loans to group companies	189,911	-	-	-	189,911
Retirement benefit assets	25,564	-	-	-	25,564
Total non-current assets	1,781,099	(17,678)	-	(17,678)	1,763,421
Current assets					
Inventories	592	-	-	-	592
Trade & other receivables	85,634	-	1,661	(1,661)	83,973
Cash & cash equivalents	12,607	-	-	-	12,607
Total current assets	98,833	-	1,661	(1,661)	97,172
Current liabilities					
Trade & other payables	(72,236)	-	(1,661)	1,661	(70,575)
Capex creditor	(20,725)	-	-	-	(20,725)
Borrowings	(254,890)	-	-	-	(254,890)
Financial instruments	(108,836)	-	-	-	(108,836)
Provisions	(11,155)	-	-	-	(11,155)
Total current liabilities	(467,842)	-	(1,661)	1,661	(466,181)
Net current assets/(liabilities)	(369,009)	-	-	-	(369,009)
Non-current liabilities					
Trade & other payables	(5,379)	-	-	-	(5,379)
Borrowings	(717,604)	-	-	-	(717,604)
Retirement benefit obligations	(3,154)	-	-	-	(3,154)
Deferred income - G&C's	(3,185)	-	-	-	(3,185)
Deferred tax	(145,395)	-	-	-	(145,395)
Total non-current liabilities	(874,717)	-	-	-	(874,717)
Net assets	537,373	(17,678)	-	(17,678)	519,695
Equity					
Called up share capital	(49,312)	-	-	-	(49,312)
Retained earnings & other reserves	(488,061)	17,678	-	17,678	(470,383)
Total equity	**(537,373)**	**17,678**	**-**	**17,678**	**(519,695)**

1C - Statement of financial position

for the 12 months ended 31 March 2019

Differences between statutory and RAG definitions	Fixed assets £000	Intangible assets £000	Total non-current assets £000	Net assets £000	Retained earnings & other resources £000	Total equity £000
Removal of Capitalised Interest	(18,295)	-	(18,295)	(18,295)	18,295	18,295
Removal of Depreciation on Capitalised Interest	617	-	617	617	(617)	(617)
Movement of Computer Software Cost	24,087	(24,087)	-	-	-	-
Movement of Computer Software Depreciation	(14,833)	14,833	-	-	-	-
Movement of Computer Software Work in Progress Cost	1,247	(1,247)	-	-	-	-
Total differences	**(7,177)**	**(10,501)**	**(17,678)**	**(17,678)**	**17,678**	**17,678**

Under IFRS, computer software is recorded as an intangible asset in the company's financial report and accounts. However, the annual performance report requires that computer software is reported as part of tangible fixed assets, hence the balance of intangible assets of £10.5 million in the statutory accounts has been restated under tangible fixed assets in the above table.

1D - Statement of cash flows

for the 12 months ended 31 March 2019

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Non-appointed £000	Total adjustments £000	Total appointed activities £000
Operating profit	86,441	(13,529)	6,392	(19,921)	66,520
Other income	-	13,422	-	13,422	13,422
Depreciation	51,300	(162)	-	(162)	51,138
Amortisation - G&C's	-	-	-	-	-
Changes in working capital	(9,298)	798	-	798	(8,500)
Pension contributions	(4,086)	(530)	-	(530)	(4,616)
Movement in provisions	1,047	-	-	-	1,047
Profit/Loss on sale of fixed assets	(377)	-	-	-	(377)
Cash generated from operations	125,027	(1)	6,392	(6,393)	118,634
Net interest paid	(31,496)	1	(138)	139	(31,357)
Tax paid	(1,304)	-	(1,188)	1,188	(116)
Net cash generated from operating activities	92,227	-	5,066	(5,066)	87,161
Investing activities					
Capital expenditure	(100,129)	-	-	-	(100,129)
Grants & contributions	-	-	-	-	-
Disposal of fixed assets	736	-	-	-	736
Other	9,156	-	-	-	9,156
Net cash used in investing activities	(90,237)	-	-	-	(90,237)
Net cash generated before financing activities	**1,990**	**-**	**5,066**	**(5,066)**	**(3,076)**
Cash flows from financing activities					
Equity dividends paid	(28,000)	-	(5,066)	5,066	(22,934)
Net loans received	32,307	-	-	-	32,307
Cash inflow from equity financing	-	-	-	-	-
Net cash generated from financing activities	**4,307**	**-**	**(5,066)**	**5,066**	**9,373**
Increase/(decrease) in net cash	**6,297**	**-**	**-**	**-**	**6,297**

1D - Statement of cash flows

for the 12 months ended 31 March 2019

Differences between statutory and RAG definitions	Operating profit £000	Other Income £000	Depreciation £000	Changes in working capital £000	Pension contributions £000
Operating Profit as per table 1A	(13,529)	-	-	-	-
Movement of Rental Income	-	516	-	-	-
Movement of Infrastructure Income	-	5,229	-	-	-
Movement of Contributions Income	-	960	-	-	-
Movement of developer contributions immediately recognised in income statement	-	6,710	-	-	-
Removal of Depreciation on Capitalised Interest	-	-	(162)	-	-
Inclusion of Pension Asset	-	-	-	798	-
Inclusion of Pension Contributions	-	-	-	-	(530)
Movement of transactions relating to Discontinued Operations	-	7	-	-	-
Total differences	**(13,529)**	**13,422**	**(162)**	**798**	**(530)**

	Cash generated from operations £000	Net interest £000	Tax paid £000	Net cash generated from operating activities £000	Other investing activities £000	Net cash used in investing activities £000
Operating Profit as per table 1A	(13,529)	-	-	(13,529)	-	-
Movement of Rental Income	516	-	-	516	-	-
Movement of Infrastructure Income	5,229	-	-	5,229	-	-
Movement of Contributions Income	960	-	-	960	-	-
Movement of developer contributions immediately recognised in income statement	6,710	-	-	6,710	-	-
Removal of Depreciation on Capitalised Interest	(162)	-	-	(162)	-	-
Inclusion of Pension Asset	798	-	-	798	-	-
Inclusion of Pension Contributions	(530)	-	-	(530)	-	-
Movement of transactions relating to Discontinued Operations	7	1	-	8	-	-
Total differences	(1)	1	-	-	-	-

	Net cash generated before financing activities £000	Net cash generated from financing activities £000	Increase/ (decrease) in net cash £000
Operating Profit as per table 1A	(13,529)	-	(13,529)
Movement of Rental Income	516	-	516
Movement of Infrastructure Income	5,229	-	5,229
Movement of Contributions Income	960	-	960
Movement of developer contributions immediately recognised in income statement	6,710	-	6,710
Removal of Depreciation on Capitalised Interest	(162)	-	(162)
Inclusion of Pension Asset	798	-	798
Inclusion of Pension Contributions	(530)	-	(530)
Movement of transactions relating to Discontinued Operations	8	-	8
Total differences	-	-	-

1E - Net debt analysis

at 31 March 2018

Interest rate risk profile	Fixed rate £000	Floating rate £000	Index linked £000	Total £000
Borrowings (excluding preference shares)	166,990	55,000	862,282	1,084,272
Preference share capital				-
Total borrowings				1,084,272
Cash				(12,607)
Short-term deposits				-
Net Debt				**1,071,665**
Gearing (%)				78.51
Adjusted Gearing				-
Full year equivalent nominal interest cost	9,310	296	54,061	63,667
Full year equivalent cash interest payment	9,310	296	25,929	35,535
Indicative interest rates				
Indicative weighted average nominal interest rate (%)	5.58	1.02	6.27	5.87
Indicative weighted average cash interest rate (%)	5.58	1.02	3.01	3.28
Weighted average years to maturity	9	1	11	10

The total borrowings in the above table differs to the borrowings in table 1C as follows:

	£000
Short term borrowing per table 1C	254,890
Long term borrowing per table 1C	717,604
Total borrowings per table 1C	972,494
Cumulative accretion due to RPI on synthetic variable rate bonds	106,719
Unamortised loan arrangement costs	5,059
Borrowing per table 1E above	**1,084,272**

1F - Financial flows for the 12 months

ended 31 March 2019

	Notional returns and notional regulatory equity %	Actual returns and notional regulatory equity %	Actual returns and actual regulatory equity %
Regulatory return on equity	4.60	2.83	4.60
Actual performance adjustment 2010-2015	0.22	0.14	0.22
Adjusted return on regulatory equity	4.82	2.96	4.82
Regulatory equity (£000)	435,236	435,236	267,672
Financing			
Gearing	-	0.89	1.45
Variance in corporation tax	-	0.43	0.70
Group relief	-	-	-
Cost of debt	-	(0.79)	(1.28)
Hedging instruments	-	-	-
Financing total	4.82	3.50	5.69
Operational performance			
Totex out/(under) performance	-	0.13	0.21
ODI out/(under) performance	-	(0.01)	(0.01)
Retail out/(under) performance	-	1.33	2.15
Other exceptional items	-	1.82	2.96
Operational performance total	-	3.27	5.31
Total earnings	4.82	6.76	11.00
RCV growth	3.06	3.06	3.06
Total shareholder return	7.88	9.82	14.06
Net Dividend	4.00	3.50	5.69
Retained value	**3.88**	**6.32**	**8.37**
Dividends reconciliation			
Gross dividend	4.00	4.55	7.40
Interest receivable on intercompany loans	-	(1.05)	(1.71)
Net dividend	4.00	3.50	5.69

1F - Financial flows for the 12 months

ended 31 March 2019 (continued)

	Notional returns and notional regulatory equity £000	Actual returns and notional regulatory equity £000	Actual returns and actual regulatory equity £000
Regulatory return on equity	20,021	12,313	12,313
Actual performance adjustment 2010-2015	958	589	589
Adjusted return on regulatory equity	20,978	12,902	12,902
Regulatory equity (£000)	-	-	-
Financing			
Gearing	-	3,876	3,876
Variance in corporation tax	-	1,877	1,877
Group relief	-	-	-
Cost of debt	-	(3,436)	(3,436)
Hedging instruments	-	-	-
Financing total	20,978	15,219	15,219
Operational performance			
Totex out/(under) performance	-	555	555
ODI out/(under) performance	-	(23)	(23)
Retail out/(under) performance	-	5,767	5,767
Other exceptional items	-	7,913	7,913
Operational performance total	-	14,212	14,212
Total earnings	20,978	29,431	29,431
RCV growth	13,318	13,318	8,191
Total shareholder return	34,297	42,749	37,622
Net Dividend	17,409	15,228	15,228
Retained value	**16,887**	**27,521**	**22,394**
Dividends reconciliation			
Gross dividend	17,409	19,810	19,810
Interest receivable on intercompany loans	-	(4,582)	(4,582)
Net dividend	17,409	15,228	15,228

Actual returns and actual regulatory equity when compared to notional returns and notional regulatory equity show a difference on the retained shareholder return of 4.49 per cent. This is largely due to the difference between actual and notional gearing of 1.45 per cent and the outperformances on retail and other exceptional items of 2.15 per cent and 2.96 per cent respectively compared to the final determination. These outperformances are offset by the difference in the actual and allowed cost of debt of 1.28 per cent.

The difference between the notional and actual gearing conveys the different structure of the company compared to the gearing level assumed by Ofwat. The actual gearing level of the company based on average net debt, calculated using the opening and closing net debt values for the year ending 31 March 2019 was 77.21 per cent. The assumed gearing ratio was 62.50 per cent. The variance in this, together with the difference between the allowed return on regulated equity and the allowed cost of debt results in a saving in financing on the average regulatory capital value of £3.9 million.

In the year, the company sold its Non-Household business equating in a profit on disposal of £9.2 million which has been deflated to base year prices for inclusion within the financial flows, giving a profit on disposal of £7.9 million in 2012/13 prices. This profit on disposal increases the retained value in the year as a percentage of regulatory equity by 2.96 per cent.In addition to this the company outperformed against its allowed household retail cost by £6.5 million.

1F - Financial flows for the 12 months

ended 31 March 2019 (continued)

This was reduced slightly by an underperformance on allowed non-household retail costs of £0.7 million, resulting in an overall outperformance on retail costs of £5.8 million. This represents a benefit of 2.15 per cent on the company's actual regulatory equity base. As a result of the company selling its non-household business in April 2018, in order to calculate the out/underperformance on non-household retail costs, one twelfth of the allowed non-household retail costs as defined in the company's final determination has been used.

It is the company's belief that the retained value stated in the above table calculated based on actual returns and notional regulatory equity has been understated through the use of the prescribed table template provided by Ofwat. Our reasoning for this is that within the prescribed template, the value of the cost of debt is linked to the calculation based upon actual returns and actual regulatory equity which uses the company's actual gearing value rather than its notional value, which contradicts the line item definition provided within RAG 4.08. If the cost of debt was to be calculated as described in RAG 4.08, using the notional gearing percentage of 62.50 per cent, the resulting value would be (£2.735) million or (0.63 per cent) as a percentage of regulatory equity and not (£3.436) million or (0.79 per cent) as a percentage of regulatory equity as reported above. This would mean that the retained value based upon actual returns and notional regulatory equity would be 6.48 per cent and not 6.32 per cent as reported in the financial flows above.

1F - Financial flows average for AMP6

	Notional returns and notional regulatory equity %	Actual returns and notional regulatory equity %	Actual returns and actual regulatory equity %
Regulatory return on equity	5.35	3.00	5.35
Actual performance adjustment 2010 to 2015	0.31	0.17	0.31
Adjusted return on regulatory equity	5.66	3.17	5.66
Regulatory equity (£000)	420,335	420,335	235,326
Financing			
Gearing	-	1.21	2.16
Variance in corporation tax	-	0.07	0.12
Group relief	-	-	-
Cost of debt	-	(0.78)	(1.79)
Hedging instruments	-	-	-
Financing total	5.66	3.66	6.15
Operational performance			
Totex out/(under) performance	-	1.02	1.82
ODI out/(under) performance	-	(0.05)	(0.10)
Retail out/(under) performance	-	1.09	1.95
Other exceptional items	-	0.47	0.84
Operational performance total	-	2.53	4.52
Total earnings	5.66	6.19	10.67
RCV growth	2.51	2.51	2.51
Total shareholder return	8.17	8.70	13.18
Net Dividend	4.00	2.14	3.82
Retained value	**4.17**	**6.56**	**9.36**
Dividends reconciliation			
Gross dividend	4.00	3.19	5.69
Interest receivable on intercompany loans	-	(1.05)	(1.87)
Net dividend	4.00	2.14	3.82

1F - Financial flows average for AMP6 (continued)

	Notional returns and notional regulatory equity £000	Actual returns and notional regulatory equity £000	Actual returns and actual regulatory equity £000
Regulatory return on equity	22,488	12,590	12,590
Actual performance adjustment 2010 to 2015	1,303	730	730
Adjusted return on regulatory equity	23,791	13,319	13,319
Regulatory equity (£000)	-	-	-
Financing			
Gearing	-	5,088	5,088
Variance in corporation tax	-	278	278
Group relief	-	-	-
Cost of debt	-	(3,298)	(4,202)
Hedging instruments	-	-	-
Financing total	23,791	15,387	14,483
Operational performance			
Totex out/(under) performance	-	4,282	4,282
ODI out/(under) performance	-	(229)	(229)
Retail out/(under) performance	-	4,597	4,597
Other exceptional items	-	1,978	1,978
Operational performance total	-	10,628	10,628
Total earnings	23,791	26,015	25,111
RCV growth	10,550	10,550	5,907
Total shareholder return	34,341	36,566	31,018
Net Dividend	16,813	9,001	9,001
Retained value	**17,528**	**27,565**	**22,017**
Dividends reconciliation			
Gross dividend	16,813	13,394	13,394
Interest receivable on intercompany loans	-	(4,393)	(4,393)
Net dividend	16,813	9,001	9,001

Actual returns and actual regulatory equity when compared to notional returns and notional regulatory equity for the AMP show a difference on the retained shareholder return of 5.19 per cent. This is largely due to the difference between actual and notional gearing of 2.16 per cent coupled with outperformances on totex and retail of 1.82 per cent and 1.95 per cent respectively compared to the final determination.

The difference between the notional and actual gearing conveys the different structure of the company compared to the gearing level assumed by Ofwat. The variance between the actual average gearing and the notional gearing ratio of 62.50 per cent assumed by Ofwat, coupled with the difference between the allowed return on regulated equity and the allowed cost of debt results in an average saving in financing on the average regulatory capital value of £5.1 million over the AMP.

The average outperformance on totex over the four year period from 1 April 2015 to 31 March 2019 equated to £4.3 million which represents 1.82 per cent of the company's average actual regulatory equity base for the same period. Calculated over the same period, the average outperformance on Retail equated to £4.6 million representing a benefit of 1.95 per cent on the company's average actual regulatory equity base.

2A- Segmental income statement

for the 12 months ended 31 March 2019

	Retail			Wholesale		Total
	Household £000	Non-household £000	Water Resources £000	Water Network+ £000	Wholesale total £000	£000
Revenue - price control	21,380	(702)		203,781	203,781	224,459
Revenue - non-price control	-	-		1,310	1,310	1,310
Operating Expenditure	(15,908)	(994)	(13,445)	(78,140)	(91,585)	(108,487)
Depreciation - tangible fixed assets	(52)	(10)	(7,418)	(43,658)	(51,076)	(51,138)
Amortisation - intangible fixed assets	-	-	-	-	-	-
Other operating income	-	-	-	376	376	376
Operating profit/(loss) before recharges	5,420	(1,706)			62,806	66,520
Recharges in respect of 'principal use' assets						
Recharges from other segments	-	-	-	-	-	-
Recharges to other segments	-	-	-	-	-	-
Operating profit/(loss)	**5,420**	**(1,706)**			**62,806**	**66,520**
Surface water drainage rebates						-

2B - Totex analysis

for the 12 months ended 31 March 2019 - wholesale water only

	Water Resources £000	Water Network+ £000	Total £000
Operating expenditure			
Power	4,366	11,915	16,281
Income treated as negative expense	-	-	-
Abstraction charges/discharge consents	2,917	163	3,080
Bulk supply/bulk discharge	1,040	5,076	6,116
Other operating expenditure:			
Renewals expensed in year (infrastructure)	-	-	-
Renewals expensed in year (non-infrastructure)	-	-	-
Other operating expenditure excluding renewals	4,210	44,181	48,391
Local authority and Cumulo rates	912	16,458	17,370
Total operating expenditure excluding third party services	13,445	77,793	91,238
Third party services	-	347	347
Total operating expenditure	13,445	78,140	91,585
Capital expenditure			
Maintaining the long term capability of the assets - infra	-	18,569	18,569
Maintaining the long term capability of the assets - non-infra	1,489	30,855	32,344
Other capital expenditure - infra	864	24,644	25,508
Other capital expenditure - non-infra	1,901	19,158	21,059
Infrastructure network reinforcement	-	4,085	4,085
Total gross capital expenditure (excluding third party)	4,254	97,311	101,565
Third party services	-	-	-
Total gross capital expenditure	4,254	97,311	101,565
Grants and contributions			
Grants and contributions	-	(13,725)	(13,725)
Totex	17,699	161,726	179,425
Cash expenditure			
Pension deficit recovery payments	542	3,275	3,817
Other cash items	-	-	-
Totex including cash items	**18,241**	**165,001**	**183,242**

2C - Operating cost analysis

for the 12 months ended 31 March 2019 - retail

Household

Overall expenditure for household retail is below equivalent final determination (FD) expectations, with total operating costs (excluding third party services) at £15.9 million versus an FD of £20.1 million. This has largely been achieved by a better cash collection performance allowing the release of amounts previously provided. We have continued to maintain customer service costs at 2013/14 levels despite an increasing measured customer base due to our metering programme. Subsequently, given the increased measured customer base we now calculate our measured cost to serve at £18.08, compared to FD target of £24.24. The impact of the above savings on unmeasured cost to serve means this is now below the FD expectations at £16.07 compared to £18.45.

Non-household

Overall expenditure for non-household retail is £1.0 million. We note that doubtful debts has decreased from our 2017/18 position due to a reassessment of the doubtful debt provision as a result of the disposal of the business on 1 May 2018.

	Household £000	Non-household £000	Total £000
Operating expenditure			
Customer services	6,339	237	6,576
Debt management	531	392	923
Doubtful debts	1,676	(354)	1,322
Meter reading	856	25	881
Service to developers	-	422	422
Other operating expenditure	6,506	272	6,778
Total operating expenditure	15,908	994	16,902
Depreciation - tangible fixed assets	52	10	62
Total operating costs	**15,960**	**1,004**	**16,964**
Debt written off	4,813	(518)	4,295

2D - Historic cost analysis of fixed assets

wholesale & retail

	Wholesale		Retail		Total
	Water £000	Water Network+ £000	Household £000	Non-household £000	£000
Cost					
At 1 April 2018	119,538	1,551,960	5,867	1,623	1,678,988
Disposals	-	(2,698)	(123)	-	(2,821)
Additions	4,254	97,311	606	40	102,211
Adjustments	-	-	-	-	-
Assets adopted at nil cost	-	-	-	-	-
At 31 March 2019	123,792	1,646,573	6,350	1,663	1,778,378
Depreciation					
At 1 April 2018	(26,453)	(155,212)	(186)	(36)	(181,887)
Disposals	-	2,470	123	-	2,593
Adjustments	-	-	-	-	-
Charge for the year	(7,418)	(43,658)	(52)	(10)	(51,138)
At 31 March 2019	(33,871)	(196,400)	(115)	(46)	(230,432)
Net book amount at 31 March 2019	89,921	1,450,173	6,235	1,617	1,547,946
Net book value at 1 April 2018	93,085	1,396,748	5,681	1,587	1,497,101
Depreciation charge for year					
Principal services	(7,418)	(43,658)	(52)	(10)	(51,138)
Third party services	-	-	-	-	-
Total	**(7,418)**	**(43,658)**	**(52)**	**(10)**	**(51,138)**

The net book value includes £41.5 million in respect of assets in the course of construction.

2E -Analysis of capital contributions and land sales

wholesale

	Fully recognised in income statement £000	Capitalised and amortised against depreciation £000	Fully netted off capex £000	Total £000
Grants and contributions – water				
Connection charges	6,711	-	-	6,711
Infrastructure charge receipts	5,229	-	-	5,229
Requisitioned mains	1,286	-	-	1,286
Other contributions (price control)	-			-
Diversions	499	-	-	499
Other contributions (non-price control)	-	-	-	-
Total	**13,725**	**-**	**-**	**13,725**
Value of adopted assets	-	-	-	-

There were no assets adopted during the year.

2E - Analysis of capital contributions and land sales (continued)

wholesale

Movements in capitalised grants and contributions	Water £000
Balance sheet	
Brought forward	75,709
Capitalised in the year	-
Amortisation (in income statement)	(71,072)
Carried forward	**4,637**
Land sales	
Proceeds from disposals of protected land	-

Following the company's adoption of IFRS 15 on 1 April 2018, income relating to grants and contributions is no longer taken to the statement of financial position and amortised as income in the income statement over the life of the underlying assets. Instead, income relating to grants and contributions is still initially recorded as deferred income in the statement of financial position on receipt, however is released in full as income in the income statement once the works to which the contributions relate have been completed.

As such, an adjustment has been made to deferred income in the statement of financial position, on the adoption of IFRS 15, in which a value of £71.9 million relating to completed projects was deducted from the carrying value of deferred income relating to grants and contributions in the statement of financial position as illustrated in the above table. Further details regarding this adjustment are included within note 5 of the annual report and financial statements.

There were no sales of protected land during the year.

2F - Household

revenues by customer type

	Wholesale charges revenue £000	Retail revenue £000	Total revenue £000	Number of customer 000	Average household retail revenue per customers £
Unmeasured water only customers	22,247	1,838	24,085	106,678	17
Measured water only customer	136,417	19,542	155,959	754,844	26
Total	**158,664**	**21,380**	**180,044**	**861,522**	**25**

2G - Non-household water

revenues by customer type

	Wholesale charges revenue £000	Retail revenue £000	Total revenue £000	Number of customers 000	Average non-household retail revenue per customers £
Total non-default tariffs	-	-	-	-	-
Default tariffs					
Potable water - unmetered	883	9	892	3,856	2
Potable water - metered 0 to 2.5 Ml/a	20,677	(332)	20,345	43,952	(8)
Potable water - metered 2.5 to 5 Ml/a	5,982	(96)	5,886	1,112	(86)
Water supplies 5 to 50 Ml	12,609	(203)	12,406	758	(268)
Water supplies 50 Ml and over	4,966	(80)	4,886	37	(2,162)
Total default tariffs	45,117	(702)	44,415	49,715	(14)
Total	**45,117**	**(702)**	**44,415**	**49,715**	**(14)**

2G - Non-household water (continued)

revenues by customer type

	Number of customers 000	Average non-household retail revenue per customer £000
Revenue per customer		
Total	**49,715**	**(14)**

2I - Revenue analysis and wholesale control reconciliation

The wholesale revenue for 2018/19 is lower than allowed revenue in the Final Determination (FD) and is due to lower consumption experienced in the year and a different mix of properties between unmeasured and measured supply. This is part offset by an additional number of new connections and higher infrastructure income compared to the FD.

The overall number of customers and the number of void properties has no material impact on the adverse variance for 2018/19.

The table below reconciles the allowed and actual wholesale revenues.

	£000
Allowed revenue for the year	218,695
Reduction due to lower consumption	(6,542)
Reduction due to mix of properties	(54)
Increase due to new connections	1,092
Increase due to infrastructure income	2,530
Increase due to capital contributions	1,286
Actual revenue for the year	217,007

As a company with a high level of metering, our revenue is very dependent on the consumption forecast used for each year. Each year consumption is forecast based on a 'normal' water resources demand profile. Should weather and/or rainfall not follow this 'normal' profile then this will impact our measured revenue accordingly. Any variation in wholesale revenue is adjusted for using the wholesale revenue forecasting incentive mechanism as prescribed by Ofwat.

New connections and infrastructure continues to exceed expectations and it is likely that a similar improvement in comparison to the final determination will be seen in future years.

	Household £000	Non-household £000	Total £000
Wholesale charge – water			
Unmeasured	22,247	883	23,130
Measured	136,417	44,234	180,651
Third party revenue	-	-	-
Wholesale total	158,664	45,117	203,781
Retail revenue			
Unmeasured	1,838	9	1,847
Measured	19,542	(711)	18,831
Other third party revenue	-	-	-
Retail total	21,380	(702)	20,678
Third party revenue – non-price control			
Bulk supplies - water			-
Other third party revenue			-
Principal services - non-price control			
Other appointed revenue			1,310
Total appointee revenue			**225,769**

2I - Revenue analysis and wholesale control reconciliation

(continued)

	Water £000
Wholesale revenue governed by price control	203,781
Grants & contributions	13,226
Total revenue governed by wholesale price control	217,007
Amount assumed in wholesale determination	217,177
Adjustment for in-period ODI revenue	-
Adjustment for WRFIM	1,518
Total assumed revenue	218,695
Difference	**(1,688)**

2J - Infrastructure network reinforcement costs

for the 12 months ended 31 March 2019

	Network reinforcement capex £000	On site / site specific capex (memo only) £000
Wholesale water network+ (treated water distribution)		
Distribution and trunk mains	4,065	13,359
Pumping and storage facilities	20	-
Other	-	491
Total	**4,085**	**13,850**

2K - New connections – infrastructure charges reconciliation

for the 12 months ended 31 March 2019

	Water £000
Impact of infrastructure charge discounts	
Infrastructure charges	5,229
Discounts applied to infrastructure charges	-
Gross infrastructure charges	5,229
Comparison of revenue and costs	
Variance brought forward	-
Revenue	5,229
Costs	(4,085)
Variance carried forward	**1,144**

Across the south east we have a high number of new developments and based on data from Government and local planning authorities this is expected to continue over the next 25 years. As a large proportion of our network is already distributing water at its maximum capacity, particularly during peak demands, we have to charge developers for offsite reinforcement work to ensure our existing customers and associated network are not negatively affected. When a developer applies for new connections we carry out detailed modelling to understand the effect on the existing network and identify areas that require reinforcement. All of our schemes are then planned and completed on a risk based approach to avoid impacting our existing customers but to deliver a quality supply to our new customers.

2K - New connections – infrastructure charges reconciliation

for the 12 months ended 31 March 2019 (continued)

We receive the infrastructure charge from developers when they apply for new connections to our network, but due to a number of constraints the work required may not always be carried out in the same financial year. On many of our schemes we have to consider environmental impacts and plan in the mitigation to protect and enhance the local biodiversity and this can mean a number of species surveys which are only carried out at certain times of the year. Where environmental concerns arise the schemes often have to be delivered during times that least impact the local environment and this can be outside of the financial year in which the contribution was received. Another reason for the difference is highways approvals to deliver schemes, particularly along busy roads or where other utility works are already planned. A number of schemes have to be delivered during school holidays; particularly longer schemes which are only allowed in summer holidays; leaving a short window to deliver the schemes and often pushing them into the next financial year.

As our schemes are planned and completed using a risk based approach we know some of the lower risk schemes with a longer build programme can be moved in the programme to accommodate the higher risk schemes and therefore they may fall outside of the financial year in which the payment was received. There are also some schemes which were not yet completed in the 2018/19 financial year and therefore a proportion of the costs will be reported in future years.

Although there is approximately a £1.1 million difference between the revenue earnt from the charges and the actual costs of delivering the work for the financial year, the work associated with the charges will be delivered in subsequent years to ensure our network continues to provide a reliable service to all of our customers.

3A- Outcome performance summary

The following table shows the performance against the company's 25 outcomes for 2018/19.

2018/19 performance

For commentary on our performance for the year please see our 2018/19 performance, people and planet report at corporate.southeastwater.co.uk/about-us/our-performance/

For performance commitment J1: Number of breaches of abstraction licences, discharge consents and environmental permits we have reported 11 breaches compared to 216 the previous year. This is broken down as five discharge consent breaches and six daily abstraction breaches.

For performance commitment M1: Number of compliance breaches with statutory obligations and licence conditions, not already reported in performance on outcomes I through to K we have reported one breach. Following a 2017 water quality event relating to discolouration of supplies, and a subsequent site audit by the Drinking Water Inspectorate (DWI) in May 2018, we received a Notice under regulation 28(4) relating to Barcombe Water Treatment Works. The Notice included prohibition conditions relating to the transfer of water and sludge and some operational activities. We immediately complied with the conditions of the Notice to ensure wholesomeness of water at the consumer's tap was protected and have met all required timescales for activity in relation to the Notice. Following a DWI review of the Notice and the progress made to date, the prohibition conditions are expected to be lifted by the DWI in 2019/20 and a revised Notice issued for completion of remedial works at the site.

Performance commitment met

Where our in year performance has met the target set by Ofwat 'yes' has been selected, if the target has not been met then 'no' has been entered. For measures that only have targets for 2019/20 'blank' has been entered.

2018/19 reward or penalty (in period outcome delivery incentives (ODIs)) and £m absolute value

We do not have any in period incentives so 'blank' has been entered in this column and therefore the adjacent column is blank.

3A- Outcome performance summary (continued)

Notional reward or penalty accrued at 31 March 2019 and £m absolute value

Where in year performance is better than target and above the outperformance payment deadband 'outperformance payment' has been selected and the accrued amount has been added in to the adjacent column.

Where in year performance is worse than target and above the underperformance penalty deadband 'underperformance penalty' has been selected and the accrued amount has been added in to the adjacent column.

Where in year performance is within the dead bands either 'outperformance payment deadband' or 'outperformance penalty deadband' is selected, the adjacent column is then blank.

For service incentive mechanism (SIM) its outperformance payment or underperformance penalty does not get calculated until the end of the price control, therefore 'blank' has been selected and the adjacent column is blank.

If the measure is a reputational performance commitment 'Not applicable' has been selected and the adjacent column is blank.

This financial year we have accrued £0.098 million underperformance penalty for our customer satisfaction performance measures. Performance has remained stable from last year in all measures except satisfaction with level of leakage. Satisfaction with the level of water restrictions has incurred an outperformance payment of £0.048 million. A company wide effort is being made to improve these scores but maintaining a stable score recognises that we are continually improving to meet rising customer expectations.

In 2018/19, we have achieved a leakage performance of 86.9 Ml/d compared to a leakage target of 89.1 Ml/d equating to a reward of £0.378 million. This has been achieved by improvements in our leakage programme, including investment in the latest technology, increases in the number of technicians, and a record number of leaks detected by our teams.

We have incurred a £0.293 million underperformance penalty for exceeding our target for interruptions to customers' water supply in 2018/19. Our overall performance for the year was 14.2 minutes against a target of 12.0 minutes per property.

We received a £0.004 million outperformance payment due to maintaining the number of properties at risk of low pressure in our region due to continual investment in schemes which will affect these properties.

In 2018/19 we received an underperformance penalty of £0.015 million for our discolouration contacts performance commitment. We have achieved 0.59 contacts per 1,000 population compared to a target of 0.58. We are disappointed that we have not met our in year target of 0.58, but pleased that we have reduced the number of discolouration contacts from 0.82 last year.

Total AMP6 reward or penalty 31 March 2020 forecast

We are forecasting to hit the targets for the remainder of the AMP that we will have the following outperformance payments and underperformance penalties:

- Customer satisfaction – we are forecasting a £0.026 million underperformance in 2019/20, this equates to total underperformance payment of £0.199 million for the AMP
- Leakage – we are forecasting a £0.063 million outperformance payment in 2019/20, giving a total outperformance payment of £1.887 million for the AMP
- Interruptions to supply – we are forecasting that we will be within our outperformance deadband in 2019/20, this equates to an overall underperformance payment of £2.554 million for the AMP
- Discolouration contacts – we are forecasting that we will be within our outperformance deadband in 2019/20, this equates to an overall underperformance payment of £0.375 million for the AMP
- Low pressure – we are forecasting a £0.004 million outperformance payment in 2019/20. This gives a total outperformance payment of £0.017 million for the AMP

3A- Outcome performance summary (continued)

Performance commitment	2017/18 performance level – actual	2018/19 performance level – actual	2018/19 PCL met?	2018/19 reward or penalty (in-period ODIs)	2018/19 notional reward or penalty accrued	2018/19 notional reward or penalty accrued £m	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m
Wholesale performance								
A1: Customer satisfaction - appearance of water	4.5	4.5	No	-	Penalty deadband	-	Penalty deadband	-
B1: Customer satisfaction - taste and odour of water	4.2	4.2	No	-	Penalty deadband	-	Penalty deadband	-
C1: Customer satisfaction - level of leakage	3.8	3.6	No	-	Penalty	(0.0777)	Penalty	(0.1813)
C2: Leakage (actual reported leakage per Ml/d per year)	87.7	86.9	Yes	-	Payment	0.3780	Payment	1.8868
D1: Customer satisfaction - direct interaction experience	4.3	4.3	No	-	Penalty	(0.0016)	Penalty	(0.0048)
D2: Service Incentive Mechanism (SIM)	85.6	85.4	-	-	-	-	-	-
E1: Customer satisfaction - bills are value for money and affordable	71%	73%	-	-	-	-	-	-
F1: Customer satisfaction - water supply is of sufficient pressure	4.3	4.3	No	-	Penalty	(0.0243)	Penalty	(0.0972)
F2: Number of properties at risk of low pressure, as recorded on the DG2 register	47	47	Yes	-	Payment	0.0042	Payment	0.0175
G1: Customer satisfaction - frequency and duration of supply interruptions	4.6	4.6	No	-	Penalty deadband	-	Penalty deadband	-
G2: Average time lost per property (measured in minutes, per property served)	44.6	14.2	No	-	Penalty	(0.2929)	Penalty	(2.5536)
H1: Customer satisfaction - frequency of water use restrictions	4.4	4.4	Yes	-	Payment	0.0432	Payment	0.1728
H2: Meeting the water resource deficit	-	-	Yes	-	-	-	-	-
I1: Mean zonal compliance (MZC)	99.95%	99.98%	No	-	Penalty deadband	-	Penalty deadband	-
J1: Number of breaches of abstraction licences, discharge consents and environmental permits	215	11	No	-	-	-	-	-
J2: Number of pollution incidents (category 1-2)	1	1	No	-	-	-	-	-
K1: Number of breaches of health and safety regulations, as defined by the Health and Safety Executive	-	-	Yes	-	-	-	-	-
L1: Number of breaches of National Security obligations (Security and Emergency Measures Direction)	-	-	Yes	-	-	-	-	-
M1: Number of compliance breaches with statutory obligations and licence conditions, not already reported in performance on outcomes I through to K	-	1	No	-	-	-	-	-
N1: Discolouration contacts	0.82	0.59	No	-	Penalty	(0.0150)	Penalty	(0.3750)
N2: Above ground asset performance assessment	Stable	Stable	Yes	-	-	-	-	-
N3: Number of company sites at risk of flooding	7	2	-	-	-	-	-	-

3A - Outcome performance summary (continued)

Performance commitment	2017/18 performance level - actual	2018/19 performance level - actual	2018/19 PCL met?	2018/19 reward or penalty (in-period ODIs)	2018/19 notional reward or penalty accrued	2018/19 notional reward or penalty accrued £m	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m
N4: Water mains bursts	2,747	2,826	No	-	Penalty deadband	-	-	-
O1: Kg of carbon emissions per customer per year	37.2	36.3	-	-	-	-	-	-
O2: We will monitor our abstractions at low flows at environmentally sensitive sites (in line with AIM)	-0.24	-0.10	Yes	-	-	-	-	-
Household retail performance								
A1: Customer satisfaction - appearance of water	4.5	4.5	No	-	Penalty deadband	-	Penalty deadband	-
B1: Customer satisfaction - taste and odour of water	4.2	4.2	No	-	Penalty deadband	-	Penalty deadband	-
C1: Customer satisfaction - level of leakage	3.8	3.6	No	-	Penalty	(0.0333)	Penalty	(0.0777)
D1: Customer satisfaction - direct interaction experience	4.3	4.3	No	-	Penalty	(0.0064)	Penalty	(0.0192)
D2: Service Incentive Mechanism (SIM)	85.6	85.4	-	-	-	-	-	-
E1: Customer satisfaction - bills are value for money and affordable	71%	73%	-	-	-	-	-	-
F1: Customer satisfaction - water supply is of sufficient pressure	4.3	4.3	No	-	Penalty	(0.0027)	Penalty	(0.0108)
G1: Customer satisfaction - frequency and duration of supply interruptions	4.6	4.6	No	-	Penalty deadband	-	Penalty deadband	-
H1: Customer satisfaction - frequency of water use restrictions	4.4	4.4	Yes	-	Payment	0.0048	Payment	0.0192

3B - Sub-measure performance

Unique ID	PC/sub-measure ID	PC/sub-measure	2017/18 performance level - actual	2018/19 performance level - actual	2018/19 PCL met?
PR14SEWWSW_N2	00	N2: Above ground asset performance assessment	Stable	Stable	Yes
PR14SEWWSW_N2	01	WTW coliforms non-compliance	0.05	0.04	Yes
PR14SEWWSW_N2	02	Service reservoir coliforms non-compliance	-	-	Yes
PR14SEWWSW_N2	03	Turbidity non-compliance	-	-	Yes
PR14SEWWSW_N2	04	Enforcement incidents	-	-	Yes

3C - AIM (Abstraction Incentive Mechanism)

Abstraction site	2018/19 AIM performance (ML)	2018/19 normalised AIM performance	Cumulative AIM performance 2016/17 onwards (ML)	Cumulative normalised AIM performance 2016/17 onwards	Contextual information relating to AIM performance
Windmill Hill	(32.0)	-	(148.0)	-	-
Kingston	-	-	(84.0)	-	-
Total	**(32.0)**	**-**	**(232.0)**	**-**	**-**

3D - SIM (Service Incentive Mechanism) score

SIM Score	Score
Qualitative SIM score	
1st survey score	4.42
2nd survey score	4.28
3rd survey score	4.27
4th survey score	4.49
Qualitative SIM score (out of 75)	63.00
Quantitative SIM score	
Total contact score	52.83
Quantitative SIM score (out of 25)	22.36
Total annual SIM Score (out of 100)	**85.36**

4A- Non-financial information

for 12 months ended 31 March 2019

Retail - household	Unmeasured 000	Measured 000
Number of void households	4,414	17,520
Per capita consumption (excluding supply pipe leakage) l/h/d	211.50	140.69

Wholesale	Water
Volume (Ml/d)	
Bulk supply export	4
Bulk supply import	52,214
Distribution input	526,652

4B - Wholesale totex analysis

At the beginning of the AMP6 Period we set up a new team whose focus was on efficient delivery of the engineering programme. The programme definition and optimisation team (PDOT) was challenged with identifying significant savings over the five year period. The focus of their work includes:-

- working with the supply chain to identify innovation
- profiling the programme so that our supply partners could deliver the programme more efficiently
- identifying alternative approaches to dealing with complex problems
- providing better information to our supply chain earlier to help them with their resource management
- review our standards to see if alternative approaches provide the same outcome without impacting on risk

In addition to this, we have found further efficiencies by reviewing some of our key strategies. An example being our leakage strategy, where we have spent additional money in the first three years of the AMP, which has reduced leakage and allowed us to defer a £4.0 million water resources scheme from the programme. This water resources scheme had potential environmental impacts.

Our engineering and assets teams have developed new contracts with the supply chain, incentivising them on efficiency targets. For instance Jacobs, our delivery partner, is incentivised on OPEX as well as CAPEX, ensuring we optimise totex, and they have helped us review our generator strategy which has helped us to reduce power costs – a programme we will continue to roll out over the rest of the AMP.

We have made efficiency savings in our domestic metering programme while at the same time remain committed to delivering the metering plan set out in our water resources management plan (WRMP) and business plan.

Expenditure for 2018/19 has seen us deliver our SOSI regulated commitments such as SEMD, DWI and SOSI projects and also refurbishments of water treatment works and water mains.

	Current Year Water £000	Cumulative 2015-20 Water £000
Actual totex		
Actual totex	183,242	669,562
Less: Items excluded from the menu		
Third party costs	347	1,549
Pension deficit recovery payments	3,817	13,347
Other 'rule book' adjustments	306	2,423
Total items excluded from the menu	4,470	17,319
Add: Transition expenditure		
Transition expenditure	-	-
Adjusted actual totex		
Adjusted actual totex	178,772	652,243
Adjusted actual totex base year prices	154,394	589,018
Allowed totex		
Allowed totex based on final menu choice – base year prices	159,000	628,300

4C - Impact of AMP performance to date on RCV

Table content summary

This table tracks year on year changes to the regulatory capital value (RCV) and reports a 'shadow' RCV as a result of actual totex and any ODI adjustments.

Background and purpose

This information is intended to show the rolling impact on the RCV of changes in investment activity relative to the determination and ODI performance over the year.

Table completion methodology

Key inputs to the table and their sources are summarised in the table below: Some of the methodologies require some choices which are discussed further in the following section.

Line	Description	Source data and analysis
1	Cumulative totex over/underspend so far in the price control period	This line is calculated as the difference between the actual totex (4B L8) and the baseline totex (4B L9) (at base year prices) inflated to current year prices using the actual RPI.
2	Customer share of cumulative totex over/underspend	The customer share of the cumulative totex over/underspend is 50% as per the baseline menu choice.
3	RCV element of cumulative totex over/underspend	The RCV element of customer share of cumulative totex over/underspend is calculated using the IAP updated totex menu reconciliation model issued by Ofwat as part of the PR14 Rulebook. The cumulative totex over/underspend from line 4C.1 is entered into the model along with the baseline of 100 from our final menu choice. The model applies an adjustment for the time value of money (WACC) and takes into account the movement from the implied menu choice (103.1) to the actual menu choice (100.0) including the final year of the AMP. The RCV adjustment is then inflated to outturn using the issued RPI of 285.1.
4	Adjustment for ODI outperformance payment or underperformance payment	There are no projected ODI adjustments to the RCV for 2018/19.
5	RCV determined at FD at 31 March	RCV at 31 March 2019 as reported in Ofwat's published RCV-PR14_2019 Regulatory Capital Values document. £1,365.036 million.

Table completion methodology discussion

The line definitions specify that the RCV is to be inflated to March 2019 using the March RPI. This correctly reports the RCV at a 'year end' position.

Our year by year PAYG ratio reported in table A2.5 of our FD company specific appendix is given below:

FD Table A2.5 South East Water's wholesale water PAYG rates

2015/16	2016/17	2017/18	2018/19	2019/20	Total
61.6%	58.2%	56.4%	59.7%	64.1%	59.9%

Ofwat guidance has specified that the weighted average PAYG ratio is to be used for this calculation

The weighted average PAYG ratio is 59.9 per cent. This is consistent with the populated totex menu reconciliation model issued by Ofwat as part of the PR14 Rulebook.

4C - Impact of AMP performance to date on RCV (continued)

Table calculations

Line	Description	Unit		
	Price base RPI index		2012/13 av 244.7	Mar-19 y/e 285.1
1	Cumulative totex over/underspend so far in the price control period (4B L8 – 4B L9 in outturn prices)	£m		(45.772)
2	Customer share of cumulative totex over/underspend (4C L1 * 50%)	£m		(22.886)
3	RCV element of cumulative totex over/underspend (calculated using the totex menu reconciliation model issued by Ofwat as part of the PR14 Rulebook)	£m	(15.942)	(18.576)
4	Adjustment for ODI outperformance payment or underperformance payment	£m		–
5	RCV determined at FD at 31 March	£m		1,365.036
6	Projected 'shadow' RCV	£m		1,346.460

Changes in methodology since prior years

There have been no changes in methodology since last year.

Risks to data accuracy and robustness

None.

	Water £000
Cumulative totex over/underspend so far in the price control period	(45,772)
Customer share of cumulative totex over/underspend	(22,886)
RCV element of cumulative totex over/underspend	(18,576)
Adjustment for ODI outperformance payment or underperformance payment	–
RCV determined at FD at 31 March	1,365,036
Projected 'shadow' RCV	**1,346,460**

4D - Wholesale totex analysis

for the 12 months ended 31 March 2019 – water

	Water resources		Network+				
	Abstraction licences £000	Raw water abstraction £000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
Operating expenditure							
Power	-	4,366	272	-	374	11,269	16,281
Income treated as negative expense	-	-	-	-	-	-	-
Abstraction charges/ discharge consents	2,917	-	-	-	163	-	3,080
Bulk supply	-	1,040	-	-	5,076	-	6,116
Other operating expenditure							
Renewals expensed in year (Infra)	-	-	-	-	-	-	-
Renewals expensed in year (Non-Infra)	-	-	-	-	-	-	-
Other operating expenditure excluding renewals	9	4,201	324	9	14,177	29,671	48,391
Local authority and Cumulo rates	-	912	193	202	1,376	14,687	17,370
Total operating expenditure excluding third party services	2,926	10,519	789	211	21,166	55,627	91,238
Third party services	-	-	-	-	-	347	347
Total operating expenditure	2,926	10,519	789	211	21,166	55,974	91,585
Capital expenditure							
Maintaining the long term capability of the assets (Infra)	-	-	72	-	43	18,454	18,569
Maintaining the long term capability of the assets (Non-Infra)	-	1,489	-	-	14,631	16,224	32,344
Other capital expenditure (Infra)	-	864	10	-	-	24,634	25,508
Other capital expenditure (Non-Infra)	-	1,901	-	-	15,580	3,578	21,059
Infrastructure network	-	-	-	-	18	4,067	4,085
Total gross capital expenditure (excluding third party)	-	4,254	82	-	30,272	66,957	101,565
Third party services	-	-	-	-	-	-	-
Total gross capital expenditure	-	4,254	82	-	30,272	66,957	101,565
Grants and contributions	-	-	-	-	-	(13,725)	(13,725)
Totex	2,926	14,773	871	211	51,438	109,206	179,425
Cash expenditure							
Pension deficit recovery payments	4	538	15	-	1,368	1,892	3,817
Other cash items	-	-	-	-	-	-	-
Totex including cash items	**2,930**	**15,311**	**886**	**211**	**52,806**	**111,098**	**183,242**

4D - Wholesale totex analysis (continued)

for the 12 months ended 31 March 2019 – water

Unit cost information (operating expenditure)	Licenced volume available	Volume abstracted	Volume transported	Average volume stored	Distribution input volume – water treatment	Distribution input volume – treated water
Volume (Ml)	270,746,542	178,859,737	31,701,533	704,470	192,227,926	192,227,926
Unit cost (£/Ml)	10,807	58,811	24,888	299,516	110,109	291,186
Population (000's)	2,235,721	2,235,721	2,235,721	2,235,721	2,235,721	2,235,721
Unit cost (£/pop)	1,309	4,705	353	94	9,467	25,036

In the year ended 31 March 2019, the company deferred the purchase of land and abstraction licences from the administrators of Aylesford Newsprint for the construction of water treatment works. As a result of this deferment, capital expenditure within the Water Resources business unit is lower than that forecasted for the year. It is however forecast that the purchase will instead go ahead in the year ended 31 March 2020.

4F - Operating cost analysis

for the 12 months ended 31 March 2019 – household retail

	Household unmeasured water £000	Household measured water £000	Total £000
Operating expenditure			
Customer services	678	5,661	6,339
Debt management	66	465	531
Doubtful debts	207	1,469	1,676
Meter reading	-	856	856
Other operating expenditure	762	5,744	6,506
Total operating expenditure excluding third party services	1,713	14,195	15,908
Third party services operating expenditure	-	-	-
Total operating expenditure	1,713	14,195	15,908
Depreciation – tangible fixed assets			
On assets existing at 31 March 2015	5	33	38
On assets acquired since 1 April 2015	2	12	14
Amortisation – intangible fixed assets			
On assets existing at 31 March 2015	-	-	-
On assets acquired since 1 April 2015	-	-	-
Total operating cost	**1,720**	**14,240**	**15,960**
Capital expenditure	**75**	**531**	**606**

Other operating expenditure includes the net retail expenditure for the following retail activities which are part funded by wholesale:

Household	£000
Demand-side water efficiency – gross expenditure	351
Demand-side water efficiency – expenditure funded by wholesale	(223)
Demand-side water efficiency – net retail expenditure	**128**
Customer-side leak repairs – gross expenditure	1,564
Customer-side leak repairs – expenditure funded by wholesale	(1,097)
Customer-side leak repairs – net retail expenditure	**467**

4G - Wholesale current cost financial performance

for the 12 months ended 31 March 2019

	Water £000
Revenue	205,091
Operating expenditure	(91,585)
Capital maintenance charges	(71,276)
Other operating income	376
Current cost operating profit	42,606
Other income	22,578
Interest income	5,421
Interest expense	(53,822)
Other interest expense	636
Current cost profit before tax and fair value movements	17,419
Fair value gain/(losses) on financial instruments	(4,668)
Current cost profit before tax	**12,751**

4H - Financial metrics - Return on regulated equity

Table/Line content summary

This parameter reports the return on regulated equity (RORE) which is a measure of the return to shareholders allowing for any out/(under) performance in the year.

Background and purpose

RORE is a measure of the return to shareholders allowing for any out/(under) performance in the year primarily from:

- totex out/(under) performance (adjusted for RCV runoff)
- retail household costs out/(under) performance
- any reward/(penalty) from ODIs in the year
- debt financing costs out/(under) performance compared to the cost of debt set by Ofwat in the final determination
- the above are adjusted for the impact net of tax

RORE is referenced against the notional balance sheet and the allowed cost of equity in the WACC assumed by Ofwat in the final determination. For PR14 Ofwat set a notional gearing level for all companies of 62.50 per cent and a base return to equity of 5.60 per cent. This information is intended to show the rolling impact on the RCV of changes in investment activity relative to the determination and ODI performance over the year.

Table/Line completion methodology

The Ofwat line definition for RORE is given below.

Line	Description	Definition
5	RORE (return on regulatory equity)	RORE calculates the return on a regulatory basis by reference to the notional gearing level of 62.50% and average RCV for each year. Where a regulated business ceases to undertake a particular activity (e.g. exiting the non-household retail market), then a note should be included setting out how this has impacted on the RORE compared to the base RORE set at FD. The base RORE set at the final determination should be adjusted for the following factors net of any tax impact. 1) The company share of totex out or under performance. This should reflect genuine out or under performance only. Any totex over or underspend which is due to timing (i.e. re-profiling of expenditure within the AMP) should not be recognised as out or under performance for the purpose of the calculation of RORE. 2) The company share of any out or underperformance on retail costs. 3) The impact on the RCV run off of the out or under performance of totex. 4) The impact of any ODI or SIM penalties or rewards earned in the year, even if they are not payable/receivable until the following AMP. 5) The difference between the actual average interest rate paid on borrowings (in real terms) and the allowed interest rate (real) on notional debt. This should be calculated based on the notional capital structure i.e. difference in actual interest rate and allowed interest rate multiplied by notional net debt. When calculating the actual real interest rate paid from actual nominal interest rate paid the actual inflation should be used and not the long term inflation assumption which was used by Ofwat in setting the cost of debt. RORE should be presented on a cumulative basis and should recognise gains and losses made in the period from the start of the AMP to the date of the APR.

4H - Financial metrics - Return on regulated equity (continued)

Key inputs to the calculation of RORE and the sources of data are summarised in the table below:

Item	Approach
Base RORE	Base RORE is 5.60% (source: Ofwat populated SEW FD RAT model available at webarchive.nationalarchives.gov.uk/20150624091829/https://www.ofwat.gov.uk/pricereview/pr14/pap_tec201412pr14ratmodel_sew.xlsm The base RORE is converted to £m for each year using the FD notional regulated equity using the regulatory notional balance sheet gearing of 62.50%. Base RORE = RCV x (100.00%-62.50%) x 5.60%.
Totex out/(under) performance	The outperformance is calculated as: Adjusted actual totex – converted to base year prices (APR table 4B Line 8) less the Allowed totex based on final menu choice – base year prices (SEW FD company specific report – table A2.4 Line 6). This outperformance is adjusted for any re-profiling of expenditure over the AMP. This is adjusted for tax at a rate of 19%.
Retail costs out/(under) performance	The outperformance is calculated as: Retail Household (HH) – Actual retail HH costs (APR table 2C Line 12) – outturn prices, less the Allowed retail HH costs (calculated as actual property numbers times the ACTS for measured and unmeasured properties from SEW FD company specific report – table A3.10 Lines 9&10) – outturn prices. The actual retail HH costs are adjusted to exclude any depreciation on assets existing at March 2015. The difference between allowed and adjusted actuals are converted to base year prices for consistency on inclusion in RORE. Retail Non-household ("NHH") – Actual retail NHH costs (APR Table 2C Line 12) – outturn prices, less the Allowed retail NHH costs (taken from Ofwat's FD model for SEW – Calc NHH'!J$980) – outturn prices, however we only had the retail NHH business until April 30 2018. i.e. 1 month, therefore the calculation has been adjusted to include just 1/12th of the FD allowed retail NHH costs. The actuals are adjusted to exclude any depreciation on assets existing at March 2015. Both items are adjusted for tax at a rate of 19%.
RCV runoff on totex out/(under) performance	Calculated using the above out/(under) performance on totex and FD RCV runoff rates for new RCV expenditure additions.
Impact of ODI/SIM penalties/rewards in year	Although any reward/(penalty) from the ODIs are not due to be recovered from customers until the next price review, for the purposes of the RORE calculation the impact is considered in the year of occurrence. The net £m reward/(penalty) from ODIs is taken from SEW APR table 3A. Items are adjusted for tax at a rate of 19%.
Difference between actual interest charge (real terms) and allowed interest (real) on notional debt.	Allowed real interest rate comes from the Ofwat FD model for SEW. Actual interest costs on a nominal basis (excluding fees and bank charges) is taken from the P&L interest note supporting APR table 1A. This is divided by the average net debt for the year. This actual nominal figure is converted to a real figure by using actual RPI in the fisher formula: (1+real) x (1+RPI) = (1+nominal). The difference between allowed and actual real interest (%) is multiplied by notional debt to generate a £m out/(under) performance on debt costs.
RORE (in year)	Sum of above in £m converted to % return on regulated equity.
RORE (cumulative)	A simple average of the in year and prior year RORE %'s.

4H - Financial metrics - Return on regulated equity (continued)

Summary calculation

Calculation of RORE	2012/13 prices	Unit	2015/16	2016/17	2017/18	2018/19
Year average RCV		£m	1,082.7	1,105.9	1,134.0	1,160.5
Notional gearing		%	62.50	62.50	62.50	62.50
Notional debt		£m	676.7	691.2	708.8	725.3
Regulatory equity		£m	406.0	414.7	425.3	435.2
Base RORE – appointee		%	5.60	5.60	5.60	5.60
Base case return		£m	22.7	23.2	23.8	24.4
Adjustments to base case return						
Company share of totex out/(under) performance		£m	1.9	4.7	6.7	0.4
Company share of out/(under) performance on retail costs		£m	1.0	2.3	2.6	2.4
Impact on RCV runoff of the out/(under) performance of totex		£m	-	(0.1)	(0.2)	(0.3)
Impact on ODI/SIM in year		£m	0.1	0.4	(1.4)	-
Difference between actual interest charge and allowed on notional debt		£m	(6.1)	(2.8)	1.6	(1.1)
Adjustments to base case return		£m	(3.1)	4.5	9.3	1.4
Adjusted return		£m	19.7	27.7	33.2	25.8
Regulatory equity		£m	406.0	414.7	425.3	435.2
Outturn annual RORE		%	4.84	6.68	7.80	5.93
Outturn cumulative RORE (arithmetic average)		%	4.84	5.76	6.44	6.31

4H - Financial metrics - Return on regulated equity (continued)

Commentary on results

RORE for the year was 5.93 per cent compared to the base case RORE of 5.60 per cent. RORE to date is 6.31 per cent. A breakdown of the RORE components is shown below.

Breakdown of RORE components	2015/16	2016/17	2017/18	2018/19	To date
Base RORE – appointee	5.60%	5.60%	5.60%	5.60%	5.60%
1 Company share of totex out/(under) performance	0.46%	1.13%	1.58%	0.10%	0.82%
2 Company share of out/(under) performance on retail costs	0.25%	0.57%	0.63%	0.56%	0.50%
3 Impact on RCV runoff of the out/(under) performance of totex	-	(0.02%)	(0.05%)	(0.07%)	(0.04%)
4 Impact on ODI/SIM in year	0.04%	0.09%	(0.34%)	-	(0.05%)
5 Difference between actual interest charge and allowed on notional debt	(1.51%)	(0.67%)	0.37%	(0.26%)	(0.52%)
Outturn RORE	4.84%	6.68%	7.80%	5.93%	6.31%

The outperformance on RORE for the year was primarily driven by outperformance on both wholesale totex and retail costs.

The value reported for 2017/18 above has been restated due to a change in property figures post audit and a correction to the treatment of timing differences in the totex calculation. The outturn annual RORE for 2017/18 remains at 7.80 per cent but the split between the totex and retail costs is changed.

Changes in methodology since prior years

None.

Risks to data accuracy and robustness

None.

4H - Financial metrics

Financial Indicators	Current Year	AMP to date
Net debt (£m)	1,071,665	
Regulated equity (£m)	293,371	
Regulated gearing (%)	78.51	
Post tax return on regulated equity (%)	14.25	
RORE (return on regulated equity) (%)	5.93	6.31
Dividend yield (%)	6.01	
Retail profit margin – Household (%)	3.01	
Retail profit margin – Non household (%)	(3.84)	
Credit rating	BBB	
Return on RCV (%)	6.65	
Dividend cover (number)	1.76	
Funds from operations (FFO) (£m)	95,661	
Interest cover (cash) (number)	3.69	
Adjusted interest cover (cash) (number)	2.31	
FFO/Debt (number)	0.09	
Effective tax rate (%)	(0.78)	
Free cash flow (RCF) (£m)	72,727	
RCF/capex (number)	0.73	

Revenues and earnings	Current year
Revenue (actual) (£000)	224,459
EBITDA (actual) (£000)	115,972

Movement in RORE	Current Year	AMP to date
Base return (%)	5.60	5.60
Totex out/(under) performance (%)	0.10	0.82
Retail cost out/(under) performance (%)	0.56	0.50
ODI out/(under) performance (%)	-	(0.05)
Financing out/(under) performance (%)	(0.26)	(0.52)
Other factors	(0.07)	(0.04)
Regulatory return for the year (%)	**5.93**	**6.31**

4H - Financial metrics (continued)

Borrowings	Current Year
Proportion of borrowings which are fixed rate (%)	15.40
Proportion of borrowings which are floating rate (%)	5.07
Proportion of borrowings which are index linked (%)	79.53
Proportion of borrowings due within 1 year or less (%)	33.36
Proportion of borrowings due in more than 1 year but no more than 2 years (%)	-
Proportion of borrowings due in more than 2 years but no more than 5 years (%)	-
Proportion of borrowings due in more than 5 years but no more than 20 years (%)	50.81
Proportion of borrowings due in more than 20 years (%)	15.83

4I - Financial derivatives

	Nominal value by maturity (net) at 31 March 2019			Total value at 31 March 2019			Interest rate (weighted average for 12 months to 31 March 2019)	
	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Nominal value (net) £m	Mark to Market £m	Total accretion at 31 March 2019 £m	Payable %	Receivable %
Interest Rate Swap (Sterling)								
Floating to fixed rate	-	-	-	-	-	-	-	-
Floating from fixed rate	-	-	-	-	-	-	-	-
Floating to index linked	-	-	-	-	-	-	-	-
Floating from index linked	-	-	-	-	-	-	-	-
Fixed to index linked	-	-	-	-	(108,836)	(106,719)	6.67	5.38
Fixed from index linked	-	-	-	-	-	-	-	-
Total	-	-	-	-	(108,836)	(106,719)		
Other financial derivatives	-	-	-	-	-	-	-	-
Total financial derivatives	-	-	-	-	**(108,836)**	**(106,719)**		

Notes

Meet the team

South East Water's finance team ensures the company meets its obligations to stakeholders through transparent reporting and effective financial management and control.

south east water

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