

Annual Report and Financial Statements
Annual Performance Report

31 March 2016

# Pure know hzow

#### **Our business**

South East Water, supplies top quality drinking water to 2.1 million customers in the south east of England. Through a network of 9,000 miles of pipe, we deliver 540 million litres of water every day. The skill and expertise of our employees ensures our customers' water meets the highest of standards.

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.

#### Our supply area



#### **Good to know**



**540 million litres of water a day** – that's how much water we supply to around 2.1 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



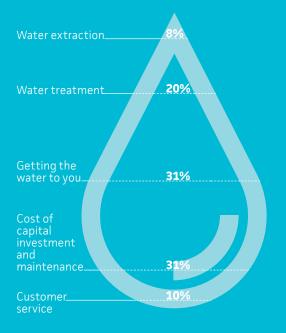
**9,000 miles of water mains** – that's how we transfer fresh drinking water direct to your tap



**849 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



# **Did you** know?

# **Every action** counts

During the year we delivered £89.2 million of schemes to improve our treatment and network



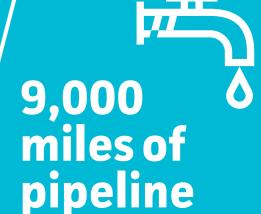
# Five-out-of-five

We've introduced an innovative customer engagement programme to help us consider the views of all our customers. not just those who contact us



# **Every** customer counts

We've had a 38% improvement in written complaints compared to last year



That's how we deliver 540 million litres of water each day



# 47,000 waiter meters

That's how many we've installed in the year. 75% of customers now have a water meter



# **Everyone** counts

Safety is our top priority - we had zero reportable accidents through the year. We received silver Investors in People accreditation

# The water supply

We plan 25 years into the future to secure supplies for our customers

# Our future counts

Our National Environment Programme will see us complete 42 schemes over the next five years

# **Every** drop counts

The installation of 1.540 electronic logger devices has helped us beat our leakage target



# 500,000 samples

That's how many water samples we test each year at our laboratory



# **Environment**

We look after 2.000 hectares of land to protect underground water sources as a result 33 of our sites are now protected as sites of special scientific interest

# 54p a day

How much the average family pays for their drinking water supply



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Additional regulatory information



We are working with local farmers to help impro quality in rivers before it even reaches our treatr Here Simon our Catchment Management Lead r

from source to tap with the

**South East Water** 

John Barnes (Independent Non-Executive Director) appointed 28 January 2016

Emma Gilthorpe (Independent Non-Executive Director)

Chris Girling (Independent Non-Executive Director)

Paul Rich (Independent Non-Executive Director)

**Directors** 

**Graham Setterfield** (Independent Non-Executive Director) resigned 28 January 2016

**Nick Salmon** (Independent Chairman) appointed 1 April 2015

Peter Dixon (Non-Executive Director)

Olivier Fortin (Non-Executive Director)

Jean Pierre Ouellet (Non-Executive Director)

Valeria Rosati (Non-Executive Director)

Paul Butler (Managing Director)

**Andrew Farmer** (Finance Director) appointed 1 August 2015

David Hinton (Asset and Regulation Director)

Jo Stimpson (Finance Director) resigned 31 July 2015

#### Company Secretary

**Nicolas Truillet** 

#### Company's bankers

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

#### Company's auditor

Deloitte LLP Chartered Accountants and Statutory Auditor London, United Kingdom

#### Registered office

Rocfort Road, Snodland, Kent ME6 5AH

egistered No. 02679874

Country of domicile and incorporation: England and Wales



Our primary duty is to supply people with a reliable service of high quality drinking water

# **Chairman's Introduction**

# Chairman's Introduction

On behalf of the Directors of South East Water, I am pleased to present our annual report and financial statements for the year ended 31 March 2016 which is the first reporting year of the current five year regulatory period. We are focusing specifically on continuing to improve customer satisfaction, using our scientific and engineering expertise to deliver a reliable service of high quality drinking water and also in preparing for the water industry opening up to retail competition for non-household customers in 2017. I am pleased to report we have made significant progress in these areas during the year.

#### **Customer satisfaction**

We are committed to putting our customers' priorities at the heart of everything we do. Our innovative approach to outcome delivery incentives (ODIs) for the current regulatory period means we are financially rewarded or penalised based on how satisfied our customers are on their priority outcomes, as well as by our underlying performance.

We developed incentives that made us look critically at the decisions we make as a business to ensure we are focused on all our customers, not just those who contact us. We aim to empower and inform both our customers and our people to

support this effort which has led to a commitment to delivering a "five-out-of-five" service across the business.

Increased investment in the training and development of our frontline teams and working throughout the year with our customer panel, listening to customers and improving our internal processes have led to significant improvements in customer service levels across the business. It is clear that this investment has yielded benefit to our customers. We received 38% less complaints than last year and improved customer satisfaction which helped us achieve a service incentive mechanism (SIM) score of 82.0 out of 100.

We know we have further work to do to reach our target of industry leading performance and during 2016/17 we will be implementing further plans to achieve this.

We have a strong sense of social responsibility in the communities in which we work as our primary duty is to supply people with a reliable service of high quality drinking water. For those customers that have difficulty with paying their bills we have developed a social tariff. The social tariff caps the water bill at a fixed amount for the year and those on a low income or who are in receipt of specific benefits may be eligible and are encouraged to apply. During the year 4,600 people have benefited from

this tariff following assistance from our dedicated customer care team to find the right support for their individual needs.

## Science and engineering excellence to deliver quality water

In February we opened our new state of the art laboratory in Farnborough, Hampshire. The new laboratory, which operates 24 hours a day, 365 days a year, is able to test 700,000 water samples each year, ensuring that the water that we provide to our customers continues to be top quality. The establishment of this new laboratory has been an important milestone for the business.

Our leakage target for the year was 91.8 million litres per day (MI/d), compared with 93MI/d in 2014/15. We are pleased to report that we have made significant progress in delivering our five-year leakage strategy, beating the target by reducing leakage to 88.1 million litres per day. This is equivalent to 16.3% (2014/15 industry average 30.1%) of our total supply and includes leaks occurring on our customers properties, which represent around a quarter of the total leakage. It has been achieved by significant improvements in performance across 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.

# During the year we invested £89.2 million in new and existing assets

# This investment is supporting our efforts to improve services for our customers

We have continued to focus on minimising interruptions to supply for our customers, on both our planned engineering works and in response to unplanned events. The engineering team has been working hard to ensure that in particular we minimise interruptions over three hours. I am pleased to report we only had eight interruptions during planned work on our network, which was an average of 0.1 minutes per property. At the beginning of the year there was a significant incident at Hailsham, East Sussex as a result of a burst in a large underground supply main, installed over 40 years ago. This meant we missed our overall target of an average of less than 11 minutes interruption per property for the year. We wrote to all customers impacted to apologise and credited their accounts in recognition of the inconvenience caused. Thankfully incidents like this one are rare and if the Hailsham interruption was not included the year would have seen an average of 9.1 minutes which was a very good performance. The team is working hard to ensure we have a successful year in 2016/17.

During the year we invested £89.2 million in new and existing assets, this includes continued investment in installing a new 7km pipeline, which now runs between Leybourne Lakes Country Park and the water treatment works at Burham, Kent and laying a 5.5km strategic water main in Swinley Forest through to Birch Hill, bringing the total investment in these two projects to £9.8 million and £5.9 million respectively. Schemes such as these are supporting our efforts to

improve services for our customers and help safeguard the environment, and we are committed to continue this level of investment.

#### Retail competition

From April 2017 businesses and other non-household customers will be able to choose their supplier of retail services, including South East Water. Retail services include all the customer related services, such as talking with customers, advising on water usage, reading water meters, billing and collecting payments. The water supplied to such customers will continue to be provided by South East Water's wholesale business (the part of the business that is responsible for the abstraction, treatment and distribution of drinking water). Household customers are not presently affected by this change. South East Water has been preparing for this new era for the industry.

The introduction of competition by the Government aims to drive down prices and improve customer service.

We currently supply approximately 55,000 non-household customers. All of these customers will be able to choose whether they stay with us or move to another retailer and therefore our business retail team has been preparing its strategy to ensure we are a player in the new market.

At the same time the wholesale and household retail teams have been ensuring they are ready for the introduction of new market codes and ensuring there is a "level playing field" for all retailers.

Since early 2015, a cross department project team has been working hard to translate the market codes into everyday business processes, ensure we have the necessary organisational structure and systems in place to operate and interface with the market and ensure the data we are uploading into the market is robust.

From now through to April 2017 we will need to pass many milestones to ensure we are ready to operate, we have to pass market testing and most important of all we have to ensure that come April 2017 should a customer wish to switch retailer we have done everything within our power to make sure this is a good customer experience.

Working with Ofwat and Market Opening Services Limited (MOSL), we have been preparing the business to be ready for the shadow operation period beginning 1 October 2016.

There is a lot of work to do during 2016/17 and I am pleased to report the team is making good progress and is on track to a successful outcome for the business and our customers.

#### Financial results

In the year ended 31 March 2016 our total revenue was £214.4m. This is marginally less than the previous year owing to a reduction in tariffs of 1.1% which was part offset by an increase in consumption from new and existing customers. Net operational costs increased by £5.0m. This increase is due to inflationary pressure on the cost base and additional expenditure in the year on leakage detection, water treatment and bulk supply of

water. Our group operating profit has decreased by £4.9 million to £74.8 million compared to £79.7 million in the previous year and our profit before tax was £42.4 million compared to £35.3 million in the prior year, primarily due to a reduction in finance costs. Our financial performance was in line with the board's expectations.

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

### Our people, working together towards future success

It is thanks to the passion of the people at South East Water that the company has been recognised with a number of awards during the year. We were delighted to be awarded with the silver accreditation by Investors in People (IIP). This is a great achievement for the business and puts us in the top seven per cent of businesses who are accredited by IIP and underpins our commitment to our people. We received the Institute of Water Innovation Award for our work using eDNA to identify endangered species ahead of engineering works, while our customer care team was named Credit Today's Utilities and Telecoms Water Team of the Year.

During the year there have been a number of changes at board level. In August, Andrew Farmer joined the board as Finance Director to replace Jo Stimpson, who retired from the company after 12 years' service. In January, Graham Setterfield retired as Non-Executive Director, after serving for 15 years to be replaced by John

Barnes who brings with him extensive water sector experience. I would like to thank Jo and Graham for their hard work and significant achievements over their time with the business and to welcome Andrew and John to the company.

The board is pleased with the business performance and achievements this year but recognises that continued improvement will be required to address the challenges and achieve our ambitions over the coming years. We believe we have the right management team in place, supported by a great team of people at both South East Water and our key business partners, to deliver on our plans, both now and in the longer term, to the benefit of today's and tomorrow's customers. We would like to thank our people and our partners for their continued hard work and support.

#### **Nick Salmon**

Chairman 15 July 2016



# at every level there is a determined focus to achieve five-out-offive and commitment that ensures every customer counts

Across the company

# Pure know how

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# Strategic report

# Managing Director's introduction

I am pleased to present our annual report and financial statements for the year ended 31 March 2016.

The strategic report summarises our activities over the first reporting year of the five year regulatory period. We are focusing specifically on delivering a five-out-of-five service and continuing to increase customer satisfaction, while at the same time preparing for the opening up of competition in the water industry for non-household customers in 2017. I am pleased to report we have made significant progress in these areas during the year.

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 strategy and support the delivery of our vision (see page 16 for further details). They relate to our customers and to everyone across the business, including our partners. They help us focus on how we run our business today and how we plan for the long-term, with our customers the priority in everything we do. ▶



We have put customer satisfaction at the heart of our business, everyone is focused on delivering a five-out-of-five service

Managing Director's introduction (continued)

#### **Every customer counts**

During the upcoming period we are committed to increase customer satisfaction across a range of measures, responding to the challenges set by our customers and our regulators. We are pleased to report that our ongoing commitment to improve our service to customers and to raise their satisfaction levels has made strong progress and this is summarised in this report.

The level of written complaints received from our customers has reduced again this year with a 38 per cent improvement compared to the prior year and a 66 per cent reduction over a two year period.

We have put customer satisfaction at the heart of our business through an innovative approach to the outcome delivery incentives (ODIs) agreed through our business plan. We wanted to focus on all customers, not just those who contact us, giving the silent majority a voice.

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. We are the only company to take this approach and begin to truly allow incentives to be based on customer satisfaction.

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 react to their views constantly. 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 about our vulnerable customers and those who have difficulty paying their bills, which is why we've developed a social tariff and a dedicated customer care team to support those who need assistance.

#### **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 any partners and businesses we work with.

# We are on track to deliver on the commitments we made to all our customers in our five year plan

# **Further information is available in our Performance, People and Planet Report**

Our silver accreditation, received this year from Investors in People, is the result of hard work and innovation across the business and demonstrates further progress we have made which include 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 too

Health and safety is a priority and we again ran our "wellbeing week" programme, this year focused on mental health. We continue with initiatives to encourage continued focus on safety, with our "Take 20" messages, which encourage everyone to take 20 seconds to think before undertaking any task to ensure there is no risk or we have plans in place to minimise risks, and the delivery of a "stop the unsafe work" card to every employee.

We are pleased to say this year saw us achieve zero reportable accidents and service strikes continue to fall.

As ever, it is important that we continue to motivate and develop our employees. Our apprenticeship programme welcomed four new apprentice technicians to the company and, with support from our longstanding employees, we are confident that they will continue to thrive in their roles.

#### **Every action counts**

For our customers the work we do behind the scenes makes a huge impact on the service they receive. We have worked hard to keep interruptions to supply to a minimum through our "every minute counts" campaign. Unfortunately at the start of the year a burst on an 18 inch diameter main in Hailsham led to a 45 hour interruption, which meant our average time was 32.1 minutes per property. However, after excluding this exceptional incident, which was probably the biggest incident South East Water has ever had, our average time would have been an average of 9.1 minutes per property.

We continue to invest in our infrastructure network so that we can provide our customers with high quality water. In this, the first year of the five year investment period, we delivered £89.2 million of capital investment. This included the continuation of our customer metering programme, with the installation of over 47,000 meters, and refurbishment of a number of our treatment works in Kent, Sussex and Berkshire. To strengthen the mains network we have laid 16km of new mains.

#### **Every drop counts**

Our ongoing investment in leak detection and repair has enabled us to beat our leakage target for the 14th year in a row and we continue to use new technology to drive the leakage levels down further. The installation this year of 1,540 logger devices has helped us find a total of 20% more detected leaks than the previous year. We hope that with all the new processes in place 2016/17 will see a further leakage reduction.

We are pleased to report that security of supply has been maintained for customers and our water resources remain in a healthy state and we do not expect the need for any restrictions this Summer.

The customer metering programme continues to roll out successfully and we've seen demand for water reduce by 18% in the homes that we have metered. Alongside this as part of our water efficiency campaign we have given out more than 36,000 water efficiency devices. We also worked with a children's author to promote a book encouraging 5 – 9 year olds to use water wisely and we've talked to hundreds of pupils in schools across our region to help everyone value water more.

#### **Our future counts**

To ensure the sustainability of the business we must ensure our financial performance continues to be satisfactory. Our revenue was £214.4 million (2015: £215.1 million). Our profit before tax for the year was £42.4 million (2015: £35.3 million). Further details of our financial performance are set out on page 31.

We are preparing for the water industry to open up to competition for non-household customers. The new market will be effective in April 2017. We continue to develop our plans to ensure we are ready for these changes – from both a wholesale and retail perspective. The wholesale part of the business is responsible for the abstraction, treatment and distribution of drinking water. The retail part includes all the customer related services, such as talking with customers and reading water meters. We are actively engaged with the Open Water and Market Operator Systems Limited (MOSL) programmes. We have also set up a number of internal work streams to ensure company readiness.

We see our roles as being guardians of the environment and work hard to protect the natural water resources we rely on. Over the next five years we are investing £16.7 million in our National Environment Programme to complete 42 schemes that will bring real benefits to our natural habitats.

#### 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 second year of our investment period, with customer satisfaction at the heart of our business promise we are pleased to see that 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.

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 2016





#### **Our business**

#### Our vision and strategy

We have put both customers and our people at the heart of our vision for the future which is to be the water company people want to be supplied by and want to work for.

#### Achieving our vision

To support the delivery of our vision we have developed 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 our customers are the priority in everything we do.

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

south east water

- 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 unique 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

We know that our people are the key to our success. Our "count me in" employee engagement programme has worked during the year to ensure both employees and our suppliers and partners understand our plans for the future and the vital role they all play. ▶

#### Our 25-year strategy

Planning for water is a long-term business, which is why it is important we set out the opportunities and challenges we face over the next 25 years.

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 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.

# How we will achieve our 25-year strategy

Our strategic direction statement, "clear water piecing together the bigger picture", sets out our approach through to 2040.

Putting customers centre stage of our 25-year journey, while ensuring we take account of all our other legal and financial obligations, 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 the outcomes, as shown opposite.

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.



Read more online at southeastwater.co.uk/businessplan

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 performance. The diagram on page 20 outlines our strategy.

### **Summary of our outcomes** Customers

#### **Performance**

Customers consider their water supply to be reliable

Customers consider their water quality is reliable

Customers consider the level of leakage to be acceptable

Customers consider the frequency of water use restrictions to be acceptable

Customers consider bills to be value for money and affordable

Customers consider their direct interaction experience to be positive

#### Stakeholders

#### Compliance

The level of compliance with statutory obligations is acceptable to our regulators

#### Performance

Stakeholders consider South East Water's general performance to be acceptable

Stakeholders consider South East Water's environmental performance to be acceptable

#### Investors

#### Performance

Investors consider the risk and return to be adequate

Shareholders consider their reputation is maintained

# Challenges we face

Rising numbers of homes and people

Meeting customer demand for water

Climate change

Maintaining supplies

Customers' changing expectations



Desalination Appual Papart and Ein Allitual Report and Thanklar Sta What is this preferred option? A scheme to abstract brackish (sea) water from underground wells. on the coastal strip at Reculver, Kent. The brackish water would be transferred via a 5km pipeline to our existing water treatment works, at Ford. There, a new desalination process using reverse osmosis, will remove salt from the water, prior to it being put into the supply network and delivered to peoples' homes. A second pipeline will take the removed salt back out to sea. What are the advantages? This £47m scheme y up to 8.4 million tr per day, when repeak periods, wiat its highest There is space Ford site for 160 a new treatme

#### Water resources for the future

Our 25-year Water Resources Management Plan sets out what we will need to do, where, and by when, to meet the future need for water from people, businesses and also the environment.

During this timescale we forecast that the household population will increase by 19 per cent.

Despite the challenges from a growing population we believe our demand management activities will help save an extra one million litres of water every day.

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.

Customers overwhelmingly supported our proposals to reduce demand for water, such as through our water efficiency, on-going customer metering and leakage reduction programmes.



Read more online at

southeast water. co.uk/water resources management plan

#### 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 155 of our annual

performance report. We have also published our performance, people and planet report 2015-16 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.

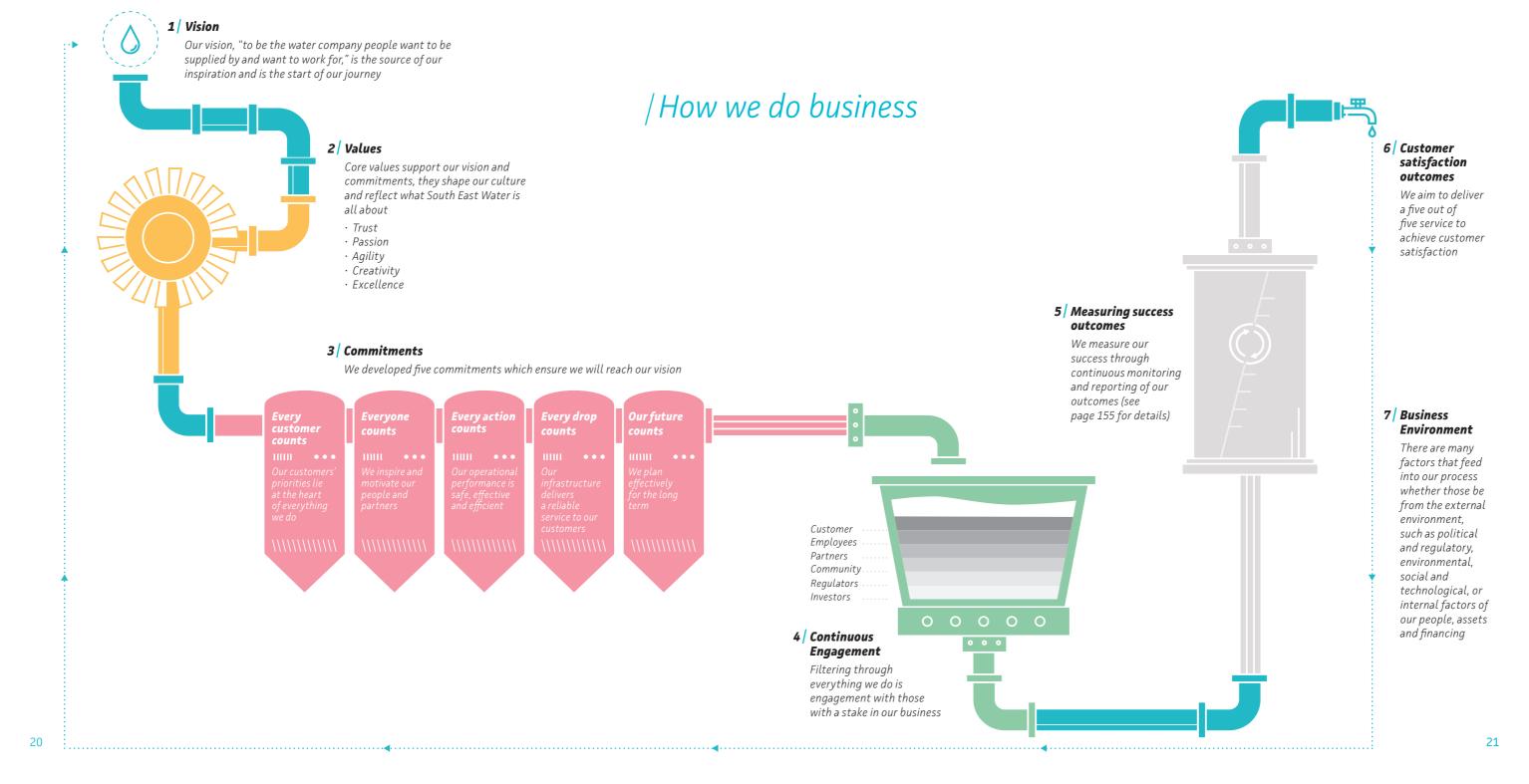
#### Our business model

We operate under an instrument of appointment issued under the Water Industry Act 1991. Our activities are regulated by Ofwat who is our economic regulator and has a duty to protect the interests of consumers. 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 high quality of service to our customers.

These business requirements are used to determine appropriate tariffs

for our customers. Our charges 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 for the wholesale business, the retail household business and the non-household retail business.



We are investing £16.7 million

in our National Environmental

# We work closely with our regulators

# Ensuring we deliver a great service now and in the future

## Creating value through a long-term approach

South East Water has grown from a rich history of long-term thinking by our predecessors who put the quality of our water resources and minimising the impact on the environment that water comes from as a priority.

Continuing this long-term view means we can ensure customers of the future will enjoy a quality service in the years to come and that our business continues to create value, through achieving customer outcomes and ensuring our investors receive an appropriate return.

Through our water bills we reflect the cost of abstracting, treating and transporting water to our customers. The price of water that we charge our customers is regulated by Ofwat as part of the five year price review.

In determining prices, Ofwat makes a number of assumptions with regard to required investment levels, the appropriate cost of capital and operational costs. We mitigate the risk of variations in these assumptions as far as possible but, to a significant extent, we carry the risk of such variations until the next price review.

Although we receive money directly from customers' bills most of our investment programme is only possible if we borrow additional money from financial institutions, like savings and pension funds, in which millions of us have an interest.

We are attractive to investors because we are a stable, regulated, efficient business, providing a steady return. For customers this financing means we can improve infrastructure now, but spread the costs over a longer term, much like a mortgage.

Customer bills and therefore our revenue are linked to inflation. Costs, including interest costs, are as much as possible linked to inflation so that any financial impact caused by a rise or fall in inflation is minimised.

In December 2015 Ofwat published a range of consultation documents setting out their key proposals for PR19. The Company responded to these documents and continues to play an active role in workshops that Ofwat have been running. A further set of documents were published in May 2016 – many of the proposals remain unchanged with further detail provided in some areas. The Company is now building on these document in formulating its plans and approach to the next price review.

Ofwat has set out its future regulatory framework for the water industry beyond 2020 and we are building on the information that has been issued to formulate plans and an approach to the next price review to ensure customers can continue to enjoy a quality service and the business continues to create value.

# Business environment

#### External environment

#### **Political and regulatory**

We operate within a strict regulatory environment and work closely with our regulators to ensure that we are delivering 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 ofwat.gov.uk
- The **Drinking Water Inspectorate** (DWI) monitors drinking water quality dwi.gov.uk
- The Environment Agency (EA) covers environmental protection gov.uk/government/organisations/ environment-agency
- The Consumer Council for Water (CCWater) represents customers' interests ccwater.org.uk
- 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 watrs.org
- Natural England (NE) is responsible for the protection of designated sites for nature conservation gov.uk/government/organisations/ natural-england

Our code of practice "your water company" provides more details on who our regulators are and what they do.

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 outcome for our customers, shareholders and other stakeholders are positive.

#### **Environmental**

We recognise that good effective environmental management must be at the heart of all 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.

Our business clearly relies on a secure supply of our natural resource – water. We must ensure 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 we are officially designated as an area of serious water stress. Our Water Resources Management Plan (see page 19 for details) is key to our 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.

**Programme** 

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 sources come from surface water, such as rivers and reservoirs we are working with local communities to improve the quality of the water within our catchment.

Through our water and farming partnership we are working with farmers to help manage the water catchment areas to protect and enhance water quality and the natural environment.

We know that as significant landowners ourselves we have tremendous responsibility in looking after 33 sites which are within sites of special scientific interest, the national nature reserve Lullington Heath in East Sussex, two nature reserves, Arlington Reservoir and Ardingly Reservoir in Sussex, and numerous 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 organisations such as Natural England and various wildlife trusts.

We are investing £16.7 million in our national environmental programme over the five year period to 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 one for the implementation of new eel regulations which seek to protect an endangered species at risk from water treatment processes.

Examples of work undertaken include the reintroduction of the endangered wartbiter cricket to our carefully managed habitat at Deep Dean water treatment works in East Sussex and the installation of barn owl boxes at Arlington Reservoir.

At the end of our treatment process we have produced a sludge product which we recycle by supplying the treated biosolids to agriculture, which provides a valuable resource to farmers.

Our charges are set out in our charges schemes which can be found at

southeastwater.co.uk/news-and-information/publications/our-charges

**P** 

Our performance, people and planet report provides more detail on our work to protect our environment for the next generation which can be found at southeastwater.co.uk/reporting2016

### Case study

Our customer metering programme continues to be a real success story. By March 2016 249,000 water meters have been installed – either through the customer metering programme or for those customers who have opted to have a meter fitted. This has been delivered with a comprehensive customer and community communication programme that has resulted in an increased understanding of why metering is needed and support for how the programme is being delivered.

that provision of water through a meter is the fairest way to charge. recognising the importance of making sure we protect vulnerable customer groups. Metering helps customers to understand their water use and make their own choices around water.

for water and so forms a key component of our 2015 to 2020

impacts that our metering work will have on water use and are forecasting that customers' use of water will reduce from a current figure of 160 litres per person per day to 148 litres per person per day by 2040.



Government and our industry are working together to understand future needs for water and we are active members of an industry-led project to look to improve resilience of water in the UK.

Our planning into the future includes considering the effects of climate change, working to protect the environment from pollution in our activities and reducing our carbon footprint.

Our education programme continues to introduce pupils to the "wonderful world of water" and we visited 38 schools during 2015/16 and gave out 36,000 water efficiency devices to customers across our region to help encourage a sustainable use of water.

We have many people that care about our business, including our customers, our communities and our employees. Our performance, people and planet report for 2015/16 summarises how we are working to meet the different requirements of this diverse group.

We take our corporate social responsibility seriously. 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 new state of the art laboratory to ensure that the water is safe to drink and that we are complying 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.

Our communities also benefit from the provision of educational, recreational and amenity opportunities that come from being able to access our land, or from the contributions we make through donations, organised charitable events and the support of our staff in their voluntary activities. In 2015/16 we donated £30,000 to 37 local groups, organisations and schools through our community chest fund, which included donations to install a weather station in the playground of Velmead Junior School in Fleet, Hampshire and help develop a community garden in Snodland, Kent.

Our intention is to be a good neighbour and take account of the views of our customers and the community in which we work, minimising 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 2016 will remain at £198 (including RPI), the same as last year, and works out at 54 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.

We understand that some customers may have difficulty with paying their bills. We have developed a social tariff and 4,600 people have transferred to this tariff following conversations with our customer care team who assist customers who are on a low income or in receipt of specific benefits and find the right assistance for them.

In addition to this new tariff, we already 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 Bureau staff to share good practice in debt management and understand the potential implications of welfare reform on customers' ability to pay our bills.

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. This year we developed a new interactive online bill to help people understand their bill

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.

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

We want to ensure our customers are easily able to find the information they need about South East Water. Our customer "code of practice" leaflets provide further information as follows:

- · South East Water: Your water company
- · Water metering: A guide for household customers
- Household water charges, payment options and debt recovery
- · Leaks from customers' supply pipes
- · Service Plus: Our services for customers with additional needs
- Guaranteed standards of service
- · When things go wrong



# We are continually looking for new approaches and innovations

We work with our supply chain to research and develop techniques that will benefit our business



#### **Technological**

The opportunities for us to improve the quality of our service are often delivered through advances in technology. We are continually looking for new approaches and innovations and work with our supply chain to research and develop techniques that will benefit our business.

We have moved our laboratory to a new purpose built location in Farnborough in order to allow further expansion and use of new technologies to improve our analytical capabilities in the future.

Starting out as an empty warehouse, the 30,000 square foot location has been transformed into a state-of-theart facility.

From here our scientists will carry out more than 700,000 tests each year and are endorsed by the United Kingdom Accreditation Service (UKAS) who found we had improved our analytical excellence despite the upheaval of moving to new premises.

The laboratory also supports a wide range of businesses including other water companies, blue chip firms, environmental health organisations, private water suppliers and building maintenance companies offering high quality analytical services to suit their individual requirements.

South East Water's operations systems team has developed a new cutting edge mobile application that enables more efficient working with our main contractor. The ROAMER app is a bespoke mobile working app that has been designed for our partners teams working with us out in the field.

The application enables teams to download job details to their mobile device and send live updates back to the office from the field. Updates including risk assessments, before and after photos and work details are viewable back in the office within minutes by our contact centre and operational managers, using a specially designed portal providing visibility of all teams' previous, current and planned work.

The app works offline when a mobile signal is not available and syncs as soon as the team drives into signal range. It has light and dark screen themes for when teams are working in daylight or out of hours.

Using one device and companyspecific apps enables both South East Water and our partners to get the information they need from teams without complicated data interfaces or manual re-keying.

In the area of customer service we see technological improvements quickly developing and customers expect us to keep up with the trends. We have been improving our website, with e-billing options and more self-service options for those who want them.

This year we launched an interactive tool on our website, which explains what each section of the bill means and how we work out customer charges, this has already had 2,000 visitors since it launched in February.

We are also using mobile communications through text and social media to keep customers updated when they need to contact us and to alert customers to interruptions to supply.



#### Internal factors (key resources)

#### **People**

We take action to protect the interests of our employees and partners and ensure that they are respected, fairly treated and highly motivated.

We aim to provide rewarding jobs for our people by improving their skills through new training and development programmes.

Through the Investors in People review process 15 per cent of our workforce were interviewed this year about what it is like to work at South East Water.

The report concluded that there was no doubt that there had been extensive improvements made since the last assessment.

It was really encouraging to hear employees be so vocal about the good work that had been done right across the company. There were several key themes that emerged over the assessment period.

Improved learning and development opportunities - with our "perfecting performance" training and apprenticeship scheme highlighted as excellent examples.

Improved and more diverse rewards package for employees - new benefits such as Health Shield and the mortgage advice were welcomed. The "STARS" recognition programme was viewed as really positive, demonstrated by the fact more than 500 employees took time to nominate a colleague for an award.

*Improved knowledge sharing across* the business – the corporate induction day was cited as a major improvement from previous inductions. The world café approach to the day, where different departments host a table and short discussion for 20 minutes and then new starters move on to the next table hosted by a different department, was seen as an excellent way to share knowledge from our experts in the business.

*Improved communications* – employees at all levels commented that communications had improved massively, not just from the top down but between departments as well. Core brief (monthly report) and Spout (our quarterly magazine) were described as valuable and were widely read and enjoyed across the business.

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

#### **Assets**

Our assets are the most vital element of our 24-hour water supply service. Keeping such an extensive network of pipes, pumping stations and treatment works running smoothly to produce reliable, high quality water supplies, requires the right investment at the right time. The way we do that is by constantly assessing the health of our assets which must be stable enough to deliver expected levels of service for many years ahead.

Gross capital investment in the year was £89.2 million (2015: £92.0 million) with our cumulative expenditure for the regulatory period broadly in line with Ofwat's final determination.

#### **Financing**

South East Water Ltd is the main

operating company in the group

of companies headed by HDF (UK)

Holdings Ltd. The ultimate owners of

HDF (UK) Holdings Ltd are Utilities of Australia Pty Ltd as Trustee for the

Utilities Trust of Australia and Caisse

de dépôt et placement du Québec

and Desjardin Employees' Pension

Fund. There are two intermediate

holding companies between South East Water Ltd and HDF (UK) Holdings Ltd:

Hastings Water (UK) Ltd, both of which,

South East Water (Holdings) Ltd and

We have worked with our strategic partner, Jacobs, to deliver our capital programme which has seen us invest £25.3 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 £15.2 million on renewing and replacing our underground mains infrastructure (the pipes that transfer water to our customers).

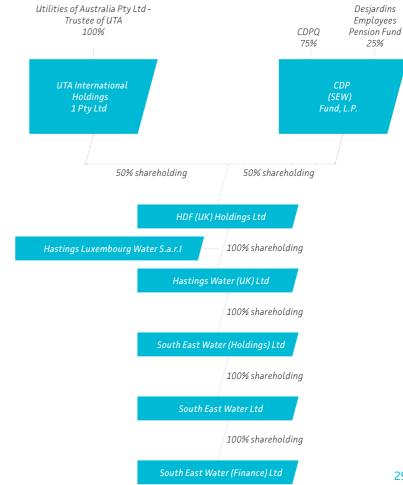
As part of our strategic objective to improve our supply and demand management, we have spent approximately £40.9 million, which includes progress towards our goal of having at least 90% of our household customer base on metered supply by 2020 and we have installed over 47,000 new water meters. This means that 76% of our domestic customer base are now on a metered supply.

together with HDF (UK) Holdings Ltd. are registered and resident in the UK. The debt financing of South East Water Ltd is arranged by South East Water Ltd through our only subsidiary, South East Water (Finance) Ltd. South East Water

(Finance) Ltd is a company registered in the Cayman Islands but 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.





South East Water

Annual Report and Financial Statements / Annual Performance Report 2016 Strategic Report

# We use a range of financial performance indicators to monitor our business

# **Business** performance

We have introduced a range of new measures and targets to track our performance for the next five years. 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 new 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.

We have introduced seven customer satisfaction measures and 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 water supply

- Customers consider their direct interaction experience to be positive
- 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 performance level has been reasonably consistent throughout the year with an upward trend in customers considering the level of leakage to be acceptable.

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 2015-16 we have scored 82.0 out of 100. 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.

For further information on all of our outcomes and targets please refer to our performance, people and planet report.

# Financial performance

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 those of our investors and they underpin our capital structure and the financial governance that we apply to our business.

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.

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

The group financial statements are set out on pages 77 to 131. 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) Ltd.

KPI	Measure	2015/16	2014/15 (*restated)
Credit rating	Standard & Poors	ВВВ	BBB
	Moodys	Baa2	Baa2
Interest cover		3.5	3.8*
RCV	£m	1,116.6	1,127.0*
Net debt to RCV	%	80.8	81.7
Turnover	£m	214.4	215.1*
Operating profit	£m	74.8	79.7
Profit before tax	£m	42.4	35.3*
Capital expenditure	£m	89.2	92.0*
Cash	£m	16.9	28.7

The adoption of IFRS has highlighted that the group's previous accounting for property, plant and equipment required restatement and has led to some of the comparative amounts for the prior year to be restated. Further details on the changes to the accounting policies and prior year restatements are provided in note 2 to the financial statements.

The turnover for the year was £214.4 million compared to the previous year of £215.1 million (restated). The revenue for the year includes a reduction in tariffs of 1.1% which was part offset by an increase in consumption from new and existing customers.

Our operating costs for the year have increased from £141.1 million (restated) to £146.1 million. This increase is due to inflationary pressure on the cost base and with additional expenditure in the year on leakage detection, water treatment and bulk supply of water costs. Operating profit has decreased from £79.7 million (restated) to £74.8 million principally due to the reasons noted above.

Profit before tax has increased from £35.3 million (restated) to £42.4 million. This is primarily due to a reduction in finance costs. Finance costs in the year were £37.5 million compared to £49.5 million in the previous year.

Included in our finance costs is the fair value movement on the interest rate swap which represented a credit to the profit and loss account of £1.6 million compared to a charge in the previous year of £5.8 million.

Profit after tax has increased from £31.3 million (restated) in the prior year to £46.5 million. The principle reason for the increase relates to the exceptional £11.9m credit movement for the impact of the rate change on deferred tax, representing the decrease from 20% to 19% with effect from 1 April 2017 and a further decrease to 18% from 1 April 2020.

The cash flow statement on page 82 shows a reduction in the cash balance from £28.7 million to £16.9 million at the year end. Owing to the significant capital expenditure programme throughout the price review period, our business, as with many other companies in the water sector, is cash negative. With capital expenditure of £89.2 million in the year, the reduction in cash is in line with expectations.

Dividends paid in the year were £9.0 million (2015: £27.1 million) and were in line with our plans.

More information is available in our Performance, People and Planet Report southeastwater.co.uk/reporting2016

include the results of South East Water million in the previous year. 31

# Our Board defines the risk management framework and reviews the risks on the register

#### 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.

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. The audit and risk committee monitors the effectiveness of our systems of risk management and internal controls on an ongoing basis. Please see page 56 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.

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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.

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. As expected the number of significant risks had reduced following the closure of risks related to the 2014 price determination.

We also reviewed new and emerging risks notably regulatory risks linked to the RCV indexation and specific risks that could affect our performance against our outcome delivery incentives (ODIs). We reviewed the mitigation for these risks and the initiatives that had been put in place to manage performance against ODIs. Market opening and competition also remain a significant focus as the date for market opening approaches.

We also took account of the specific risks posed by new vulnerabilities (zero-day threats) in our assessment of cyber risks.

#### 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 pages 34 to 38. These principal risks have been considered in the context of our business model and strategy. Please see page 21 and page 18 of this strategic report for additional information on these topics.

Some of the risks described in this section, such as the opening of the non-household retail market, 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.



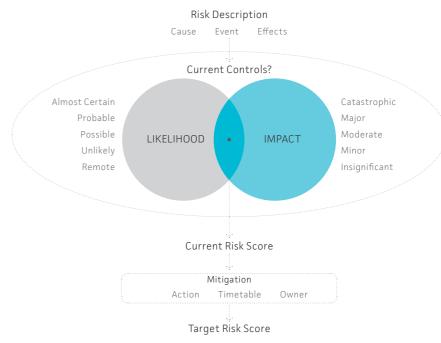
#### Look here for more

Please see page 56 for the report from our audit and risk committee

### Managing key risks

The audit and risk committee monitors the effectiveness of our systems of risk management and internal controls on an ongoing basis

#### 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

#### · Impac

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.

ttee 33

We have comprehensive processes in place including policies, standard operating procedures, risks assessments and toolbox talks involving our employees, partners and contractors

#### **Our principal risks**

#### Category

#### Health & safety

#### Risks description

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.

#### Mitigation

We have comprehensive processes in place including policies, standard operating procedures, risks assessments and toolbox talks involving our employees, partners and contractors.

Our performance on RIDDOR has improved in the last year but we continuously take actions on training and awareness to ensure that our employees and contractors always adopt safe practices. Our employees received a card from our Managing Director giving them authority to stop any unsafe practice.

Our health and safety committee works with sub-committees which have been created to facilitate a closer involvement of each section of the business and a specific focus on their specific risks.

Our Directors review health and safety performance regularly and reviews performance at each Board meeting.

#### Category

#### Water quality

#### Risks description

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.

#### Mitigation

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 Organisation (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.

#### Category

#### **Operational performance**

#### Risks description

Strategic asset failures and significant operational incidents (such as bursts 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.

#### Mitigation

We have established procedures and emergency plans for dealing with incidents and targeted investment to address specific operational risks when identified.

#### Category

#### Market reforms

#### Risks description

The extension of competition on the non-household retail market, the proposed introduction of competition for water resources at PR19 (Water 2020) and the potential introduction of competition for household retail customers create new risks and uncertainties.

We could face reputational damage and possible enforcement action under a new readiness condition if we were not ready to operate in the market. We also need to manage external risks relating to the quality of data from other companies, readiness of MOSL and of the central market system and remaining uncertainties on market rules and guidance from Ofwat.

#### Mitigation

We are implementing an extensive programme to achieve readiness for the non-household market opening in 2017 with oversight from a dedicated steering group and our audit and risk committee.

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 are reviewing and anticipating the potential impact of regulatory changes on our ability to secure finance at no less favourable terms.

#### Category

### Adverse changes to the regulatory framework

#### Risks description

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 includes Ofwat's decision to reduce the RCV of companies in its rulebook and the proposal to use CPI instead of RPI for the indexation of the RCV.

#### Mitigation

We are assessing the implications of the use of CPI and are developing a strategy to limit the negative impact of the change, taking account of the fact that there is currently no market for CPI indexed debt.

We operate in an area of serious water stress and manage demand through our metering programme which will be completed in 2020

Our principal risks continued

#### Category

### Price determination

#### Risks description

The price review at PR14 introduced separate price controls, the use of totex and new outcome delivery incentives (ODIs).

There are new compliance requirements in relation to separate prices controls.

There are also uncertainties about PR19 retail methodology and totex modelling.

#### Mitigation

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 are developing our approach to PR19 and are considering the impact of the proposed changes and are contributing to the proposals for PR19 and Water 2020.

#### Category

# Delivery of Business Plan and performance against ODIs

#### Risks description

There are financial and reputational risks associated with a failure to deliver our Business Plan commitments and ODIs and our position at PR19 may also be impacted.

If our service incentive mechanism (SIM) performance is less than expected we may incur a penalty but it may also have an impact on other ODIs based on customer satisfaction.

#### **Mitigation**

We have taken a number of business improvement initiatives to deliver our ODIs and ensure employee engagement. Dedicated steering groups monitor key measures such as interruption, water quality, customer services, customer perception and leakage.

#### Category

### Investment programme delivery

#### Risks description

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.

#### Mitigation

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.

#### Category

## Water resources and climate change

#### Risks description

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.

#### Mitigation

We operate in an area of serious water stress and manage demand through our metering programme which will be completed by 2020.

We have also consistently met our leakage targets.

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.

#### Category

### Regulatory and legal compliance

#### Risks description

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 will also affect the perception of South East Water by customers, regulators and others with a stake in our business.

#### Mitigation

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.

#### Category

## Security and information security

#### Risks description

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 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.

#### Mitigation

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 work with relevant external organisations to test the effectiveness of our resilience and security measures.

South East Water

Annual Report and Financial Statements / Annual Performance Report 2016 Strategic Report

Implemented a successful apprenticeship scheme and the 'Steps to Leadership' programme is developing managers of the future

Our principal risks continued

#### Category

#### Financing

#### Risks description

Unfavourable market conditions 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.

#### Mitigation

We will be refinancing a significant part of our debt in the next two years and are closely monitoring market conditions and the key risks for this refinancing.

We continuously monitor and report regularly to our board on compliance with our financial covenants.

#### Category

#### Bad debt

#### Risks description

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.

#### Mitigation

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.

#### Category

### Human resources and culture changes

#### Risks description

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.

#### Mitigation

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.

#### **Viability statement**

To prepare our viability statement we considered the prospects of South East Water in light of our current position and our review of principal risks.

On the recommendation of the audit and risk committee we have assessed the prospects of the company over a period of five years to March 2021. This duration is consistent with our planning horizon and regulatory cycle. We consider that a five year rolling period is likely to remain appropriate as more information becomes available on performance against our regulatory commitments and on the price review methodology for the next AMP.

Uncertainties arising from market reforms were considered but are not such that a shorter period is necessary, considering the plans in place to manage the change and achieve readiness and that wholesale activities form the main part of the business of the company.

We followed a dual approach for the assessment of the prospects of the company over the chosen period, combining our assessment of the principal risks, and additional targeted assessment using sensitivity testing and stress testing for some categories of risks. The purpose of the targeted assessment was to measure how South East Water would withstand the occurrence of certain risks in severe but plausible scenarios. Our scenarios combined qualitative and quantitative criteria and placed emphasis on assessing resilience to risks occurring.

Our targeted assessment covered the following aspects to assess their impact on liquidity and compliance with financial ratios until 2021:

- Inflation: sensitivity testing to assess the ability to sustain a long period of low inflation which results in lower receipts from customers than forecast
- Severe weather events: sensitivity testing to assess the ability to withstand an unplanned increase in our wholesale operating costs resulting from a severe weather event
- Critical asset failure: sensitivity testing considering very severe scenarios that would result in a significant increase in capital expenditure and the impact on liquidity
- Refinancing risk: sensitivity testing considering a severe economic shock that would result in an increase in the cost of borrowing at the time the bond and associated financial derivative that mature in September 2019 are refinanced

When reviewing the impact of critical asset failure scenarios, we took account of the availability of credit facilities that would provide access to funds necessary to face urgent additional capital expenditure comparing this to the known costs of major engineering projects.

This testing demonstrated that under a range of challenging scenarios the company remained financially robust.

In making our assessment of the prospects of the company we considered the current position as described in this strategic report and the financial statements, having regard to the visibility afforded by the price determination and our Corporate Plan until the end of the AMP.

We also considered the key factors determining the overall risk profile arising from our business model and environment:

- We operate within an established regulatory framework even if changes are expected from market reforms especially on retail activities over the relevant period
- Ofwat has a duty to ensure that we can finance the proper carrying out of our functions and the company is entitled to refer price determinations to the CMA if necessary. We can also require an interim determination when faced with certain severe unforeseen circumstances
- We operate within a regulatory and legal framework which requires extensive reporting on performance and compliance, with internal and external assurance, ensuring a regular and objective review of our performance and risks
- We carry out extensive medium and long term planning including a five year Business Plan, Corporate Plan and Drought Plan, a 25 year Water Resources Management Plan and Strategic Plan; we also maintain comprehensive emergency plans
- We continuously monitor the financial performance of the company against key financial ratios ensuring that we maintain a strict discipline in the financial management of our business
- The Directors review and confirm annually that the company has the resources and internal systems of control to meet our regulatory obligations

Based on the assessment described above, the Directors have a reasonable expectation that South East Water will be able to continue in operation and meet the liabilities as they fall due over the period to March 2021.

#### **Paul Butler**

Managing Director 15 July 2016

This annual report

has been redesigned

to provide clear and

concise information

on our business to our

customers, investors,

regulators and other

stakeholders

# Pure know how

# **Governance**

#### Governance

Corporate governance report 4:
Directors' remuneration report 6:

# Corporate governance report

#### **Introduction from the Chairman**

Corporate governance and compliance is an integral part of how our board and our business as a whole operate. We keep our governance under constant review and this year we updated our corporate governance code to reflect the changes introduced in the 2014 UK corporate governance code. Our own code of corporate governance also incorporates the principles of governance published by Ofwat our economic regulator.

This annual report has been redesigned to provide clear and concise information on our business to our customers, investors, regulators and other stakeholders. We have taken into account developments in reporting requirements especially on risk management and viability and feedback from Ofwat on how companies comply with their principles of governance. This annual report is also a reflection of the commitments we set out in our company monitoring framework.





#### Corporate governance report (continued)

I am pleased to report that we have completed our plan for the implementation of our corporate governance code. The changes to the composition of our board, which commenced in 2014, were concluded this year with the appointment of John Barnes and our committees are now well established in their role based on revised terms of reference. This ensures compliance with the principles of our corporate governance code.

As Chairman of the nomination committee I have worked with the members of the committee to renew the skillset of our board while maintaining the right balance of experience and skills. John Barnes was appointed as a new Independent Non-Executive Director and Andrew Farmer as Finance Director. We provide more details on the activities of the nomination committee on

We have also agreed further actions in 2016-17 in relation to talent management and succession planning based on the findings of our board evaluation.

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 2016

#### **Code principles**

Leadership and Effectiveness II read more on page 46

Transparency and Accountability II read more on page 55

Remuneration II read more on page 60



You will find our corporate governance code and more information on governance on our website at southeastwater.co.uk/about-us/our-governance

## **Meet our Board of Directors**

Independent Non-Executive Directors\*

Nick Salmon Chairman



Nick was appointed as Chairman of South East Water on 1 April 2015. He brings a wealth of experience from a number of senior roles and an engineering background. Nick is also a Senior Independent Director of Elementis plc and a Non-Executive Director at Interserve plc.

*Non-Executive Directors* 

Olivier Fortin Non-Executive Director



Olivier is Director of Asset Management at CDP Capital France - a subsidiary of Caisse de Dépôt et Placement du Québec (CDPQ). Prior to his involvement with CDPQ. Olivier has a long experience with the infrastructure asset class in the UK and continental Europe with regulated and non-regulated assets.

John Barnes

Independent Non-Executive Director



John was appointed as 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 thirty years' experience in the water industry, mainly in the UK, but with spells in the Middle East and New Zealand.

### 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 Strategy, Planning and Regulation Director at Heathrow Airport Holdings Ltd, Emma was previously BT plc's Group Director of Industry Policy and Regulation.

*Jean Pierre Ouellet* 





Jean Pierre retired from RBC Capital Markets, the investment banking arm of Royal Bank of Canada, in October 2008 where he was Vice-Chairman with responsibility for the firms' activity in Quebec since 2000. Prior to that he was Senior Vice President, Chief Legal Officer and Corporate Secretary of Canadian National Railway starting in 1996.

Valeria is Executive Director at Hastings and was appointed to the South East Water board in December 2007. Hastings is the manager of one of the funds which own South East Water. Valeria is responsible for leading Hastings' operations in Europe. She leads European asset management activities and is sector lead for regulated assets.

\*As defined in the UK Corporate Governance Code

Chris Girling

Independent Non-Executive Director



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.

**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 and Young and Marks and Spencer.

Paul Rich

Independent Non-Executive Director



Paul was appointed as a Non-Executive Director in 2013 bringing with him more than 25 years' experience working in national service businesses. Paul was Chairman of NHS Business Services Authority and was previously Royal Mail plc's Deputy Managing Director and Marketing Director.

#### Non-Executive Directors

Peter Dixon Non-Executive Director



Peter was appointed as a Non-Executive Director in 2014. Peter brings with him extensive experience acquired in the gas and water UK utilities as a CEO and board member. Until recently, Peter was Group CEO of Phoenix Energy Holdings a gas utility and service group in Northern Ireland.

### 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 as 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. Astrong science background David has held previous senior roles in microbiology including laboratory management for Public Health Laboratory Services.



# This report describes how the Board has applied the principle of the Company's corporate governance code in the financial year

# Board composition

5 Independent Non-Executive Directors

4 Non-Executive Directors
3 Executive Directors

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 of 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 principle of our corporate governance code in the financial year.



You will find our corporate governance code on our website at southeastwater.co.uk/about-us/our-governance

# Leadership and effectiveness

## The role of the board and 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 our company meets our statutory duties and other obligations. It provides leadership within a framework of prudent and effective controls and ensures that the necessary financial 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.

#### **Board balance and composition**

Independent Non-Executive Directors are the majority group on the board and our committees which are also chaired by an Independent Non-Executive Director. This ensures they play a significant role in challenging both 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 opposite.

Nick Salmon was appointed Chairman of the Board in April 2015 replacing Gordon Maxwell. He is independent of management and has no link to shareholders that could affect his impartiality as required by South East Water's corporate governance code and Ofwat's principles of governance.

In addition to the Chairman, two new directors have joined the board in the financial year each bringing a new perspective and refreshing the balance of skills and experience of the board. Andrew Farmer was appointed as Finance Director in August 2015 replacing Jo Stimpson and John Barnes was appointed as Independent Non-Executive Director in January 2016 replacing Graham Setterfield. The appointments of Emma Gilthorpe and Paul Rich were also extended for three years.

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.

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.

We also believe that the mix of Executive and Non-Executive Directors is appropriate.

Non-Executive Directors and Independent Non-Executive Directors are given direct access to management as requested and to review specific areas of the business directly with management.

Our directors' biographies can be found on page 44.

#### **Board composition**

Five Independent Non-Executive Directors	Appointme	nt   Term*	Aua	lit Remuneration	n Nomination
Nick Salmon (Chairman)	01/04/15	12 m			Chair
John Barnes	28/01/16	2 m		•	
Emma Gilthorpe	18/10/12	3 yrs 5 m		Chair	•
Chris Girling	30/10/14	1 yr 5 m	Chair		
Paul Rich	25/04/13	2 yrs 11 m		•	•

Four Non-Executive Directors (shareholder nominated)	Appointment	Term*	Audi	t Remuneration	Nomination
Peter Dixon	27/02/14	2 yrs 1 m			
Olivier Fortin (CDPQ)	30/10/14	1 yr 5 m		•	•
Jean-Pierre Ouellet	25/07/13	2 yrs 8 m			
Valeria Rosati (Hastings)	18/12/07	8 yrs 3 m	•	•	•

<b>Three</b> Executive Directors	Appointment	Term*
Paul Butler (Managing Director)	02/10/06	9 yrs 5 m
Andrew Farmer (Finance Director)	01/08/15	8 m
David Hinton (Asset and Regulation Director)	01/06/13	2 yrs 10 m

\*as at 31 March 2016

### Report from the nomination committee

I am pleased to report on the work of the nomination committee over the last 12 months.

With the planned retirement of Graham Setterfield, the committee managed the
recruitment process for his replacement which concluded with the appointment of John
Barnes in January 2016. The committee considered the overall balance of skills on the board
and defined the profile of the new director recognising the need of the board to maintain a
good level of operational and industry knowledge after Graham's retirement. John brings
operational and industry knowledge and a new perspective to the board.

• The committee also exercised oversight on the recruitment of the new Finance Director which concluded with the appointment of Andrew Farmer. The description of the role took account of the importance to South East Water of shareholder and investor relations and of the planned refinancing during this regulatory period.

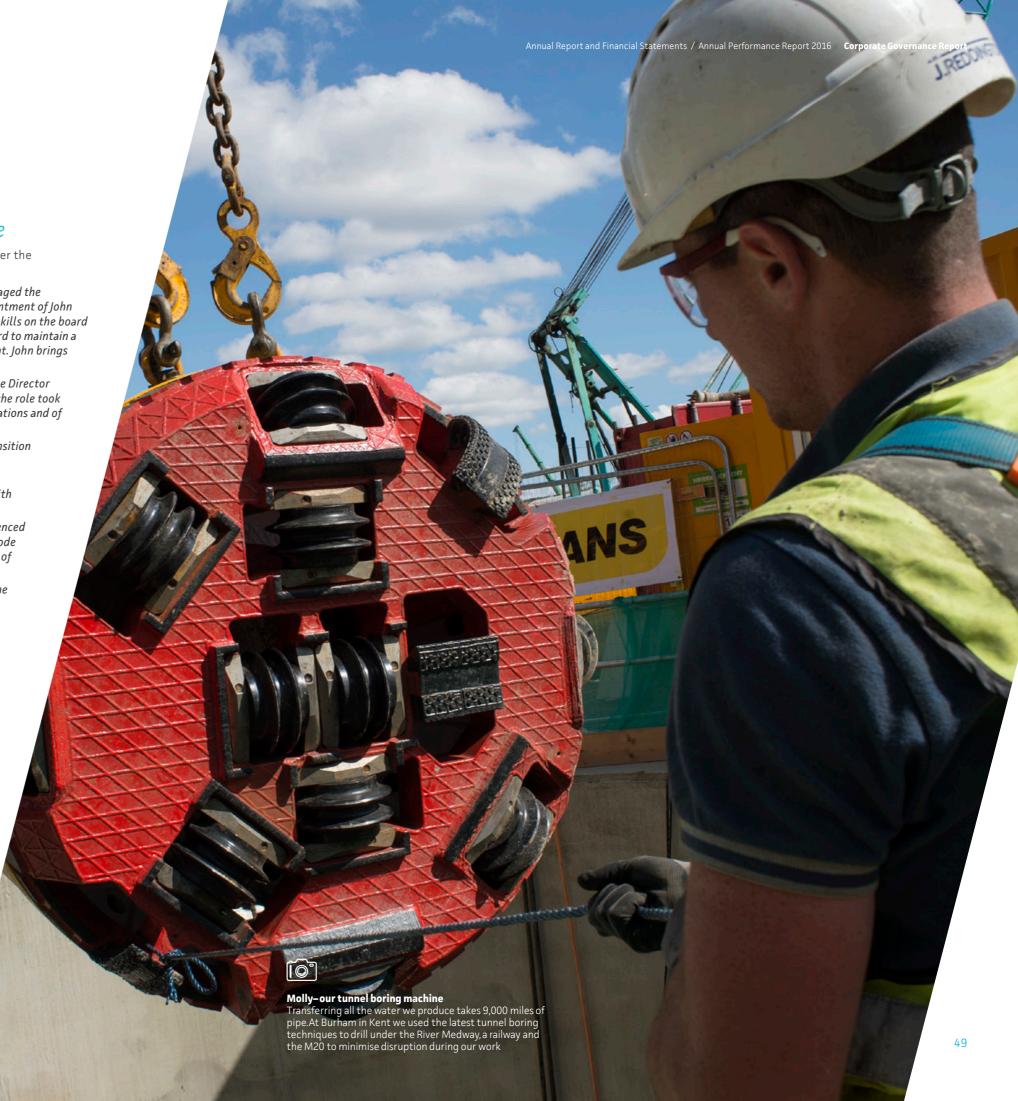
- · Both John and Andrew received a comprehensive induction allowing time for transition with their predecessors.
- Both recruitments were carried out through the external search consultancy firms
   Hoggett Bowers and Odgers Berndtson which did not have any other connection with
   South East Water.
- The appointment of John Barnes concluded the renewal of the board that had commenced in 2014 to bring the composition of our board in line with our corporate governance code and Ofwat's principles of corporate governance. This was one aspect of a wider review of the board's approach to corporate governance.
- The appointments of Emma Gilthorpe and of Paul Rich were extended for three years. The committee was satisfied that they continued to meet the criteria of independence of our corporate governance code. As part of the regular review of the operations of the board and of its committees, Emma was also appointed chair of the remuneration committee replacing Graham Setterfield.
- The board has a good mix of experience and cultural diversity. We duly considered the benefits of diversity as part of our selection processes in the year.
- 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. It will work in 2016-17 on formalising South East Water's talent management and succession planning which was an area highlighted by the directors in this year's Board evaluation.

#### Nick Salmon

Chairman 15 July 2016



You will find the terms of reference of our nomination committee on our website at southeastwater.co.uk/about-us/our-governance



# How the board operates

#### How we fulfil our role

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. 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. This list was updated in July 2015. 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 and Operations Director. There are several steering groups which deal with key aspects of the business.

#### 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. An ad hoc regulatory committee also met in the year to scrutinise the annual regulatory reporting and to report to the board before approval of the reporting by the board.

Board committees have formal terms of reference which have also been reviewed and updated during the year to reflect our revised South East Water corporate governance code. Our audit and risk committee was fully established in May 2015. 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.

You will find our reserved matters and the terms of reference of our committees on our website at southeastwater.co.uk/about-us/our-governance

#### 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 the Company's values and standards of governance and monitors compliance with regulatory and statutory obligations. It balances the interests of customers, the environment, shareholders and stakeholders.

#### Executive Team

#### Chair: Paul Butler

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

#### Competition and Regulatory Strategy

Our Future Market Counts Steering Group and the Regulatory Strategic Group provide oversight of the implementation of competition and regulatory strategies including our business plan and water resources management plan. 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: Emma Gilthorpe

Reviews the remuneration policy for the Executive Directors and the Chairman of the Board. It determines the remuneration package of Executive Directors, and other designated senior executives including the design and application of any annual performance based remuneration. It reviews any performance related pay scheme.

#### 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.

#### Health & Safety

The Health & Safety Committee 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 Committee 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 Action Counts and the Every Customer Counts steering groups monitor the implementation and effectiveness of our initiative to ensure the delivery of our ODIs, customer services performance, corporate plan objectives and business improvement.



You will find our strategic plans on our website at southeastwater.co.uk/news-and-information/publications/company-reports-and-plans

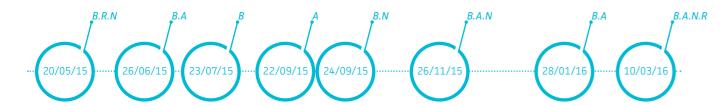
# The Board meets every two months but receives a full performance report every month

During the period from 1 April 2015 to 31 March 2016 the board met on seven occasions reflecting a reviewed pattern of meetings for the board and its committees. The board meets every two months but receives a full performance report every month.

#### Attendance at board and committee meetings

Director	Board	Audit & Risk	Nomination	Remuneration	
N Salmon	7/7		4/4		
J Barnes (A-28/01/2016)	1/1			1/1	
E Gilthorpe	6/7		4/4	2/2	
C Girling	6/7	5/5			
P Rich	6/7	4/5	4/4	2/2	
G Setterfield (R-28/01/2016)	5/6			1/1	
P Dixon	7/7				
O Fortin	7/7	1/1*	4/4	2/2	
J P Ouellet	7/7				
V Rosati	7/7	4/5	4/4	2/2	
P Butler	7/7				
D Hinton	7/7				
A Farmer (A-01/08/2015)	4/4				
J Stimpson (R-31/07/2015)	3/3				*^

\*As alternate for Valeria Rosati



B: Board A: Audit and risk committee R: Remuneration committee N: Nomination committee

# Board activities in 2015-16

#### Business performance

- Reviewed South East Water's response to the interruption affecting the Hailsham area, the lessons learnt and the implementation of the plan of action developed following the incident
- Reviewed South East Water's water quality performance and our initiatives to address issues identified and specific areas raised by the Drinking Water Inspectorate in its report
- Reviewed the IT update to the board and considered the status and plans for improvement to the essential IT infrastructure including for market opening
- Reviewed and discussed the outcome delivery incentive performance and initiatives taken for ensuring that South East Water meets the targeted performance, and carried out a deep-dive review of the leakage strategy
- Reviewed the half-year and full year capital expenditure reports on the delivery of the capital programme

# Governance, internal controls and risk management

- Reviewed the composition of the board and its committees and the appointment of new directors to the board
- Reviewed the changes introduced by the 2014 UK corporate governance code and approved a revised corporate governance code reflecting these changes
- Considered the health and safety annual update to the board, and considered the effectiveness of current measures and further initiatives in relation to health and safety and wellbeing
- Reviewed and approved the board's approach to the capital programme management and approval of key capital investment and operational expenditure
- · Carried out the annual review of risks and of the risk management process
- · Considered Ofwat's feedback on how companies have applied their principles of leadership and governance

#### Financial

- Reviewed and approved the terms for the renewal of our capital expenditure and liquidity facilities
- Reviewed treasury policies and compliance with finance documents and our approach to planned refinancing
- Reviewed and approved the annual report and financial statements and the regulatory accounts for 2014-15 and the half-year financial reporting
- Considered and approved the proposal for changes to certain financial ratios in our finance documents to reflect Ofwat's change of approach in the price determination
- Reviewed and approved the budget for 2016-17
- Considered the feedback from the audit committee on the audit plan and approval of the auditor's fees

#### Strategy, regulation and stakeholders

- Reviewed and approved the approach to the preparation and assurance of our annual regulatory reporting and approved the annual regulatory reporting including the annual performance report and the risk and compliance statement
- Considered and discussed our programme and readiness for market opening and our retail strategy throughout the year
- Reviewed and discussed the approach for setting water charges for 2016-17 and the internal and external assurance process. Approved the board assurance statement and statement of significant changes and the charges with detailed conditions for the delegation of the final calculation of the charges following publication of the relevant RPI
- Reviewed our performance against the Corporate Plan and the implementation of initiatives to deliver the corporate plan objectives
- Reviewed the approach to the development of our company monitoring framework and final approval
- Considered and discussed the strategy of South East Water in relation to Water 2020
- · Considered and approved proposed changes to the instrument of appointment proposed by Ofwat
- · Considered and discussed the implications for South East Water of the PR14 reconciliation rulebook
- Met with Roger Darlington, Chair of the customer panel and discussed his feedback on the work of the panel and the constitution of the customer challenge group (CCG) for PR19.

52 challenge group (CCG) for PR19. 53

Annual Report and Financial Statements / Annual Performance Report 2016 Corporate Governance Report

#### **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 nonattributable 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 report on their findings in their respective sections of this corporate governance report.

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 led by the shareholders nominated directors receiving feedback from the Managing Director.

The main areas highlighted by directors as requiring the most focus were succession planning, specific sessions dedicated to strategy and the format of board papers. We agreed to work on formalising our talent management and succession planning in 2016-17. The board also discussed the diversity of the board itself and of South East Water's management and workforce which would also be considered as part of succession planning. We concluded that the information received by the board was of good quality and that changes to the board papers already implemented would meet the directors' expectations. We also agreed to schedule a specific strategy session of the board including presentations from external speakers.

#### Commitment, information and support

The expected commitment is reviewed as part of the appointment process of the Non-Executive Directors including outside scheduled board meetings when required. 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 have 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 44.

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 the 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 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.

# Transparency and Accountability

#### Transparency and accountability

The board and the audit and risk committee ensure that the business, financial and regulatory reporting of South East Water is both 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 34 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.

#### Annual Report and Financial Statements / Annual Performance Report 2016 Corporate Governance Report

## Report from the audit and risk committee

I am pleased to report on the work of the audit and risk committee over the last 12 months.

- 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 have considered the requirement for a new viability statement and reviewed our approach
  to the assessment of principal risks and stress testing. We have recommended that the board
  adopt a lookout period of five 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 prospect of South East Water. The full description of our principal
  risks and our viability statement are included on pages 34 to 39 of the strategic report.
- We have reviewed the content and format of the 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 also reviewed our corporate social responsibility reporting.
- This year our annual report is also combined with our annual performance report. 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.
- Market opening is the single most important project currently being carried out by South East Water to ensure readiness and compliance with the new market arrangements when the non-household retail market opens in 2017. The committee is therefore overseeing progress against the plan, and the identification and management of internal and external project risks. Since the beginning of 2016 we have held additional meetings before each board meeting to review the status of the project.

#### 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 changes in the period and in particular the transition to international financial reporting standards (IFRS), new corporate governance requirements on risk reporting and viability and new regulatory reporting requirements. We also reviewed the areas of focus of the audit which in addition to those identified in previous years as typical of a water company included determination of the fair value of fixed assets on transition to IFRS, useful economic lives of fixed assets, deferred tax in the context of the transition to IFRS, revenue recognition, the definition of charges in line with the new price determination, the provision for leak allowance and the fair value of assets.



Louise-Inorganic Chemistry Analyst
At every stage from source to tap, scientists like Louise
are monitoring the quality of the water at our laborator

· Fair balanced and understandable

The committee has reviewed the 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 position and prospects. The auditors presented their audit report to the committee and we discussed with them how the financial statement risks had been identified and described. We reviewed in particular any specific note and explanation 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 South East Water's annual report 2015-16 is fair, balanced and understandable.

· Significant judgments and issues considered

A key consideration for the committee this year has been the transition from UK Generally accepted accounting principles (GAAP) to IFRS and its impact on the interim and full year financial statements. This included in particular the fair value valuation of fixed assets on transition, related depreciation rules and the impact on deferred tax. We also considered the impact of the transition to IFRS on the IFRS group accounts. We worked with our auditors to maintain the consistency and clarity of our financial reporting throughout this transition.

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.

South East Water Ltd is the sponsoring employee for the South East Water and Mid Kent Water pension schemes. In preparing the annual costs and valuations of assets and liabilities of the pension scheme, the committee considers the estimates provided by the company's actuaries and ensures that the underlying assumptions are within an acceptable range considering the economic environment.

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 based.

The valuation of our interest rate swap is determined with reference to appropriate projections of interest and inflation rates, and market conditions for Government bonds. The committee considers the valuation of this financial instrument to be an important judgement which is validated for technical compliance.

#### **External auditors**

Audit fee

We reviewed the audit fee proposal from the auditors and based on the audit plan and comparing with the previous year's fee and taking account of the specific work required for the transition to IFRS 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.

#### Risk management and internal controls

- The committee dedicates time at each of its meeting to the monitoring of the effectiveness of South East Water's risks management systems. We also reviewed specific areas of risk or compliance.
- As regulatory reporting and external assurance is an essential aspect of the business we have overseen the tendering process for the appointment of a new independent assurance partner. A key objective of this process was to ensure our reporting met new reporting requirements and the emphasis from our regulator, Ofwat, on self-reporting and the company's ownership of their performance reporting.
- We also scrutinised the preparation of the company monitoring framework (including the statement of strength, risk and weaknesses and the assurance plan) and recommended the approach and methodology to the board which covered a wide range of documents and reports and included a transparent assessment of risks and mitigation following engagement with a wide range of stakeholders. We also reviewed the benchmarking provided by our auditors on companies approaches to their company monitoring framework to take account of good practice examples.
- 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 and concluded that an internal audit function was not required at this stage. We also reviewed the internal reviews of key controls and systems carried out by our finance team and discussed a forward programme of further audits taking account of risks included on our risk register.
- During the year we have reviewed the principal risks of South East Water and recommended that the board adopt a lookout period of five 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 on which to base the viability statement. The description of our principal risks and our viability statement are included on pages 34 to 39 of the strategic report {Principal risks and uncertainties}.
- We also reviewed the effectiveness of our policies and practices in relation to the prevention of fraud, whistleblowing and anti-bribery. Chris Girling became our Independent Non-Executive Director's contact under the whistleblowing policy replacing Graham Setterfield. We recommended that the Staff Council be added as a new channel for protected disclosure under the policy. We also decided to refresh the awareness of all these policies, in addition to our standard regular training to employees, by issuing short and simple messages about reporting issues and adopting the right conduct to employees and contractors.
- 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 2016

#### **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.

#### 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 2016. The report summarises our key objectives, our remuneration policy, the linkage of directors' pay to the performance of the company and the level of director's emoluments for the year.

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

During the year, the committee set the remuneration of Andrew Farmer (Finance Director appointed 1 August 2015) and John Barnes (Non-Executive Director appointed 28 January 2016). Remuneration packages were set after considering comparative roles and positions with similar responsibilities in the water sector and in other sectors.

We have reviewed the performance of Executive Directors against the measures we had set for the annual executive bonus scheme and assessed each Executive Director's performance taking account of their contribution to the success of the business. The directors' remuneration report describes remuneration paid in the financial vear ended 31 March 2016.

In the first year of our regulatory period, we also reviewed the performance measures and objectives for our executive bonus scheme 2015-16 to ensure they were in line with our price determination and our outcome delivery incentives.

This year's customer services performance continued to improve building on the significant efforts made over the last few years. We exceeded our reduction target for customer complaints and improved our service incentive mechanism position. We expect that we will continue to meet our leakage target and our other operational and financial measures are on track. Early in the year, a large burst affected our performance on interruption and we therefore missed the target for the year. However, we are taking extra steps in order to catch up and aim to meet the overall target by the end of the regulatory period. We have taken this performance into account in our assessment of the 2015-16 executive bonus.

We developed and introduced a long term incentive plan to put even more emphasis on the long-term success of the company. The Independent Non-Executive Directors played a significant role in reviewing the objectives, the phasing of the incentives and the rules of the scheme to ensure that overall it provides the right type and level of incentives to support the long term goals of the company. The committee is responsible for the operation of the scheme in accordance with its rules which take account of the principles of our corporate governance code on recovery and withholding.

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 and in accordance with its terms of reference.

# Directors' Remuneration Report

#### **Remuneration policy**

Independent Non-Executive Directors' remuneration is based on a structure of fixed fees which are periodically compared with market practice.

Rewards for the Managing Director and senior executives are based on a total reward package of basic salary. annual performance and long term incentive schemes and 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 stretching operational, financial and personal targets to motivate strong commitment to achieving the goals set, and to establish a close link between overall rewards and corporate performance.

Operational targets include improving South East Water's customer satisfaction and service incentive mechanism scores, health and safety performance and performance measures such as leakage and interruptions. 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 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 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.

South East Water's reward policy is to maintain a total reward package for employees throughout the business consisting of basic salary and benefits sufficient to attract, motivate and retain good quality people. 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.

#### **Emma Gilthorpe**

Chair 15 July 2016



#### 2015/16 Annual bonus performance criteria

The bonus payable to each director is calculated by establishing multipliers for each performance category and applying the product of those multipliers to the maximum bonus level.

Operational objectives	<ul> <li>Customer Satisfaction</li> <li>Health and Safety</li> <li>Leakage (MI/d)</li> <li>Interruptions</li> <li>SIM score</li> </ul>	Multiplier range 0% to 115%  Actual Performance 65%*
Financial objectives	· Cash collection as a percentage of actual billing · Whole business totex	Multiplier range 0% to 150% Actual Performance 135%
Personal objectives	· Set individually for each Executive Director	Multiplier range of 0% to 100%

<sup>\*</sup> The remuneration committee exercised discretion to reflect the impact of the exceptional incident at Hailsham.

#### 2015/16 Bonus as a percentage of basic salary

Directors	Payout at combined multiplier of 100%	Awarded
Paul Butler	50.0%	32.9%
Andrew Farmer	30.0%	21.1%
David Hinton	30.0%	19.2%

The payments under the performance incentive scheme were made in June 2016 and are set out in the director's emoluments section below.

#### Long-Term Incentive Plan

During the year a Long Term Incentive Plan (LTIP) was introduced. This incentive plan aligns the long-term interests of shareholders and the executive team, retains and rewards executive management of appropriate calibre and 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 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 follows:

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

		Multiplier 1		Multiplier 2		Multiplier 3	
Base award	Х	Operational cash flow	х	ODI	Х	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

<sup>\*</sup>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 AMP 7 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%

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

#### **Directors' emoluments**

	Salary and fees £000	Other Emoluments £000	Bonus £000	2016 Total £000	2015 Total £000
Directors					
Nick Salmon (Chairman)	100	1	-	101	-
Paul Butler (Managing Director)	193	91	64	348	334
Andrew Farmer (Finance Director) (A–1 August 2015)	120	9	28	157	-
David Hinton (Asset & Regulation Director)	140	13	27	180	174
Jo Stimpson (Finance Director) (R – 31 July 2015)	50	20		70	219
Peter Dixon (Non-Executive Director)	-	-	-	-	-
Olivier Fortin (Non-Executive Director)	-	-	-	-	-
Jean Pierre Ouellet (Non-Executive Director)	-	-	-	-	-
Valeria Rosati (Non-Executive Director)	-	-	-	-	-
Independent Non-Executive Directors					
John Barnes (A-28 January 2016)	8	-	-	8	-
Emma Gilthorpe	33	3	-	36	34
Chris Girling	40	3	-	43	18
Paul Rich	33	1	-	34	34
Graham Setterfield (R – 28 January 2016)	28	7	-	35	38

A–Appointed R – Resigned

With effect from 1 April 2016 the salaries of the executive directors were increased in line with the company's pay award of 1.4%, with the exception of Paul Butler. Paul Butler's total remuneration package was reviewed and his combined salary and pension package was increased by 6% in order to align it with comparative roles. The executive bonus scheme for 2016/17 is unchanged.

In the year, Paul Butler and Jo Stimpson were members of a defined benefit pension scheme. The above includes a cash supplement in lieu of the pension cap of £77,291 (2015: £26,844) and £15,068 (2015: £nil) respectively.

Other emoluments also comprises 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 Ltd 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		
Emma Gilthorpe	1 October 2015	30	3		
Paul Rich*	25 April 2013	36	3		
Chris Girling	30 October 2014	19	3		
John Barnes	28 January 2016	33	3		

Peter Dixon, Olivier Fortin, Jean Pierre Ouellet and Valeria Rosati, were appointed by South East Water's ultimate shareholders to sit on the Board of South East Water Ltd and do not receive any remuneration for this service from South East Water Ltd.

#### Pension benefits earned

#### Approved contributory final salary pension scheme

Three Directors were members of the defined benefit pension scheme during the year. Their accrued entitlements under the scheme were as follows:

Accrued benefits	Paul Butler	David Hinton	Jo Stimpson				
At March 2016							
Annual pension	0	27,277	36,038				
Lump sum	0	81,830					
At March 2015							
Annual pension	69,341	27,277	35,788				
Lump sum	68,586	81,830					
Increase in accrued benefits excluding inflation							
Annual pension	0	0	0				
Lump sum	0	0	0				
Increase in accrued benefits after allowing for inflation							
Annual pension	0	0	0				
Lump sum	0	0	0				

During the year, Paul Butler exercised his right to draw a pension and as such there are no benefits accruing in the pension scheme as at 31 March 2016.

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

#### **Approved defined contribution scheme**

In the year to 31 March 2016 two Executive Directors were members of the defined contribution scheme.

The table below summarises the contributions that were made and the value of the contributions in the scheme as at 31 March 2016:

	Contributions in 2014/15		Contributions in 2015/16	Value of scheme contributions as at 31 March 2016
Andrew Farmer	0	0	27,274	27,274
David Hinton	0	0	28,000	28,000

Contributions in 2014/15 for the directors were nil because the scheme was not open until 1 April 2015.

Approved by the board and signed on its behalf by:

#### **Emma Gilthorpe**

Chair 15 July 2016

<sup>\*</sup> Contract extended to 24 April 2019.

The principal activities of the group comprise the supply of water to a population of 2.1 million in an area of 5,657 square kilometres

# Pure know how

#### **Group Financial Statements**

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# **Group Financial Statements**

#### **Directors' Report**

The Directors have pleasure in presenting the group directors' report relating to South East Water Ltd ("South East Water" or the "Company") and its subsidiary South East Water (Finance) Ltd (together referred to as the "Group") for the year ended 31 March 2016.

#### **Principal activities**

The principal activities of the group comprise the supply of water to a population of 2.1 million in an area of 5,657 square kilometres 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 Ltd 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.



South East Water Ltd is the main operating company in the group of companies headed by HDF (UK) Holdings Ltd

### Directors' Report (continued)

The conditions of the instrument of appointment cover a variety of areas including charges, accounts and requirements to produce information and various codes of practice.

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 F 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 F 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 controller of South East Water is bound by a binding undertaking with Ofwat required under Condition P to procure that its 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 Ltd is the main operating company in the group of companies headed by HDF (UK) Holdings Ltd. Further details of the structure of the HDF group are provided in the strategic report on page 29.

### **Capital structure**

Details of the authorised and issued share capital are shown in note 25 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. Each share carries the right to one vote at the general meeting of the Company.

# The Directors have pleasure in presenting their annual report on the affairs of the Group.

### For the year ended 31 March 2016

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 and provided in note 29 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 summarise our performance for the year and incorporate the performance of South East Water Ltd and South East Water (Finance) Ltd. At the beginning of the financial year South East Water Ltd adopted IFRS for the first time for its company only reporting. This has highlighted that the group's previous accounting for property, plant and equipment required restatement and has led to some of the comparative amounts for the year to 31 March 2015 being restated. Further details on the changes to the accounting policies and the prior periods' restatements are provided in note 2 of the financial statements.

### Business review and future developments

The turnover of the group for the year ended 31 March 2016 was £214.4 million (2015: £215.1 million) and operating profit was £74.8 million for the year (2015: £79.7 million). Profit before taxation for the year was £42.4 million (2015: £35.3 million). The financial position at 31 March 2016 for the group and for the Company is shown on pages 78 and 79 respectively. Further analysis of the performance of the business and future developments is included in the strategic report on page 30.

### 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 £9.0 million (2015: £27.1 million) for the year, paid in equal instalments of £2.25 million per quarter. Further details are given in note 10 of the financial statements. South East Water's immediate parent company, South East Water (Holdings) Ltd used £4.9 million of this dividend (2015: £4.8 million) to pay interest on an inter-company loan back to South East Water Ltd.

### Capital expenditure

During the year the group's capital expenditure totalled £89.2 million (2015: £92.0 million). Further details are given in notes 12 and 13 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 (UK) Holdings Ltd group in practice we defer taking some capital allowances and purchase group relief to settle the resulting tax charge.

### **Directors and their interests**

The directors who served at the date of this report are set out on page 5. During the year Andrew Farmer was appointed as Finance Director and John Barnes was appointed to the board as an Independent Non-Executive Director. Jo Stimpson and Graham Setterfield resigned from the board

No director held any shares or loan stock in South East Water or other associated companies 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 the 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.

### 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. Further details are given in the strategic report. We also report on our greenhouse gas emissions in our performance, people and planet report.

### **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 that South East Water is 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.

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 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 22 of the financial statements.

### **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.

Therefore, the directors believe that the South East Water Ltd 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

There were no important events affecting the group since the end of the financial year.

### **Auditor**

The directors who were members of the board at the time of approving the directors' report are listed on page 5. 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; and
- 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.

### **Donations**

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

Approved by the board and signed on its behalf by:

### **Nicolas Truillet**

Company Secretary 15 July 2016



Annual Report and Financial Statements / Annual Performance Report 2016 Group Financial

Group Financial

## 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 IFRSs 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; and
- · 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; and
- 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 performance, business model and strategy.

### Paul Butler

Managing Director 15 July 2016

### **Andrew Farmer**

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

We have audited the financial statements of South East Water Ltd for the year ended 31 March 2016 which comprise group income statement, the group statement of comprehensive income, the group and parent company balance sheets, the group and parent company cash flow statements, the group and parent company statements of changes in equity and the related notes 1 to 29.

The financial reporting framework that has been applied in their preparation is applicable law and international financial reporting standards (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.

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.

### Respective responsibilities of directors and auditor

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and international standards on auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Finance Director
15 July 2016

**South East Water** 

In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### **Opinion on financial statements**

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2016 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- 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.

### Opinion on other matter prescribed by the Companies Act 2006

In our opinion 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.

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- 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; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

### Jacqueline Holden FCA

(Senior statutory auditor)

for and on behalf of Deloitte LLP Chartered Accountants and Statutory Auditor London, United Kingdom 15 July 2016

### Group income statement

for the year ended 31 March 2016

		2016	2015 (restated)
	Notes	£000	£000
Revenue	3	214,430	215,080
Group net operating costs	5	(146,125)	(141,082)
Other income	3	6,467	5,686
<b>Group operating profit</b> Finance costs Finance income	7 8	74,772 (37,458) 5,122	79,684 (49,526) 5,127
Profit before taxation Taxation	9	42,436 4,043	35,285 (4,012)
Profit for the year		46,479	31,273
<b>Earnings per share</b> Basic and diluted from continuing operations	11	94.25p	63.42p

Profit for the current and prior year is generated entirely from continuing operations.

### Group statement of comprehensive income

for the year ended 31 March 2016

		2016	2015 (restated)
	Notes	£000	£000
Profit for the year		46,479	31,273
Items that will not be reclassified subsequently to profit or loss: Remeasurement of defined benefit asset/liability Deferred tax on defined benefit pension schemes Impact of deferred tax rate change in respect of the pension schemes	23 9	11,121 (2,223) (509)	20,319 (4,061)
		8,389	16,258
Total comprehensive income for the year attributable to Owners of the Company		54,868	47,531

The prior year restatement relates to changes in the accounting policy for property, plant and equipment and is discussed further in note 2.

South East Water

Annual Report and Financial Statements / Annual Performance Report 2016 Group Financial

### Group statement of financial position

as at 31 March 2016

	Notes	31 March 2016 £000	31 March 2015 (restated) £000	1 April 2014 (restated) £000
Non-current assets Intangible assets Property, plant and equipment Amount due from parent undertaking Defined benefit pension surplus	12 13 15 23	11,046 1,412,184 190,013 9,003	10,651 1,369,190 190,013 2,794	11,046 1,322,800 190,013
		1,622,246	1,572,648	1,523,859
Current assets Inventories Trade and other receivables Cash and cash equivalents	16 17 18	185 66,650 16,947	245 65,614 28,719	267 63,713 52,710
		83,782	94,578	116,690
Total assets		1,706,028	1,667,226	1,640,549
Current liabilities Loans and borrowings Trade and other payables Deferred income Provisions	19 21 24 20	(85,257) (6,803) (3,834)	(89,597) (5,590) (4,130)	(1,237) (86,226) (3,630) (3,233)
Non-current liabilities Loans and borrowings Trade and other payables Derivative financial instruments Net deferred tax liabilities Defined benefit pension liability Deferred income	19 19 19 9 23 24	(95,894) (869,880) (2,589) (87,226) (140,566) (1,466) (65,633)	(99,317) (863,418) (1,751) (88,811) (150,295) (9,783) (61,876)	(94,326) (853,338) (1,012) (82,971) (144,264) (33,230) (59,820)
		(1,167,360)	(1,175,934)	(1,174,635)
Total liabilities		(1,263,254)	(1,275,251)	(1,268,961)
Net assets		442,774	391,975	371,588
<b>Equity</b> Ordinary share capital Capital redemption reserve Revaluation reserve Retained earnings	25	49,312 - 264,134 129,328	49,312 - 264,155 78,508	49,312 4,000 269,424 48,852
Total equity		442,774	391,975	371,588

The Group's statement of financial position for 1 April 2014 and 31 March 2015 contain a number of restated values due to the adoption of IFRS by the Company. Further details are given in note 2, Accounting policies.

The financial position of the Group at 1 April 2014 is provided to coincide with the requirement of IFRS 1 First time adoption of International Financial Reporting Standards which requires the Company to provide this information on its first time adoption.

The accompanying notes are an integral part of this statement of financial position.

The consolidated financial statements on pages 77 to 131 were approved by the board of directors and authorised for issue on 15 July 2016 and were signed on its behalf by:

### Paul Butler

### **Andrew Farmer**

Finance Director 15 July 2016

### Company statement of financial position

as at 31 March 2016

	Notes	31 March 2016 £000	31 March 2015 £000	1 April 2014 £000
Non-current assets Intangible assets Property, plant and equipment Amount due from parent undertaking Defined benefit pension surplus	12 13 15 23	11,046 1,412,184 190,013 9,003	10,651 1,369,190 190,013 2,794	11,046 1,322,800 190,013
		1,622,246	1,572,648	1,523,859
Current assets Inventories Trade and other receivables Cash and cash equivalents	16 17 18	185 66,085 16,360 82,630	245 65,042 28,383 93,670	267 63,168 52,484 115,919
Total assets		1,704,876	1,666,318	1,639,778
Current liabilities Loans and borrowings Trade and other payables Deferred income Provisions	19 21 24 20	(85,427) (6,803) (3,834)	(89,970) (5,590) (4,130)	(1,237) (86,692) (3,630) (3,233)
Non-current liabilities Loans and borrowings Trade and other payables Derivative financial instruments Net deferred tax liabilities Defined benefit pension liability Deferred income	19 19 19 9 23 24	(96,064) (869,880) (2,589) (87,226) (140,566) (1,466) (65,633)	(99,690) (863,418) (1,751) (88,811) (150,295) (9,783) (61,876)	(853,338) (1,012) (82,971) (144,264) (33,230) (59,820)
		(1,167,360)	(1,175,934)	(1,174,635)
Total liabilities		(1,263,424)	(1,275,624)	(1,269,427)
Net assets		441,452	390,694	370,351
<b>Equity</b> Ordinary share capital Capital redemption reserve Revaluation reserve Retained earnings	25	49,312 - 264,134 128,006	49,312 - 264,155 77,227	49,312 4,000 269,424 47,615
Total equity		441,452	390,694	370,351

The accompanying notes are an integral part of this statement of financial position.

The financial position of the Company is provided in accordance with IFRS 1 First time adoption of International Financial Reporting Standards . Further details are provided in note 2, Accounting policies.

The consolidated financial statements on pages 77 to 131 were approved by the board of directors and authorised for issue on 15 July 2016 and were signed on its behalf by:

Paul Butler Andrew Farmer

Managing Director Finance Director
15 July 2016 Finance Director

### Group statement of changes in equity

for the year ended 31 March 2016

	Issued share capital £000	Capital redemption reserve £000	Revaluation reserve (restated) £000	Retained earnings (restated) £000	Total equity £000
Balance at 1 April 2014	49,312	4,000	269,424	48,852	371,588
Profit for the year Other comprehensive income		-		31,273 16,258	31,273 16,258
Total comprehensive income Dividends (see note 10) Issue of bonus shares Cancellation of capital redemption reserve Cancellation of share capital Amortise revaluation reserve Release revaluation on disposals Deferred tax on reserve releases	22,768 - (22,768) - - -	(4,000) - - - -	(6,138) (447) 1,316	47,531 (27,144) - 4,000 - 6,138 447 (1,316)	47,531 (27,144) 22,768 - (22,768) - -
Balance at 31 March 2015	49,312	-	264,155	78,508	391,975
Profit for the year Other comprehensive income	-	-	-	46,479 8,389	46,479 8,389
Total comprehensive income Dividends (see note 10) Amortise revaluation reserve Release revaluation on disposals Deferred tax on reserve releases Impact of deferred tax rate change	- - - -	- - - - -	(6,130) (57) 1,235 4,931	54,868 (9,000) 6,130 57 (1,235)	54,868 (9,000) - - - 4,931
Balance at 31 March 2016	49,312	-	264,134	129,328	442,774

All transactions relate to the equity holders of the Company.

The prior year restatement relates to changes in the accounting policy for property, plant and equipment and is discussed further in note 2.

### Non-distributable reserves

The retained earnings of the Group previously included non-distributable reserves of £22.7 million arising from the transfer of the trade and certain assets and liabilities of Mid Kent Water Ltd to the Group. During January 2015 this part of the retained earnings reserve was converted into ordinary £1 shares through an issue of bonus shares at par. The bonus shares were subsequently cancelled as part of a capital reduction and the value was transferred to distributable reserve.

The capital redemption reserve related to the redemption of 4,000,000 8.75% redeemable preference shares on 31 March 1996. In January 2015 this reserve was cancelled and converted into distributable reserves by means of a capital reduction.

### Company statement of changes in equity

for the year ended 31 March 2016

	Issued share capital £000	Capital redemption reserve £000	Revaluation reserve £000	Retained earnings £000	Total equity £000
Balance at 1 April 2014	49,312	4,000	269,424	47,615	370,351
Profit for the year Other comprehensive income	-	-		31,229 16,258	31,229 16,258
Total comprehensive income Dividends (see note 10) Issue of bonus shares Cancellation of capital redemption reserve Cancellation of share capital Amortise revaluation reserve Release revaluation on disposals Deferred tax on reserve releases	22,768 - (22,768) - - -	(4,000) - - - -	- - - (6,138) (447) 1,316	47,487 (27,144) - 4,000 - 6,138 447 (1,316)	47,487 (27,144) 22,768 - (22,768) - -
Balance at 31 March 2015	49,312	-	264,155	77,227	390,694
Profit for the year Other comprehensive income	-	-	-	46,438 8,389	46,438 8,389
Total comprehensive income Dividends (see note 10) Amortise revaluation reserve Release revaluation on disposals Deferred tax on reserve releases Impact of deferred tax rate change	- - - - -	- - - - -	(6,130) (57) 1,235 4,931	54,827 (9,000) 6,130 57 (1,235)	54,827 (9,000) - - - 4,931
Balance at 31 March 2016	49,312	-	264,134	128,006	441,452

All transactions relate to the equity holders of the Company..

The statement of changes in equity of the Company is provided in accordance with IFRS 1 First time adoption of International Financial Reporting Standards. Further details are provided in note 2,Accounting policies..

### Non-distributable reserves

The retained earnings of the Company previously included non-distributable reserves of £22.7 million arising from the transfer of the trade and certain assets and liabilities of Mid Kent Water Ltd to the Company. During January 2015 this part of the retained earnings reserve was converted into ordinary £1 shares through an issue of bonus shares at par. The bonus shares were subsequently cancelled as part of a capital reduction and the value was transferred to distributable reserve.

The capital redemption reserve related to the redemption of 4,000,000 8.75% redeemable preference shares on 31 March 1996. In January 2015 this reserve was cancelled and converted into distributable reserves by means of a capital reduction.

### Group statement of cash flows

for the year ended 31 March 2016

	Notes	2016 £000	2015 (restated) £000
Operating activities Net cash flow from operating activities Interest received Interest paid Group tax relief paid	26	120,182 5,094 (34,947) (2,530)	119,494 5,247 (34,703) (3,023)
Net cash flow before investing and financing activities		87,799	87,015
Investing activities Proceeds from sale of property, plant and equipment Purchase of property, plant and equipment Purchase of intangible assets Fixed asset contributions received		142 (88,214) (3,368) 878	160 (81,177) (2,371) 811
Net cash flow used in investing activities		(90,562)	(82,577)
Financing activities Finance lease principal payments Repayments of borrowings Dividends paid to shareholder	10	(9) (9,000)	(1,237) (48) (27,144)
Net cash flow used in financing activities		(9,009)	(28,429)
<b>Decrease in cash and cash equivalents</b> Cash and cash equivalents at the beginning of the year		(11,772) 28,719	(23,991) 52,710
Cash and cash equivalents at the year end	18	16,947	28,719

The statement of cash flows of the group for the 31 March 2015 contains a number of restated values due to the adoption of IFRS by the Company. Further details are given in note 2, Accounting policies.

### Company statement of cash flows

for the year ended 31 March 2016

		2016	2015
	Notes	£000	£000
Operating activities  Net cash flow from operating activities Interest received Interest paid Group tax relief paid	26	120,184 5,084 (35,220) (2,500)	119,496 5,229 (34,820) (3,000)
Net cash flow before investing and financing activities		87,548	86,905
Investing activities Proceeds from sale of property, plant and equipment Purchase of property, plant and equipment Purchase of intangible assets Fixed asset contributions received		142 (88,214) (3,368) 878	160 (81,177) (2,371) 811
Net cash flow used in investing activities		(90,562)	(82,577)
Financing activities Finance lease principal payments Repayments of borrowings Dividends paid to shareholder	10	- (9) (9,000)	(1,237) (48) (27,144)
Net cash flow used in financing activities		(9,009)	(28,429)
<b>Decrease in cash and cash equivalents</b> Cash and cash equivalents at the beginning of the year		(12,023) 28,383	(24,101) 52,484
Cash and cash equivalents at the year end	18	16,360	28,383

The statement of cash flows of the Company is provided in accordance with IFRS 1 First time adoption of International Financial Reporting Standards. Further details are provided in note 2, Accounting policies.

for the year ended 31 March 2016

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

The financial statements of South East Water Ltd and its subsidiary (the "Group") for the year ended 31 March 2016 were authorised for issue by the Board of Directors on 15 July 2016 and the Statement of Financial Position was signed on the Board's behalf by Paul Butler and Andrew Farmer. South East Water Ltd is a limited liability company incorporated in the United Kingdom and domiciled in England and Wales.

The principal accounting policies adopted by the Group are set out in note 2.

#### 2. Accounting policies

#### **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 property, plant and equipment which was 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.

The financial statements of the Company contain a number of restated values for the results for the year ended 31 March 2015. These changes are as a result of the Company and its subsidiary adopting IFRS for their company only reporting for the first time in the current year. The Group had previously adopted IFRS and its prior year reporting was prepared under international standards, although the Group statements do contain restated values which are explained below. Further explanations of the nature of these changes and the amounts involved are provided below.

#### **Basis of consolidation**

These financial statements incorporate the financial information of South East Water Ltd (the "Company") and its subsidiary South East Water (Finance) Ltd.

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.

#### **Restatement of Group balances**

South East Water Ltd has previously reported under UK GAAP at a company level. It has adopted IFRS in the year, with a transition date of 1 April 2014. These financial statements for the year ending 31 March 2016 include the first set of accounts published by the Company under IFRS.

An extensive exercise has been performed to determine the most appropriate accounting policies for the Company under the new accounting framework. This has highlighted that the Group's previous accounting for property, plant and equipment ("PP&E") did not adequately reflect our current understanding of our PP&E valuation and componentisation, and as a result of this, it has been necessary to correct the Group's accounts to be consistent with the Company's new accounting policies and practices.

The information available to the Group now in relation to fixed assets was not available at the date of the original IFRS transition and it is therefore impracticable to restate the accounts back to the original date. The earliest date at which it is practicable to obtain corrected information is as at 1 April 2014.

### Notes to the financial statements

for the year ended 31 March 2016

#### 2. Accounting policies (continued)

The following restatements have been recognised at Group level:

	Statement of financial position			Income statement		
	Property, plant & equipment £000	Intangible assets £000	Deferred tax £000	Operating profit £000	Tax charge £000	
1April 2014						
Amounts as previously reported Adjustments	1,206,508 116,292	9,713 1,333	(120,619) (23,645)			
	1,322,800	11,046	(144,264)			
31 March 2015						
Amounts as previously reported Adjustments	1,266,462 102,728	9,237 1,414	(130,896) (19,399)	92,787 (13,103)	(8,256) 4,244	
	1,369,190	10,651	(150,295)	79,684	(4,012)	

**Property, plant & equipment:** As described above, the Group has adopted new accounting policies in respect of componentisation and useful economic lives in relation to fixed assets. The principles and methodology adopted by the Group have now been applied to the Group's PP&E balances together with the related corrections to the subsequent accounting for additions, disposals and depreciation.

**Intangible assets:** During the review of PPE it was identified that an amount of work in progress, previously included in PPE, related to intangible assets. The values of intangible assets and PPE have been adjusted to reflect this correction.

**Deferred tax:** The increase in deferred tax relates to the change in valuation of the fixed assets. The revaluation of fixed assets will be amortised over the lives of the underlying fixed assets and the appropriate proportion of deferred tax will be released to the income statement in line with these transactions.

**Operating profit:** The changes to the accounting policies in respect of useful economic lives and the recognition of reactive maintenance charges has resulted in changes to the depreciation and reactive maintenance charges recorded within the income statement, as well as the level of customer contributions amortised within revenue. These changes have caused depreciation and reactive maintenance charges to increase by £6.1m and £7.3m respectively. Additionally customer contributions recognised as revenue total £0.3m with a corresponding reduction in the level of deferred income recorded at 31 March 2015 within the statement of financial position.

**Other presentational changes:** A number of presentational adjustments have been made to better reflect the nature of certain balances. The revaluation reserve relating to PP&E has been reclassified from retained earnings into a separate revaluation reserve and adjusted for the PP&E revaluation discussed above. An amount of £1.7m has also been reclassified from Trade and other payables to Deferred income.

### Company transition to International Reporting Standards

This is the first year in which the Company has presented its financial statements under IFRS. The last financial statements for the Company were for the year ended 31 March 2015 and were prepared under UK GAAP. IFRS 1 requires that international standards are applied retrospectively to establish the Company's statement of financial position at the date of transition, being 1 April 2014. Therefore, the comparative information for the Company as at 31 March 2015 in these statements has been restated to reflect the Company's adoption of IFRS.

The analysis below shows a reconciliation of equity at both 1 April 2014 and 31 March 2015 and the total recognised gains for the year ended 31 March 2015 as reported under UK GAAP to the revised equity and total comprehensive income under IFRS reported in these financial statements.

for the year ended 31 March 2016

### 2. Accounting policies (continued)

### Reconciliation of the Company's comprehensive income statement for the year ended 31 March 2015

	UK GAAP £000	Property, plant & equipment £000	Deferred income £000	Deferred tax £000	Other items £000	Restated under IFRS £000
<b>Turnover:</b> Amortisation of contributions	213,982	-	1,098	-	-	213,982 1,098
Total revenue	213,982	-	1,098	-	-	215,080
Operating costs: Depreciation & amortisation Profit on sale of fixed assets Reactive maintenance Other operating costs	(52,157) 24 (5,223) (81,724)	6,393 (113) (7,251)	- - -	- - - -	- - - (1,029)	(45,764) (89) (12,474) (82,753)
Total operating costs Other operating income	(139,080) 5,686	(971)	-	-	(1,029)	(141,080) 5,686
Profit on ordinary activities before interest Interest receivable and similar income Interest payable and similar charges Other finance expense	80,588 5,109 (48,374) (2,000)	(971) - - -	1,098 - - -	- - -	(1,029) - - 809	79,686 5,109 (48,374) (1,191)
Profit on ordinary activities before taxation Tax on profit on ordinary activities	35,323 (17,569)	(971) 325	1,098	13,243	(220)	35,230 (4,001)
Profit on ordinary activities after taxation Actuarial gain on pension scheme for the year Restriction on defined benefit scheme surplus Deferred tax on defined benefit pension schemes	17,754 20,103 (2,794) (3,461)	(646) - - -	1,098 - - -	13,243 - - -	(220) 216 2,794 (600)	31,229 20,319 - (4,061)
Total recognised gains since last annual report and financial statements	31,602	(646)	1,098	13,243	2,190	47,487

### Notes to the financial statements

for the year ended 31 March 2016

### 2. Accounting policies (continued)

### Reconciliation of the Company's statement of financial position at 1 April 2014

	UK GAAP £000	Revaluation of property, plant & equipment £000		Deferred income £000	Revaluation reserve £000	Deferred tax £000	Other items £000	Restated under IFRS £000
Non-current assets								
Intangible assets	-	-	9,713	-	-	-	-	9,713
Property, plant and equipment	938,973	394,873	(9,713)	-	-	-	-	1,324,133
Amount due from parent undertaking	190,013	-	-	-	-	-	-	190,013
	1,128,986	394,873	-	-	-			1,523,859
Current assets								
Inventories	267	-	-	-	-	-	-	267
Trade and other receivables	63,168	-	-	-	-	-	-	63,168
Cash and cash equivalents	52,484	-	-	-	-	-	-	52,484
	115,919	-	-	-	-	-	-	115,919
Total assets	1,244,905	394,873	-	-	-			1,639,778
Current liabilities								
Loans and borrowings	(1,237)	-	-	-	-	-	-	(1,237)
Trade and other payables	(88,415)	-	-	1,723	-	-	-	(86,692)
Deferred income	-	-	-	(3,630)	_	-	-	(3,630)
Provisions	-	-	-	-		-	(3,233)	(3,233)
	(89,652)	-	-	(1,907)	-	-	(3,233)	(94,792)

for the year ended 31 March 2016

### 2. Accounting policies (continued)

Reconciliation of the Company's statement of financial position at 1 April 2014 (continued)

	UK GAAP £000	Revaluation of property, plant & equipment £000			Revaluation reserve £000	Deferred tax £000	Other items £000	Restated under IFRS £000
Non-current liabilities								
Loans and borrowings	(853,338)	-	-	-	-	-	-	(853,338)
Trade and other payables	(1,012)	-	-	-	-	-	-	(1,012)
Derivative financial instruments	(82,971)	-	-	-	-	-	-	(82,971)
Deferred tax liabilities	(29,937)	(67,356)	-	1	-	(53,618)	6,646	(144,264)
Other provisions	(3,233)	-	-	-	-	-	3,233	-
Defined benefit pension liability	(26,584)	-	-	-	-	-	(6,646)	(33,230)
Deferred income	(3,633)	(58,093)	-	1,906	-	-	-	(59,820)
	(1,000,708)	(125,449)	-	1,907	-	(53,618)	3,233	(1,174,635)
Total liabilities	(1,090,360)	(125,449)	-	-	-	(53,618)	-	(1,269,427)
Net assets	154,545	269,424	-	-	-	(53,618)		370,351
Equity								
Ordinary share capital	49,312	-	-	-	-	-	-	49,312
Capital redemption reserve	4,000	-	-	-	-	-	-	4,000
Revaluation reserve	-	269,424	-	-	-	-	-	269,424
Retained earnings	101,233	-	-	-	-	(53,618)	-	47,615
Total equity	154,545	269,424	-	-	-	(53,618)	-	370,351

### Notes to the financial statements

for the year ended 31 March 2016

### 2. Accounting policies (continued)

Reconciliation of the Company's statement of financial position at 31 March 2015

	UK GAAP £000	Revaluation of property, plant & equipment £000		Deferred income £000	Revaluation reserve £000		Other items £000	Restated under IFRS £000
Non-current assets								
Intangible assets	-	-	10,651	-	-	-	-	10,651
Property, plant and equipment	981,947	394,873	(11,622)	3,992	-	-	-	1,369,190
Amount due from parent undertaking	190,013	-	-	-	-	-	-	190,013
Defined benefit pension surplus	-	-	-	-	-	-	2,794	2,794
	1,171,960	394,873	(971)	3,992	-	-	2,794	1,572,648
<b>Current</b> assets								
Inventories	245	-	-	-	-	-	-	245
Trade and other receivables	65,042	-	-	-	-	-	-	65,042
Cash and cash equivalents	28,383	-	-	-	-	-	-	28,383
	93,670	-	-	-	-	-	-	93,670
Total assets	1,265,630	394,873	(971)	3,992	-	-	2,794	1,666,318
Current liabilities								
Trade and other	(91,671)	-	-	1,706	-	-	(5)	(89,970)
payables				(5,590)	-	-	-	(5,590)
Deferred income Provisions	-	-	-				(/, 120)	(/, 120)
Provisions		-		-			(4,130)	
	(91,671)	-		(3,884)	_	_	(4,135)	(99,690)

South East Water

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### Notes to the financial statements

for the year ended 31 March 2016

#### 2. Accounting policies (continued)

Reconciliation of the Company's statement of financial position at 31 March 2015 (continued)

	UK GAAP £000	Revaluation of property, plant & equipment £000	Property, plant & equipment £000	Deferred income £000	Revaluation reserve £000	Deferred tax £000	Other items £000	Restated under IFRS £000
Non-current liabilities								
Loans and borrowings	(863,418)	-	-	-	-	-	-	(863,418)
Trade and other payables	(1,751)	-	-	-	-	-	-	(1,751)
Derivative financial instruments	(88,811)	-	-	-	-	-	-	(88,811)
Deferred tax liabilities	(44,247)	(67,356)	-	-	1,317	(41,408)	1,399	(150,295)
Other provisions	(4,130)	-	-	-	-	-	4,130	-
Defined benefit pension liability	(7,826)	-	-	-	-	-	(1,957)	(9,783)
Deferred income	(4,773)	(58,093)	-	990	-	-	-	(61,876)
	(1,014,956)	(125,449)	-	990	1,317	(41,408)	3,572	(1,175,934)
Total liabilities	(1,106,627)	(125,449)	-	(2,894)	1,317	(41,408)	(563)	(1,275,624)
Net assets	159,003	269,424	(971)	1,098	1,317	(41,408)	2,231	390,694
Equity								
Ordinary share capital	49,312	-	-	-	-	-	-	49,312
Revaluation reserve	-	269,424	-	-	(5,269)	-	-	264,155
Retained earnings	109,691	-	(971)	1,098	6,586	(41,408)	2,231	77,227
Total equity	159,003	269,424	(971)	1,098	1,317	(41,408)	2,231	390,694

### Notes to the financial statements

for the year ended 31 March 2016

#### 2. Accounting policies (continued)

### Notes to the reconciliations

**Revaluation of property, plant and machinery:** Under IFRS1 "Adoption of International Reporting Standards" the Company has elected to measure fixed assets at their fair value and use the fair value as the deemed cost at 1 April 2014.

The fair value of fixed assets was calculated by reference to value of the Company as a whole, calculated as a multiple of the Regulatory Capital Value ("RCV") of 1.15 at the transition date. The fair values of assets and liabilities, excluding fixed assets, (which in most cases have been the carrying values) have been deducted from the valuation of the Company. The result has been adopted as the fair value of fixed assets. The resulting increase in fixed assets was then allocated to the individual classes of assets, including the revised categories of infrastructure asset detailed below, based on their gross modern equivalent asset values.

As a result of the revaluation of fixed assets, a number of contributions previously offset against fixed assets totalling £53.1 million were re-evaluated and transferred to deferred income. This re-evaluation was performed to bring the Company reporting into line with the Group, which had previously adopted IFRS in 2004.

The impact of the revaluation at 1 April 2014 and 31 March 2015 was to increase fixed assets by £394.9 million. This also resulted in an increase in deferred tax liabilities of £121.0 million and the creation of a revaluation reserve of £269.4 million, net of tax. The re-evaluation of contributions resulted in a reduction in retained earnings of £53.6 million.

**Property, plant and equipment:** The adoption of IFRS has led to a significant change in the accounting for infrastructure assets. Under UK GAAP, the Company accounted for infrastructure assets under renewals accounting as provided for in FRS 15 "Tangible fixed assets". Renewals accounting is not allowed under IAS 16 "Property, plant and equipment" and the Company has redefined the categories of infrastructure assets and assessed the economic lives of the assets as detailed below, with depreciation being charged to the income statement on a straight line basis over the remaining lives of the assets. This change has also required the Company to account for disposals of infrastructure assets when they are replaced.

The change in accounting treatment for infrastructure assets has resulted in a lower charge for depreciation being made for infrastructure assets than was made under renewals accounting totalling £5.9 million. This is partially offset by the additional depreciation being charged on the increased value of fixed assets as a result of the revaluation of £1.0 million. The disposal of infrastructure assets has resulted in an additional loss on fixed assets disposals charged to the income statement of £0.1 million.

Additionally, to bring the accounting for reactive maintenance into line with the new policy on disposals of infrastructure assets an additional £7.3 million of maintenance costs have been charged to the income statement which would previously have been accounted for as capital expenditure.

**Deferred income:** Under IFRS, contributions received towards work on infrastructure assets are no longer allowed to be credited against the related capital expenditure and are now held on the statement of financial position and released to the income statement over the life of the underlying fixed asset. This has increased turnover for the Company by £1.1 million for the year ended 31 March 2015.

**Revaluation reserve:** The revaluation reserve of £269.4 million was created as a result of the revaluation of fixed assets on 1 April 2014. The reserve is amortised to retained earnings over the lives of the revalued assets on a straight line basis, adjusted for any fixed assets disposals, which revaluations are immediately transferred to retained earnings. These accounting changes have resulted in £4.9 million and £0.4 million, net of tax, of the restated balance at 31 March 2015 being transferred to retained earnings.

**Deferred tax:** The adoption of IFRS has resulted in a change to the accounting for deferred tax assets. FRS 19 "Deferred tax" permitted, but did not require, deferred tax assets and liabilities to be discounted, which the Company chose to adopt. IAS 12 "Income taxes" does not allow the discounting of deferred tax assets and liabilities.

The removal of the movement in the deferred tax discount for the year ended 31 March 2015 from the net deferred tax liability has resulted in an increase in deferred tax of £12.2 million, which, together with the deferred tax on the amortisation of the revaluation reserve of £1.3 million has been charged to the income statement.

South East Water

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### Notes to the financial statements

for the year ended 31 March 2016

### 2. Accounting policies (continued)

#### Notes to the reconciliations (continued)

**Other items:** Other items mainly relate to the accounting for the Company's defined benefit pension schemes. Under IFRS, IAS 19 "Employee benefits" requires that pension surpluses and deficits are accounted for gross of deferred tax. Previously, under FRS 17 "Retirement benefits" the Company accounted for these balances net of deferred tax. Also, under FRS 17, the surplus on one of the Company's schemes did not qualify as an asset of the Company and was excluded from the statement of financial position. The qualification requirements of FRS 17 do not apply under IFRS and the surplus on £2.8 million on the Mid Kent Group Pension Scheme ("MKGPS") was added to the Company's statement of financial position.

The grossing of the pension scheme balances has resulted in an increase in the deferred tax liability at 1 April 2014 of £6.6 million and at 31 March 2015 of £1.4 million. The inclusion of the surplus on the MKGPS has resulted in an increase in retained earnings of £2.2 million.

Provisions have been re-aligned between short-term and long-term to reflect the expected usage.

### Changes in accounting policies

The remaining accounting policies adopted are consistent with those of the financial statements for the year ended 31 March 2015 as described in those financial statements, except for the treatment of infrastructure assets, which have been redefined into the following categories and the economic lives of these assets have been reassessed as detailed below:

Category	Economic lives (years)
Surface Reservoirs	250
Communication pipes	100
Distribution mains – ductile Iron	70
Distribution mains – cast iron	100
Distribution mains – polyethylene	100
Other mains	70

#### 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 financial position of the Group, its cash flows, liquidity position and borrowing facilities are described on pages 77 to 131. The strategic report on page 11 includes a description of the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The Group finances its working capital requirements through cash generated from operations and committed facilities that can be called upon as required. Its facilities were undrawn during the year and at the date of signing these financial statements. The Group's annual budget and forecasts together with its five year plan and longer-term resources planning all indicate that the Group should be able to continue in operation utilising its current financial resources and the proceeds of future borrowing opportunities expected to become available.

The Directors believe that the Company and Group are well placed to manage its business risks successfully. After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and financial statements.

### Notes to the financial statements

for the year ended 31 March 2016

#### 2. Accounting policies (continued)

#### Judgements and key sources of estimation uncertainty

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

The most significant judgements, estimates and assumptions for the Group are set out below:

- the useful lives of infrastructure and non-infrastructure assets: the Group's and Company's asset lives 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 is undertaken annually to write down the value of assets where it is considered appropriate to do so;
- · un-invoiced water income at the year-end: domestic metered and smaller commercial customers are billed on a six monthly cycle which means at the year end a large volume of water has been supplied that has not been invoiced. Management estimates the value of the water supplied based on previous consumption. The value of unbilled water income at 31 March 2016 was £30.6 million (2015: £30.5 million);
- the capitalisation of employee and other directly attributable costs: the Group determines employee costs directly attributable to capital projects based on time spent. Other directly attributable costs are then assessed and costs relating to capital projects are capitalised into individual projects. During the year £12.4 million of employee and other directly attributable costs have been capitalised (2015: £11.3 million);
- the provision for doubtful trade receivables: an estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt. The value of the provision for doubtful debts as at 31 March 2016 was £29.6 million (2015: £28.8 million);
- the fair value of the interest rate swap: this valuation requires the Group to make estimates about expected inflation and future interest rates, hence the valuation is subject to uncertainties. The fair value at 31 March 2016 is £87.2 million (2015: £88.8 million):
- pension and other post-employment benefits: There are a range of variables required to be determined to value the Company's 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 23. Pension increases are based on expected future inflation rates. The net employee asset at 31 March 2016 is £6.7 million (2015: liability of £7.0 million); and
- the assets and liability of the Company were revalued at 1 April 2014 on adoption of IFRS. This resulted in the fixed assets of the Company being increased by £394.9 million and the deferred income for the Company and the Group increasing by £58.1 million. See "Revaluation of Property, Plant and Equipment" above for details.

#### Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group, there has been a transfer of risk and control 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. Specific recognition criteria must also be met before revenue is recognised as detailed below.

#### Metered and unmetered water income

Metered water income is recognised when water has been delivered to the customer. 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 based upon a measure of unbilled water consumed, which is calculated from historical customer data. Unmetered water income was invoiced in full for the financial year 2015/16 on 1 April 2015.

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

for the year ended 31 March 2016

#### 2. Accounting policies (continued)

#### 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. Such fees are recognised in the income statement when they are received.

#### Other income

Other income includes rechargeable works' charges and charges for engineering, scientific, laboratory, billing and cash collection services. Rechargeable works represent payments received from developers for installing meters and connections to new property developments. Other income is recognised when the work is complete.

#### Finance income

Finance income is recognised using the effective interest 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 recognised 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.

### Notes to the financial statements

for the year ended 31 March 2016

#### 2. Accounting policies (continued)

#### 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.

#### 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 for short life assets and 100 years for all other infrastructure assets. See table above for more details of the infrastructure asset useful economic lives.

#### 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.

for the year ended 31 March 2016

### 2. Accounting policies (continued)

#### 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.

#### 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 7 for further details.

#### **Grants and contributions**

Grants and contributions are received in respect of both infrastructure and non-infrastructure assets. These are recognised as deferred income and are released to the income statement over the life of the assets to which they relate.

#### 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 of purchase.

Work-in-progress for chargeable services is valued at the lower of cost and net realisable value.

#### 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.

### Notes to the financial statements

for the year ended 31 March 2016

#### 2. Accounting policies (continued)

### **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.

### 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 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.

### Short-term trade and other receivables

Short-term trade receivables are recognised and carried at original invoice amount less an allowance for any doubtful debts. An estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socioeconomic conditions.

for the year ended 31 March 2016

#### 2. Accounting policies (continued)

### Impairment of financial assets

At each reporting date an assessment is carried out to determine whether there is any indication that financial assets may be impaired. Where there is objective evidence that an impairment loss has arisen, the carrying amount is reduced through the use of an allowance account in accordance with IAS 39 Financial Instruments: Recognition and measurement, with the loss being 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.

#### 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 so as 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.

### Notes to the financial statements

for the year ended 31 March 2016

#### 2. Accounting policies (continued)

### 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.

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.

### Company comprehensive income statement and cash flow statement

The Company has taken advantage of the exemption under IFRS 3 Business Combinations not to provide a comprehensive income statement and cash flow statement.

### ${\bf New\, standards\, and\, interpretations\, adopted}$

The Group has not adopted any new or amended IAS, IFRS and IFRC interpretations as of 1 April 2015.

### New standards and interpretations not applied

As the Group prepare 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.

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 9 (amended 2014) Financial Instruments
IFRS 11 (amended) Joint Arrangements

IFRS 12 (amended) Disclosure of Interests in Other Entities

IFRS 14 Regulatory Deferral Accounts

IFRS 15 Revenue from Contracts with Customers

IFRS 16 Leases

IAS 1 (amended) Presentation of Financial Statements
IAS 16 (amended) Property, Plant and Equipment

IAS 19 (amended) Defined Benefit Plans: Employee Contributions

IAS 27 (amended) Separate Financial Statements
IAS 28 (amended) Investments in Associates

IAS 38 (amended) Intangible Assets
IAS 41 (amended) Agriculture
IFRIC 21 Levies

for the year ended 31 March 2016

The adoption of IFRS 9, which the Group plans to adopt for the year beginning on 1 April 2018, will impact both the measurement and disclosure of Financial Instruments..

The adoption of IFRS 16, which the Group plans to adopt on 1 April 2019 will require the recognition of the asset for the use of the Company's laboratory building and the recognition of the related financing under the terms of the 20 year lease. The value of both the fixed asset and the financing liability at the balance sheet date, based on discounted future cash flows was £2.5 million.

The directors do not expect that the adoption of the other standards listed above will have a material impact on the financial statements of the Group in future periods.

#### 3. Total income

	2016 £000	2015 £000
Revenue Unmetered water income Metered water income Other sales	56,850 151,935 5,645	71,255 138,711 5,114
Total Revenue	214,430	215,080
Other income Rental income Sundry income	1,138 5,329	1,168 4,518
Total other income	6,467	5,686
Total income	220,897	220,766

All revenue is from customers within the United Kingdom.

Sundry income includes charges for billing and cash collection services amounting to £3.2 million (2015: £2.5 million), and laboratory income of £1.0 million (2015: £1.0 million).

### Notes to the financial statements

for the year ended 31 March 2016

### 4. 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 regulated activities, non-regulated activities and new connections to the Group's network. However, because of the relative size of the latter two segments they are reported together as "Other activities" below.

Year ended 31 March 2016	Regulated activities £000	Other activities £000	Adjustments £000	Total £000
Total Revenue	214,261	11,892	(5,256)	220,897
Operating profit	71,304	3,468	-	74,772
Finance costs Finance income				(37,458) 5,122
Profit before taxation Taxation			_	42,436 4,043
Profit for the year			_	46,479
Year ended 31 March 2015				
Total Revenue	214,278	11,296	(4,808)	220,766
Operating profit	73,527	6,157	-	79,684
Finance costs Finance income				(49,526) 5,127
Profit before taxation Taxation				35,285 (4,012)
Profit for the year				31,273

The Group analyses results by segment to operating profits only, so no segmental statement of financial position or statement of cash flows are presented.

The adjustment of revenue relates to work performed on the Group's network for new connections on behalf of third parties. This is reported as revenue for management purposes, but is treated as capital contributions for the purposes of these accounts.

for the year ended 31 March 2016

### 5. Net operating costs

Notes	2016 £000	2015 £000
Employee benefits expense 6	26,314	25,042
Asset expense/(income):  Depreciation – owned assets  Depreciation – leased assets  Impairment of fixed assets  Amortisation of intangible assets  Impairment of intangible assets  (Profit)/loss on disposal of non-current assets	41,460 580 736 2,960 13 (70)	39,845 565 2,516 2,841 - 89 45,856
Other operating expenses: Operating lease rentals: vehicles and office equipment land and buildings Fees payable to the Group's auditor (see below) Other expenses (see below) Other operating expenses charged to capital projects	144 440 213 78,741 (5,406)	72 462 242 74,469 (5,061)
	74,132	70,184
	146,125	141,082
Fees payable to the Group's auditor in respect of: Audit of the Group and Company financial statements Audit of subsidiary	146 1	114 1
Total audit	147	115
Regulatory accounts Other assurance services	25 23	25 55
	48	80
Services relating to taxation	18	47
Total non-audit services	66	127
Total fees charged to income statement	213	242

### Notes to the financial statements

for the year ended 31 March 2016

	£000	£000
Other expenses comprise:		
Energy costs	16,384	16,039
Rates	14,884	14,499
Contractors	19,377	18,560
Bulk water supplies and abstraction licences	7,789	6,947
Bad debts	3,110	2,295
Chemicals	2,435	2,539
Insurance	2,659	2,823
Other	12,103	10,767
	78,741	74,469

### 6. Directors and employees

The average monthly number of employees, including salaried Directors, of the Group in the year was:

		2016 Number	2015 Number
Operations Management and administration		521 328	514 300
		849	814
	Notes	2016 £000	2015 £000
The aggregate payroll costs of these persons were: Wages and salaries Social security costs Pension costs for defined benefit schemes Pension costs for defined contribution schemes	23 23	27,191 2,884 1,449 1,744	25,433 2,559 2,681 648
Less: direct salary costs charged to capital projects		33,268 (6,954) 26,314	31,321 (6,279) 25,042

for the year ended 31 March 2016

Emoluments of the Directors, who are the Group's key management, were:

	2016 £000	2015 £000
Aggregate emoluments including bonuses Company contributions to defined contribution scheme	1,012 55	1,334 25
	1,067	1,359
Emoluments of the highest paid Director were: Aggregate emoluments including bonuses	348	334

Retirement benefits are accruing to three Directors (2015: four) under the defined benefit pension schemes and two Directors (2015: one) under a defined contribution scheme. Further disclosures in respect of directors' emoluments are set out in the remuneration report on page 63.

### 7. Finance costs

	Notes	2016 £000	2015 £000
Debenture interest		42	44
Effective interest on listed debt		21,788	21,594
Fair value movements on interest rate swap		(1,585)	5,840
Indexation on variable rate bonds		2,011	2,097
Bank interest and other finance charges		623	716
Financing guarantee fees		1,486	1,585
Interest payable on finance leases		-	125
Interest payable on index linked loans		11,225	11,101
Indexation on index linked loans		3,913	7,483
Amortisation of loan issue costs		547	547
Pension fund finance charge	23	164	1,191
Interest payable		40,214	52,323
Interest capitalised		(2,756)	(2,797)
		37,458	49,526

Interest capitalised during the year amounted to £2.8 million (2015: £2.8 million) and is calculated using the weighted average interest rate of the Group's long-term lending of 4.28% (2015: 4.28%).

### 8. Finance income

	2016 £000	2015 £000
Interest receivable on bank balances and short-term deposits Interest receivable from group undertakings	214 4,908	284 4,843
	5,122	5,127

### Notes to the financial statements

for the year ended 31 March 2016

#### 9. Taxation

Major components of the Group's tax expense for the years ended 31 March 2016 and 2015 are:

Group	2016 £000	2015 £000
Group income statement Current tax:		
Current tax: Current UK tax charge Amounts under provided in previous years	3,391 96	2,041 1
	3,487	2,042
Deferred tax: Relating to origination and reversal of temporary differences Impact of deferred tax rate change	4,398 (11,928)	1,970
	(7,530)	1,970
Tax (credit)/charge reported in the group income statement	(4,043)	4,012
Tax charge to equity Deferred tax on defined benefit pension schemes Impact of deferred tax rate change in respect of the pension schemes	2,223 509	4,061 -
Tax reported in comprehensive income statement	2,732	4,061

### 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:

	2016 £000	2015 £000
Profit before tax	42,436	35,285
Profit multiplied by the rate of corporation tax in the UK of 20% (2015: 21%) Effects of:	8,487	7,410
Adjustments to current tax charge in respect of previous years Adjustments to deferred tax charge in respect of previous years Expenses not deductible for tax purposes Impact of rate change on deferred tax	96 (1,170) 472 (11,928)	1 (3,813) 414
Total tax (credit)/charge reported in the group income statement	(4,043)	4,012

for the year ended 31 March 2016

#### 9. Taxation (continued)

Deferred tax

The movement on the net deferred tax liability is as shown below:

	2016 £000	2015 £000
At 1 April (Credit)/charge to the income statement Charge to equity Credit to reserves	150,295 (7,530) 2,732 (4,931)	144,264 1,970 4,061
At 31 March	140,566	150,295

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:

	Accelerated tax depreciation £000	Pension provision £000	Total £000
Deferred tax liabilities At 1 April 2014 Charge to the income statement Charge to equity	153,172 794	(6,646) 1,186 4,061	146,526 1,980 4,061
At 1 April 2015 (Credit)/charge to the income statement Charge to equity Credit to reserves	153,966 (8,715) - (4,931)	(1,399) 22 2,732	152,567 (8,693) 2,732 (4,931)
At 31 March 2016	140,320	1,355	141,675
	Fair value Swap £000	Other provision £000	Total £000
Deferred tax assets At 1 April 2014 (Charge)/credit to the income statement	2,113 (91)	149 101	2,262 10
At 1 April 2015 (Charge)/credit to the income statement	2,022 (1,204)	250 41	2,272 (1,163)
At 31 March 2016	818	291	1,109

### Notes to the financial statements

for the year ended 31 March 2016

#### 9. 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 2016 was £140.6 million (2015: £150.3 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 rates of 20%, changing to 19% from 1 April 2017 and 18% from 1 April 2020. (2015: 20%).

For the year ended 31 March 2016 a UK corporation rate of 20% has been used as enacted by Finance Act 2013. The Finance (No.2) Act 2015, which was substantively enacted on 26 October 2015, provides for a reduction in the main rate of UK corporation tax to 19% effective from 1 April 2017 and 18% from 1 April 2020. These rate reductions have been reflected in the calculation of deferred tax. The rate is expected to further reduce to 17% from 1 April 2020, although this reduction was not substantively enacted at the balance sheet date.

### 10. Dividends

Group and Company	2016 £000	2015 £000
Equity dividends paid during the year: First interim dividend of 4.56p per ordinary share (2015: 13.76p per ordinary share)	2,250	6,786
Second interim dividend of 4.56p per ordinary share (2015: 13.76p per ordinary share)	2,250	6,786
Third interim dividend of 4.56p per ordinary share (2015: 13.76p per ordinary share)	2,250	6,786
Final dividend of 4.56p per ordinary share (2015: 13.76p per ordinary share)	2,250	6,786
	9,000	27,144

There were no dividends proposed for approval as at 31 March 2016 and 31 March 2015.

for the year ended 31 March 2016

### 11. 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	2016 £000	2015 £000
Profit for the year	46,479	31,273
	Number	Number
Basic and diluted weighted average number of shares	49,312,354	49,312,354
Basic and diluted earnings per share	94.25p	63.42p

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.

### 12. Intangible assets

Group and Company	Computer software £000	Assets in the course of construction £000	Total £000
Cost At 1 April 2015	12,008	1,414	13,422
Additions	,	3,368	3,368
Transfers	1,313	(1,313)	-
Disposals	(73)	-	(73)
At 31 March 2016	13,248	3,469	16,717
Amortisation and impairment			
At 1 April 2015	(2,771)	-	(2,771)
Charge for the year	(2,960)	-	(2,960)
Eliminated on disposals	73	-	73
Impairment	(13)		(13)
At 31 March 2016	(5,671)	-	(5,671)
Net book amount at 31 March 2016	7,577	3,469	11,046
Deemed cost			
At 1 April 2014	9,713	1,333	11,046
Additions	-	2,452	2,452
Transfers	2,371	(2,371)	-
Disposals	(76)	-	(76)
At 31 March 2015	12,008	1,414	13,422
Amortisation At 1 April 2014	_	_	_
Charge for the year	(2,841)	-	(2,841)
Eliminated on disposals	70	-	70
At 31 March 2015	(2,771)	-	(2,771)
Net book amount at 31 March 2015	9,237	1,414	10,651

### Notes to the financial statements

for the year ended 31 March 2016

13. 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 2015 Additions Transfers Disposals	218,582 - 5,978 (2,075)	885,588 - 30,550 (31)	225,349 - 33,886 (996)	81,835 85,842 (70,414)	1,411,354 85,842 - (3,102)
At 31 March 2016	222,485	916,107	258,239	97,263	1,494,094
Accumulated depreciation and impairment At 1 April 2015 Charge for the year Eliminated on disposals Impairment	(5,704) (3,991) 2,075 (174)	(16,310) (16,734) 1	(20,150) (21,315) 954 (562)	- - - -	(42,164) (42,040) 3,030 (736)
At 31 March 2016	(7,794)	(33,043)	(41,073)	-	(81,910)
Net book amount at 31 March 2016	214,691	883,064	217,166	97,263	1,412,184
Net book amount of leased assets included above	4,575	-	6,296	-	10,871
Assets under construction relate to the following categories	5,841	64,062	27,360	-	97,263
Deemed cost At 1 April 2014 Additions Transfers Disposals	211,784 - 6,862 (64)	846,507 - 39,759 (678)	182,257 - 43,350 (258)	82,252 89,554 (89,971)	1,322,800 89,554 - (1,000)
At 31 March 2015	218,582	885,588	225,349	81,835	1,411,354
Accumulated depreciation and impairment At 1 April 2014 Charge for the year Eliminated on disposals Impairment	(3,840) 59 (1,923)	- (16,434) 571 (447)	(20,136) 132 (146)	- - - -	(40,410) 762 (2,516)
At 31 March 2015	(5,704)	(16,310)	(20,150)	-	(42,164)
Net book amount at 31 March 2015	212,878	869,278	205,199	81,835	1,369,190
Net book amount of leased assets included above	4,735	_	6,715		11,450
Assets under construction relate to the following categories	6,144	42,999	32,692	-	81,835

for the year ended 31 March 2016

#### 13. Property, plant and equipment (continued)

The impairment loss on land, wells, reservoirs and buildings relate to abortive projects on a number of the Group's operational sites. Plant, equipment and vehicles have been impaired in respect of carbon filter media at our treatment works which is no longer viable.

### 14. Investments in subsidiaries

Details of the Company's subsidiary, the results of which are included in the Group financial statements at 31 March 2016 and 31 March 2015 are as follows:

Company			Ordinary share	
Name of subsidiary	Place of incorporation	Principal activity	ownership interest %	Voting rights held %
South East Water (Finance) Limited	Cayman Islands	Finance Company	100	100

South East Water (Finance) Ltd's principal purpose is to raise listed debt on behalf of South East Water Ltd and any proceeds from such issues are lent on to South East Water Ltd. South East Water (Finance) Ltd is tax resident in the UK.

### 15. Amount due from parent undertaking

Group and Company	2016 £000	2015 £000
Non-current assets Loans receivable carried at amortised cost Amount due from parent due in more than one year	190,013	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 2%.

#### 16. Inventories

Group and Company	2016 £000	2015 £000
Consumables Work-in-progress	185	177 68
	185	245

### Notes to the financial statements

for the year ended 31 March 2016

#### 17. Trade and other receivables

	Group		Company —	
	2016 £000	2015 £000	2016 £000	2015 £000
Financial asset receivables Trade receivables Accrued income Amounts due from parent and fellow subsidiary undertakings due within	29,968 30,645	28,422 30,459	29,968 30,645	28,422 30,459
one year	148	59	148	59
	60,761	58,940	60,761	58,940
Non-financial asset receivables Prepayments and accrued income Other receivables	2,894 2,995	2,928 3,746	2,329 2,995	2,356 3,746
	5,889	6,674	5,324	6,102
Total trade and other receivables	66,650	65,614	66,085	65,042

### **Group and Company**

All trade receivables at 31 March 2016 and 31 March 2015 are denominated in sterling.

Trade receivables are stated after provision for doubtful debts of £29.6 million (2015: £28.8 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:

Provision brought forward Charge for the year Amounts utilised Provision carried forward

2016	2015
£000	£000
28,775	29,601
3,095	2,295
(2,223)	(3,121)
29,647	28,775

for the year ended 31 March 2016

#### 17. Trade and other receivables (continued)

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
2016	29,968	6,522	4,105	1,727	1,013	1,112	8,967	6,522
2015	28,422	4,824	3,919	1,968	1,183	1,253	9,262	6,013

### 18. Cash and cash equivalents

Cash and cash equivalents comprise the following at 31 March:

	Group		Com	pany
	2016	2015	2016	2015
	£000	£000	£000	£000
Cash at bank and in hand	5,547	13,419	5,460	13,383
Short term bank deposits	11,400	15,300	10,900	15,000
	16,947	28,719	16,360	28,383

Included in the Group and Company cash at bank and in hand balance at 31 March 2016 was £4.8 million (2015: £12.2 million) held on an on demand deposit account.

At 31 March 2016, £1.5 million (2015: £0.5 million) of restricted cash was held for the Group in designated bank accounts and £0.9 million (2015: £0.1 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 19).

### Notes to the financial statements

for the year ended 31 March 2016

#### 19. Financial liabilities

Group		2016 £000	2015 £000
Non-current liabilities: summary analysis Loans and borrowings (see below) Derivative financial instruments – Inflation swap (see below) Trade and other payables (see below)	(i)	869,880 87,226 2,589	863,418 88,811 1,751
		959,695	953,980
Loans and borrowings: detailed analysis Irredeemable debenture stock Listed bonds Index linked loans	(ii) (iii) (iv)	991 518,645 350,244	1,000 516,258 346,160
		869,880	863,418
Trade and other payables: detailed analysis Trade and other payables Financial guarantee fees received in advance	(v)	2,489 100	1,611 140
		2,589	1,751

### (i) Derivative financial instruments – Inflation 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 2016 the interest rate swap is stated at its fair value of a liability of £87.2 million (2015: £88.8 million), as detailed in the above table. The decrease in the fair value of the liability of £1.6 million (2015: increase of £5.8 million) during the year has been recognised in the income statement in finance costs (see note 7).

	2016 £000	2015 £000
(ii) Irredeemable debenture stock		
3 % perpetual stock 3 ½ % perpetual stock 4 % perpetual stock 5 % perpetual stock 5 ½ % perpetual stock 6 % perpetual stock	25 384 178 366 1 37	26 391 178 367 1 37
	991	1,000

Interest on irredeemable debenture stock is payable six monthly.

South East Water

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### Notes to the financial statements

for the year ended 31 March 2016

#### 19. Financial liabilities (continued)

#### (iii) Listed bonds

The Group holds bonds listed on the London Stock Exchange with an original value of £496 million (2015: £496 million), with effective terms, having taken account of a related interest rate swap, as follows:

- •£200 million at a variable rate linked to inflation, falling due for repayment on 30 September 2019 (or earlier at the option of the Group);
- $\cdot$  £166 million at a fixed rate of 5.5834%, falling due for repayment on 29 March 2029 (or earlier at the option of the Group); and
- $\cdot$ £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.

Indexation on the bond repayable in 2019 accrues due to the related inflation linked swap and is included in the fair value of that instrument. Indexation also 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
2016 Original loan consideration Indexation on bonds Less: unamortised issue costs	200,000 - (759)	166,000 - (1,437)	130,000 26,107 (1,266)	496,000 26,107 (3,462)
Listed bonds	199,241	164,563	154,841	518,645
2015 Original loan consideration Indexation on bonds Less: unamortised issue costs	200,000 - (975)	166,000 - (1,548)	130,000 24,097 (1,316)	496,000 24,097 (3,839)
Listed bonds	199,025	164,452	152,781	516,258

### (iv) Index linked loan

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);
- $\cdot$ £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); and
- •£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 2016

#### 19. 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
2016 Original loan amounts Indexation on bonds Less: unamortised issue costs	135,000 64,685 (1,361)	34,000 12,646 (248)	100,000 7,153 (1,631)	269,000 84,484 (3,240)
Loans	198,324	46,398	105,522	350,244
2015 Original loan amounts Indexation on bonds Less: unamortised issue costs	135,000 62,664 (1,443)	34,000 12,174 (261)	100,000 5,733 (1,707)	269,000 80,571 (3,411)
Loans	196,221	45,913	104,026	346,160

The irredeemable debentures, listed bonds and index linked loans detailed in (ii), (iii) and (iv) above respectively are secured on the assets of South East Water (Holdings) Ltd, South East Water Ltd and South East Water (Finance) Ltd (the South East Water (Holdings) Ltd group) as far as allowed by the Water Industry Act 1991 and South East Water Ltd'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 on page 11.

### (v) Trade and other payables

Trade and other payables comprise financing guarantee fees of £100,000 (2015: £140,000) and deposits payable to developers of £2.5 million (2015: £1.6 million). Financing guarantee fees waived comprises cash received in advance to settle fees in connection with the £200 million listed debt raised (see (iii)) which were subsequently waived. The balance is being amortised over the life of the listed debt.

Company	2016 £000	2015 £000
Irredeemable debenture stock (see below) (i) Amounts due to subsidiary undertakings (see below) (ii) Index linked loans (see below) (iii) Trade creditors and other payables (see below) (iv)	991 711,393 244,722 2,589	1,000 709,095 242,134 1,751
Creditors amounts falling due after more than one year	959,695	953,980
(i) Irredeemable debenture stock 3% perpetual stock 3½% perpetual stock 4% perpetual stock 5% perpetual stock 5½% perpetual stock 6% perpetual stock	25 384 178 366 1 37	26 391 178 367 1 37
	991	1,000

for the year ended 31 March 2016

#### 19. Financial liabilities (continued)

### (ii) Amounts due to subsidiary undertakings

The Company's subsidiary undertaking, South East Water (Finance) Ltd, has debt with an original consideration of £596 million (2015: £596 million), of which £496 million (2015: £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 (2015: £43,000) is charged by South East Water (Finance) Ltd.

The effective terms of the £596 million loans due to South East Water (Finance) Ltd are as follows:

- $\cdot$  £200 million at a variable rate linked to inflation, falling due for repayment on 30 September 2019 (or earlier at the option of the Company);
- •£166 million at a fixed rate of 5.5834%, falling due for repayment on 29 March 2029 (or earlier at the option of the Company);
- $\cdot$ £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); and
- •£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.

Indexation on the loan repayable in 2019 accrues due to the related inflation linked swap and is included in the fair value of that instrument. Indexation also 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) Ltd, South East Water Ltd and South East Water (Finance) Ltd (the South East Water (Holdings) Ltd group) as far as allowed by the Water Industry Act 1991 and South East Water Ltd'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 on page 11.

The amounts due to group undertakings are stated at the original consideration plus fair value of the interest rate swap, accrued indexation and less issue costs unamortised at the balance sheet date as follows:

	Loan due	Loan due	Loan due	Loan due	
	2019	2029	2041	2037	Total
	£000	£000	£000	£000	£000
2016					
Original loan consideration	200,000	166,000	130,000	100,000	596,000
Fair value of interest rate swap	87,226	-	-	-	87,226
Indexation on bonds	-	-	26,107	7,153	33,260
Less: unamortised issue costs	(759)	(1,437)	(1,266)	(1,631)	(5,093)
Loans	286,467	164,563	154,841	105,522	711,393
Loans 2015	286,467	164,563	154,841	105,522	711,393
	286,467	<b>164,563</b> 166,000	130,000	<b>105,522</b> 100,000	<b>711,393</b> 596,000
2015	•	•	•	•	
2015 Original loan consideration	200,000	•	•	•	596,000
2015 Original loan consideration Fair value of interest rate swap	200,000	•	130,000	100,000	596,000 88,811
2015 Original loan consideration Fair value of interest rate swap Indexation on bonds	200,000 88,811	166,000	130,000 - 24,097	100,000	596,000 88,811 29,830

### Notes to the financial statements

for the year ended 31 March 2016

#### 19. Financial liabilities (continued)

### (iii) 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); and
- •£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.

The listed bonds and unlisted loan are secured on the assets of South East Water (Holdings) Ltd, South East Water Ltd and South East Water (Finance) Ltd (the South East Water (Holdings) Ltd group) as far as allowed by the Water Industry Act 1991 and South East Water Ltd's licence.

The agreements for both 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 on page 11.

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	Loan due	
2032	2033	Total
£000	£000	£000
135,000	34,000	169,000
64,685	12,646	77,331
(1,361)	(248)	(1,609)
198,324	46,398	244,722
135,000	34,000	169,000
62,664	12,174	74,838
(1,443)	(261)	(1,704)
196,221	45,913	242,134
	2032 £000 135,000 64,685 (1,361) <b>198,324</b> 135,000 62,664 (1,443)	2032 2033 £000 £000 135,000 34,000 64,685 12,646 (1,361) (248) 198,324 46,398 135,000 34,000 62,664 12,174 (1,443) (261)

### (iv) Trade creditors and other payables

Trade creditors and other payables comprise financing guarantee fees of £100,000 (2015: £140,000) and deposits payable to developers of 2.5 million (2015: £1.6 million). Financing guarantee fees are cash received in advance to settle fees in connection with the £200 million owed to South East Water (Finance) Ltd (see (iv)) which were subsequently waived. The balance is being amortised over the life of the listed debt.

for the year ended 31 March 2016

#### 20. Provisions

Group and Company	Insurance excess £000	Leak allowance £000	Cash accounts £000	Total £000
31 March 2016				
As at 1 April 2015 Additional provisions Amounts utilised	1,450 1,171 (1,065)	2,555 2,487 (2,890)	125 1 -	4,130 3,659 (3,955)
	1,556	2,152	126	3,834
31 March 2015				
As at 1 April 2014 Additional provisions Amounts utilised	1,663 1,200 (1,413)	1,400 1,155 -	170 45 (90)	3,233 2,400 (1,503)
	1,450	2,555	125	4,130

It is anticipated that all provisions will be utilised within the next year.

### 21. Trade and other payables

	Group		Com	pany
	2016 £000	2015 £000	2016 £000	2015 £000
Financial liability payables Trade payables Amounts due to parent and fellow subsidiary undertakings	10,803 10,120	14,366 9,132	10,803 16,957	14,366 16,040
Other payables Accruals	770 30,582	1,286 32,488	770 23,915	1,286 25,953
	52,275	57,272	52,445	57,645
Non-financial liability payables Payments received in advance Other taxes and social security	32,009 973	31,413 912	32,009 973	31,413 912
	32,982	32,325	32,982	32,325
	85,257	89,597	85,427	89,970

As at 31 March 2016 and 2015, amounts due to parent and fellow subsidiary undertakings represent unsecured non-interest bearing balances relating to, for the Group, the surrender of group tax relief and for the Company the surrender of group tax relief and interest due on debt with the subsidiary company.

### Notes to the financial statements

for the year ended 31 March 2016

#### 22. Group financial instruments

### Financial risk management objectives and policies

The Group's financial instruments comprise fixed and variable rate borrowings, index linked loans, fixed rate debentures, an interest rate swap, a loan to its parent undertaking, cash, short-term and medium-term deposits and 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.

### 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 2016 there was a net outflow of nil from financing activities within the Group (excluding dividend payments) (2015: £1.3 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.

for the year ended 31 March 2016

### 22. Group financial instruments (continued)

The following table demonstrates the sensitivity to a reasonably 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
2016 Sterling	+200	(4,800)	(3,840)
Sterling	-200	4,800	3,840
2015 Sterling	+200	(4,800)	(3,696)
Sterling	-200	4,800	3,696

#### 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 and in note 19. 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 19). The Group considers that the inflation rate risk is effectively managed as Ofwat allows revenues to be increased in line with inflation.

### 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. An estimate for the provision for doubtful debts is calculated by the Group's management based on applying expected recovery rates to an aged debt profile and an assessment of current socio-economic conditions (see note 17). 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 on page 11.

#### 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.

### Notes to the financial statements

for the year ended 31 March 2016

#### 22. Group financial instruments (continued)

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 2016.

	Notes	Book Value 2016 £000	Fair Value 2016 £000	Book Value 2015 £000	Fair Value 2015 £000
Loans and receivables Trade and other receivables Cash Amounts due from parent undertaking	17 18 15	60,761 16,947 190,013	60,761 16,947 139,385	58,940 28,719 190,013	58,940 28,719 152,004
Financial liabilities at amortised cost		267,721	217,093	277,672	239,663
Trade and other payables Irredeemable debentures Listed bonds Index linked loans	21 19 19 19	42,155 991 518,645 350,244	41,651 766 601,959 393,500	48,140 1,000 516,258 346,160	47,533 691 631,496 391,946
Amounts due to parent and group undertakings  At fair value through the income statement	21	10,120 922,155	9,999	9,132	9,052
Interest rate swap		87,226	87,226	88,811	88,811

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 value 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 £0.1 million (2015: £2.6 million) and for the life to date of the swap is £6.3 million (2015: £6.2 million). The difference between the carrying value of the swap, above, and the amount payable at maturity is £18.2 million (£21.6 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; and
- · Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

for the year ended 31 March 2016

### 22. 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 2016				
Financial liabilities at fair value through the income statement Interest rate swap	(87,226)	-	(87,226)	_
31 March 2015				
Financial liabilities at fair value through the income statement Interest rate swap	(88,811)	-	(88,811)	
The Group held the following financial instruments ware required:	hich are not measu	ured at fair value	but fair value dis	sclosures
	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
31 March 2016				
Fair value of financial assets: loans and receivables Amounts due from parent undertaking	139,385	-	139,385	-
Fair value of financial liabilities at amortised cost Trade and other payables Irredeemable debentures Listed bonds Index linked loans Amounts due to parent and group undertakings	(41,651) (766) (601,959) (393,500) (9,999)	- - (601,959) - -	(41,651) (766) - (393,500) (9,999)	- - - - -
Total fair value of financial liabilities at amortised cost	(1,047,875)	(601,959)	(445,916)	-
31 March 2015				
Fair value of financial assets: loans and receivables Amounts due from parent undertaking	152,004	-	152,004	-
Fair value of financial liabilities at amortised cost Trade and other payables Irredeemable debentures Listed bonds Index linked loans Amounts due to parent and group undertakings	(47,533) (691) (631,496) (391,946) (9,052)	- (631,496) - -	(47,533) (691) - (391,946) (9,052)	- - - - -
Total fair value of financial liabilities at amortised cost	(1,080,718)	(631,496)	(449,222)	-

During the reporting years ended 31 March 2016 and 2015, 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 2016

### 22. 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 2016	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 Listed bond	42 9,268	84 18,536	126 27,804	1,050 240,144	1,302 295,752
Total fixed rate financial liabilities	9,310	18,620	27,930	241,194	297,054
Floating rate Floating rate financial assets: Short term financial assets Long-term financial assets	60,761 4,898	9,796	- 14,694	- 253,687	60,761 283,075
Total floating rate financial assets	65,659	9,796	14,694	253,687	343,836
Floating rate financial liabilities: Short term financial liabilities Listed bond Index-linked loans	52,277 12,537 11,305	- 25,830 23,187	- 327,341 36,221	332,418 633,486	52,277 698,126 704,199
Total floating rate financial liabilities	76,119	49,017	363,562	965,904	1,454,602
Year ended 31 March 2015					
Fixed rate Fixed rate financial liabilities: Irredeemable debentures Listed bond	42 9,268	84 18,536	126 27,804	1,050 249,412	1,302 305,020
Total fixed rate financial liabilities	9,310	18,620	27,930	250,462	306,322
Floating rate Floating rate financial assets: Short-term financial assets Long-term financial assets	28,422 4,778	- 9,556	- 14,334	- 256,905	28,422 285,573
Total floating rate financial assets	33,200	9,556	14,334	256,905	313,995
-	33,200	- /			
Floating rate financial liabilities: Short-term financial liabilities Listed bond Index-linked loans	57,328 12,418 11,178	25,504 22,932	- 341,550 35,839	339,492 648,671	57,328 718,964 718,620

The £200 million fixed rate instrument is classified as a floating rate financial liability due to the associated interest rate swap arrangement.

for the year ended 31 March 2016

#### 22. Group financial instruments (continued)

#### **Borrowing facilities**

The Group has committed borrowing facilities of £144.0 million (2015: £144.0 million), of which £nil (2015: £nil) was drawn down. Any drawdowns under these facilities are repayable in less than one year.

### Items of income, expense, gains and losses

The net gains or losses of the different classes of financial instruments on the income statement are:

	2016 £000	2015 £000
Financial assets, loans and receivables (see note 8)	5,122	5,127
Financial liabilities at amortised cost (see note 7)	(39,003)	(42,495)
Financial liabilities at fair value through profit or loss (see note 7)	1,585	(5,840)
Financial assets due to impairment (see note 17)	(3,095)	(2,295)

#### 23. 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 2014.

The Group contribution rate was nil (2015: 33.8%) of pensionable remuneration during the year plus an annual contribution of £3.57 million (2015: £5.95 million). The Group's future annual contribution is expected to be £3.6 million.

The expected return on assets is based on the long-term expectation for each asset class at the beginning of the period (i.e. as at 1 April 2015 for the year to 31 March 2016). The overall gross expected return on assets used for the start year figures was 4.12% p.a. (2015: 4.12%).

The pension expense for the year to 31 March 2016 takes account of assumptions set at the start of the year (i.e. as at 1 April 2015). The calculation of the pension expense for the year to 31 March 2016 uses an expected rate of return after deducting an allowance for expenses. The expenses paid over the year to 31 March 2016 are equivalent to a deduction of 0.6% (2015: 0.6%) from the expected return on assets. Therefore an overall net expected return on assets of 3.52% (2015: 3.52%) has been used in the calculation of the 2016 pension cost.

As a result of the merger of South East Water Ltd and Mid Kent Water Ltd 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 2014.

### Notes to the financial statements

for the year ended 31 March 2016

#### 23. Retirement benefit schemes (continued)

The Group contributed nil (2015: 36.1%) of pensionable remuneration plus £1.24 million (2015: £1.35 million) in respect of the deficit as at 31 March 2016 to the scheme during the year. The Group's future annual contribution is expected to be £1.24 million.

The expected return on assets is based on the long-term expectation for each asset class at the beginning of the period (i.e. as at 1 April 2015 for the year to 31 March 2016). The overall gross expected return on assets used for the start year figures was 4.01% p.a. (2015: 4.01%).

The pension expense for the year to 31 March 2016 takes account of assumptions set at the start of the year (i.e. as at 1 April 2015). The calculation of the pension expense for the year to 31 March 2016 uses an expected rate of return after deducting an allowance for expenses. The expenses paid over the year to 31 March 2016 are equivalent to a deduction of 0.6% (2015: 0.6%) from the expected return on assets. Therefore an overall net expected return on assets of 3.41% (2015: 3.41%) has been used in the calculation of the 2016 pension cost.

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 will become 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.

Pension costs recognised in the income statement for the defined contribution scheme were as follows:

	2016 £000	2015 £000
Defined contribution scheme	1,744	648

The major assumptions used for the actuarial valuations were:

	SEW	SEW	MKW	SEW
	Pensions	Pensions	Pensions	Pensions
	2016	2015	2016	2015
	%	%	%	%
Main assumptions: Rate of increase in pensions in payment Rate of increase in deferred pensions	1.95	1.95	1.95	1.95
	1.95	1.95	1.95	1.95
Discount rate RPI assumption CPI assumption	3.40	3.15	3.40	3.15
	2.95	2.95	2.95	2.95
	1.95	1.95	1.95	1.95
Post-retirement mortality (in years) Current pensioners at 65 – male Current pensioners at 65 – female Future pensioners at 65 – male Future pensioners at 65 – female	22.2	22.6	22.2	22.6
	24.0	24.4	24.0	24.4
	24.5	25.0	24.5	25.0
	25.6	26.2	25.6	26.2

for the year ended 31 March 2016

### 23. 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)/	(Decrease)/
	increase in	increase
	liabilities	
	£000	%
0.1% increase to the discount rate	(3,800)	(1.5)
0.1% decrease to inflation	(2,800)	(1.1)
One year increase in life expectancy	10,300	4.0

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
2016 Equities Corporate bonds Government bonds Property Cash Insured persons	31,849	24,034	55,883
	68,261	47,089	115,350
	33,153	26,660	59,813
	8,046	5,775	13,821
	6,101	2,722	8,823
	5,249	5,278	10,527
Total fair value of assets	152,659	111,558	264,217
Present value of funded obligations	(149,945)	(102,555)	(252,500)
Net over funding in funded plans	2,714	9,003	11,717
Present value of unfunded obligations	(4,180)		(4,180)
(Deficit)/surplus in the schemes	(1,466)	9,003	7,537
2015 Equities Corporate bonds Government bonds Property Cash	32,469	22,950	55,419
	49,647	32,590	91,741
	59,151	47,608	97,255
	14,932	10,213	25,145
	645	587	1,232
Total fair value of assets	156,844	113,948	270,792
Present value of funded obligations	(162,330)	(111,154)	(273,484)
Net over funding in funded plans	(5,486)	2,794	(2,692)
Present value of unfunded obligations	(4,297)		(4,297)
(Deficit)/surplus in the schemes	(9,783)	2,794	(6,989)

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 2016

### 23. Retirement benefit schemes (continued)

Analysis of amounts charged/(credited) to income statement:

	SEW	MKW	
	Pensions	Pensions	Total
	£000	£000	£000
2016	262	(00)	167
Net interest on defined liability/(asset)	262	(98)	164
Administrative expenses	672	505	1,177
Total amount charged to income statement	934	407	1,341
2015			
Current service cost	701	955	1,656
Administrative expenses	646	379	1,025
•			· · · · · · · · · · · · · · · · · · ·
Amounts charged to operating profit	1,347	1,334	2,681
Net interest on defined liability	1,000	191	1,191
Total amount charged to income statement	2,347	1,525	3,872
Analysis of amounts recognised in the statement of comprehen	sive income:		
	SEW	MKW	
	Pensions	Pensions	Total
	£000	£000	£000
2016			
Return on schemes' assets excluding interest income	(3,292)	(1,036)	(4,328)
Actuarial gain due to changes in financial assumptions	5,988	4,272	10,260
Actuarial gains due to changes in demographic assumptions	2,940	2,249	5,189
Actuarial gains due to changes in demographic assumptions		2,243	
Actuarial gain recognised in the statement of			
comprehensive income	5,636	5,485	11,121
Cumulative actuarial losses	(8,565)	(16,035)	(24,600)
2015			
Return on schemes' assets excluding interest income	18,300	14,836	33,136
Actuarial loss due to changes in financial assumptions	(15,891)	(10,798)	(26,689)
Actuarial gains due to changes in demographic assumptions	8,974	6,400	15,374
Experience gain/(loss) on obligation	1,400	(2,902)	(1,502)
	·		
Actuarial gain recognised in the statement of	42 502	D 500	20.240
comprehensive income	12,783	7,536	20,319
Cumulative actuarial losses	(14,201)	(21,520)	(35,721)
			<u> </u>

for the year ended 31 March 2016

### 23. Retirement benefit schemes (continued)

Reconciliation of defined benefit obligations:

	Pensions £000	Pensions £000	Total £000
2016			
Opening defined benefit obligations	166,627	111,154	277,781
Interest cost	5,112	3,415	8,527
Contributions by scheme participants	22	22	44
Actuarial gain	(8,928)	(6,521)	(15,449)
Benefits paid	(8,708)	(5,515)	(14,223)
Closing defined benefit obligations	154,125	102,555	256,680
2015			
Opening defined benefit obligations	160,473	103,091	263,564
Current service costs	701	955	1,656
Interest cost	6,600	4,237	10,837
Contributions by scheme participants	285	285	570
Actuarial gains	5,517	7,301	12,818
Benefits paid	(6,949)	(4,715)	(11,664)
Closing defined benefit obligations	166,627	111,154	277,781
Reconciliation of fair value of plans' assets:			
Reconciliation of fair value of plans assets.			
	SEW	MKW	
	Pensions	Pensions	Total
	£000	£000	£000
2016			
Opening fair values of schemes' assets	156,844	113,948	270,792
Interest income on assets	4,850	3,513	8,363
Return on scheme assets excluding interest income	(3,292)	(1,036)	(4,328)
Contributions by scheme participants	22	22	44
Contributions by employer Administrative expenses	3,615	1,131 (505)	4,746 (1,177)
Benefits paid	(672) (8,708)	(5,515)	(14,223)
·			
Closing fair values of schemes' assets	152,659	111,558	264,217
2015	400.007	0.7.00.7	222.224
Opening fair values of schemes' assets	133,097	97,237	230,334
Interest income on assets Contributions by scheme participants	5,600 18,301	4,046 14,836	9,646 33,137
Contributions by scheme participants  Contributions by employer	285	14,636 285	570
Actuarial gains	7,156	2,638	9,794
Administrative expenses	(646)	(379)	(1,025)
Benefits paid	(6,949)	(4,715)	(11,664)
Closing fair values of schemes' assets	156,844	113,948	270,792
5.55g fair values of sofferines assets		110,040	_,,,,,_

SEW

MKW

### Notes to the financial statements

for the year ended 31 March 2016

### 23. Retirement benefit schemes (continued)

The five year history of the schemes is as follows:

Year ended 31 March 2016	2016 £000	2015 £000	2014 £000	2013 £000	2012 £000
SEW Pensions Fair value of scheme assets Present value of defined benefit obligation	152,659 (154,125)	156,844 (166,627)	133,097 (160,473)	130,177 (163,348)	116,985 (146,068)
Deficit in the scheme	(1,466)	(9,783)	(27,376)	(33,171)	(29,083)
Experience adjustment on schemes' assets: Amount Percentage of scheme's assets (%)	1,558 1.0%	18,108 11.5%	(3,378) (2.5)%	5,948 4.6%	387 0.3%
Experience adjustments on schemes' liabilities: Amount Percentage of the scheme's liabilities (%)	(8,928) (5.8)%	1,400 0.8%	- -	(200) (0.1)%	- -
MKW Pensions Fair value of plan assets Present value of defined benefit obligation	111,558 (102,555)	113,948 (111,154)	97,237 (103,091)	96,374 (104,566)	89,149 (103,611)
Surplus/(deficit) in the scheme	9,003	2,794	(5,854)	(8,192)	(14,462)
Experience adjustment on schemes' assets: Amount Percentage of scheme's assets (%)	2,477 2.2%	14,813 13.0%	(1,447) (1.5)%	4,694 4.9%	726 0.8%
Experience adjustments on schemes' liabilities: Amount Percentage of the scheme's liabilities (%)	(6,521) (6.4)%	(2,903) (2.6)%	-	(11,500) (11.0)%	- -

The surplus on the Mid Kent Water Pension Scheme has been recognised in the above tables, despite there being no explicit agreement for the Group to recover the surplus, as permitted under IAS 19(R) Employee Benefits.

### 24. Deferred income

Group and Company	2016 £000	2015 £000
As at 1 April Received in the year Released during the year	67,466 13,272 (8,302)	63,450 12,542 (8,526)
As at 31 March	72,436	67,466
Non-current Current	65,633 6,803	61,876 5,590
	72,436	67,466

Amounts received towards above ground assets are released to the income statement over the period to which they are deemed to relate. Contributions received towards below ground assets are released to the income statement over the period that corresponds to the life of the asset to which the contribution relates, which is typically 100 years.

for the year ended 31 March 2016

#### 25. Issued share capital

Group and Company	2016 £000	2015 £000
Allotted, issued, called up and fully paid 49,312,354 ordinary shares of £1 each (2014: 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 2016 (2015: £100 million).

### 26. Cash flow from operating activities

	Group		Com	pany
	2016	2015	2016	2015
	£000	£000	£000	£000
Profit for the year	46,479	31,273	46,438	31,229
Adjustments for: Income tax expense Finance income Finance costs Depreciation and impairment of property, plant and equipment Amortisation and impairment of intangibles Profit on disposal of fixed assets Difference between pension contributions paid and amounts recognised in the income statement	(4,043)	4,012	(4,053)	4,001
	(5,122)	(5,127)	(5,112)	(5,109)
	37,458	49,526	37,501	49,565
	42,776	42,923	42,776	42,923
	2,973	2,841	2,973	2,841
	(70)	89	(70)	89
	(3,626)	(7,113)	(3,626)	(7,113)
Changes in working capital: Increase in trade and other receivables Decrease/(increase) in inventory Increase in trade and other payables	(1,002)	(2,230)	(1,002)	(2,230)
	60	22	60	22
	4,299	3,278	4,299	3,278
Net cash flow from operating activities	120,182	119,494	120,184	119,496

### 27. Capital Commitments

Group and Company	2016 £000	2015 £000
Contracts placed for future capital expenditure not provided in the financial statements	31,672	38,004
28. Obligations under operating leases		
Group and Company	2016 £000	2015 £000
Minimum lease payments under operating leases recognised as an expense in the year (see note 5)	584	534

### Notes to the financial statements

for the year ended 31 March 2016

#### 28. Obligations under operating leases (continued)

Future minimum lease payments under non-cancellable operating leases are as follows:

Group and Company	Land and buildings 2016 £000	Land and buildings 2015 £000
Amounts for the following periods: - within one year - in the first to second - in the second to fifth years - after five years	190 195 585 2,730	363 - 770 2,925
	3,700	4,058

A heads of terms agreement for the lease of the new laboratory was entered into on 30 June 2014. The contract, which is expected to run for a term of 20 years, was signed in May 2015. The rental on the lease is £185,000 per annum.

#### 29. Group related party transactions

The Group's joint ultimate holding companies are Utilities of Australia Pty Ltd as Trustee for the Utilities Trust of Australia, which is resident in Australia, and Caisse de dépôt et placement du Québec and Desjardin Employees' Pension Fund, which are resident in Canada. It is the directors' belief that they control the Group jointly.

The group of companies into which results of the Group are consolidated is that headed by HDF (UK) Holdings Ltd, a company registered in England and Wales. The consolidated financial statements of HDF (UK) Holdings Ltd 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 South East Water (Holdings) Ltd of £190 million (2015: £190 million) is disclosed in note 15 under non-current receivables. Loan interest receivable during the year was £4.9 million (2015: £4.8 million). There was no interest outstanding as at 31 March 2016 (2015: £nil) included under trade and other receivables in note 17.

Also, as at 31 March 2016 the Group has a current account debt due to its parent company of £8.0 million (2015: £8.0 million) in respect of group tax relief payable.

### Transactions with other related parties

As at 31 March 2016 the Group has net current account balances due to other related parties totalling £2.0 million (2015: £2.21 million) all relating to group tax relief payable.

The Company has granted an unsecured loan to its immediate parent company as detailed above.

The Company has received loans totalling £716.5 million (2015: £714.6 million) on various terms from its subsidiary company as disclosed in note 19. Interest of £24.4 million (2015: £24.2 million) has been charged on these loans during the year. Interest outstanding on the loans at 31 March 2016 totalled £6.8 million (2015: £6.9 million).

At 31 March 2016, the Company also owed group tax relief to related parties, excluding its immediate parent company, totalling £2.0 million (2015: 1.1 million).

Key management compensation is disclosed in note 6.

Contributions to retirement benefit schemes are disclosed in note 23.

Across the company at every level there is a determined focus to achieve five-out-of-five and commitment that ensures every customer counts

# Pure know how

### **Annual Performance Report**

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## **Regulatory Reporting**

**Annual Performance Report** 

### Introduction and Statements by Directors

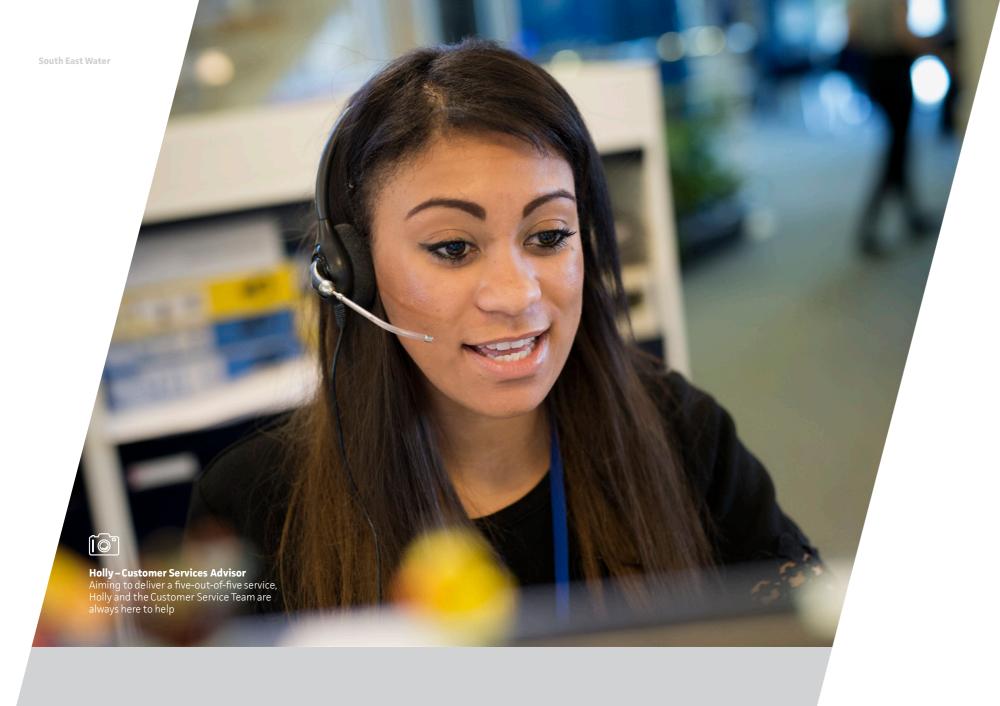
These accounts are prepared in accordance with Condition F of South East Water's instrument of appointment ("Licence") and in accordance with the latest regulatory accounting guidelines ("RAG") issued by Ofwat.

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 accounts 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 2016 (see page 77).

### Directors' remuneration and standards of performance

The directors' remuneration report on page 61 sets out the remuneration paid (or that became due) during the financial year to the directors of our company under arrangements linking the remuneration of directors to standards of performance in connection with the carrying out by South East Water of our 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. >



Our directors take all necessary steps to ensure they are aware of relevant audit information

Introduction and Statements by Directors (continued)

### Disclosure to auditor

The directors who were members of the board at the time of approving the annual performance report are listed on page 5. 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 South East Water'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 South East Water'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 conditions F6A.5A(f) and F6.12 of the Licence which provide that dividend must be in accordance with the dividend policy and must not impair the ability of South East Water 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.

Dividends paid in the year amounted to £9.0 million, of which £4.9 million was

used by our parent company South East Water (Holdings) Ltd to pay interest on a loan from South East Water.

#### **Accounting policies**

### Price 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 2.05. Where costs cover more than one price control unit, an appropriate basis of allocation consistent with the activities that cause the costs is used to allocate the costs to the relevant price control units.

Assets and associated depreciation are directly attributed to price control units that solely use the assets. Where assets are used by more than one price control unit, the assets are allocated to the price control unit where the principal use occurs with a recharge being made to other price control units using the asset 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's methodology statement which is available on our website.

Annual Report and Financial Statements / Annual Performance Report 2016 Regulatory Reporting

### Revenue recognition

The revenue recognition policy is the same in the regulatory and 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 in the methodology in calculating the measured income accrual in the year. A review was undertaken of the previous year's measured income accrual and there were no significant differences between the accrual and the amounts billed in the year.

The following applies in regards 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 with an application form to properties that are empty for over 21 days. If there is no response a further letter is 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 time spent. Other directly attributable costs are then assessed and costs relating to capital projects are capitalised into individual projects. Training costs, administration and other general overhead costs are not capitalised. Our policies have not changed during the year.

### Bad debt

The bad debt policy remains unchanged during the year.

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 and where the 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 and an assessment of current socio-economic conditions. We have no significant concentration of credit risk, with exposure spread over a large number of domestic and commercial customers.

#### **Condition K compliance**

The directors of South East Water confirm that, in their opinion, the company was in compliance with sub-paragraph 3.1 of Condition K of its Licence at the end of the financial year ended 31 March 2016 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.

### Diversification and protection of core business

In the opinion of the directors, the company will have available sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months from the date of signing the accounts, the regulated activities as defined in the Licence (including the investment programme) necessary to fulfil our obligations under the Licence.

In the opinion of the directors, the company will, for at least the next 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 us to carry out the regulated

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 appointee, to ensure that we are able to meet all our obligations as a water undertaker.

In providing this certificate, 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 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 assess the potential impact of risks; and
- The long term viability statement set out in the strategic report on page 39 and the going concern statement set out at page 72.

### Statement of directors' responsibilities

The directors are responsible under Condition F of the Licence for:

- Ensuring that proper accounting records are maintained by the appointee to enable compliance with the requirements of Condition F and having regard also to the terms of guidelines notified by Ofwat to the appointee from time to time
- Preparing regulatory financial statements on a consistent basis for

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

- Preparing financial statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued by Ofwat from time to time
- Preparing such other financial and related information as is required by Condition F having regard also to the terms of guidelines issued by Ofwat from time to time
- Ensuring that we maintain an investment grade credit rating (license condition F6A.6)

 Ensuring that we have 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 £2.7 million in profit before tax includes capitalised interest of £2.8 million and the removal of depreciation on capitalised interest of £0.1 million
- in the statement of financial position, cumulative capitalised interest less depreciation of £11.2 million has been excluded from fixed assets. Fixed assets also include an intercompany adjustment for compliance with RAG 5 relating to the year ended 31 March 2005

### **Transactions with associate companies**

Loans from associate companies

Associate	Interest	Loan period	2016 £000
South East Water (Finance) Limited	Index linked plus 0.01% margin fee	Repayable in September 2019	200,000
	Indexation		87,226
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	Repayable in December 2041	130,000
	Indexation		26,107
South East Water (Finance) Limited	Index linked plus 0.01% margin fee	Repayable in December 2037	100,000
	Indexation		7,153

#### Interest and fees payable to associate companies

Associate	Nature of transaction	Terms of supply	2016 £000
South East Water (Finance) Limited	Interest, RPI indexation and margin fees on intercompany loans (see below)	(See above)	26,260
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	234

### Loans to associate companies

Associate	Nature of transaction	Terms of supply	2016 £000
South East Water (Holdings) Limited	Interest on intercompany loans of £190 million	LIBOR plus 2%	4,908

To the best of the directors' knowledge, all appropriate transactions with associated companies have been disclosed in compliance with condition F and RAG 5.06.

### Taxation 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.

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 share owner value 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 resolving in a responsible manner.

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 20%, changing to 19% from 1 April 2017 and 18% from 1 April 2020. (2015: 20%).

For the year ended 31 March 2016 a UK corporation rate of 20% has been used as enacted by Finance Act 2013. The Finance (No.2) Act 2015, which was substantively enacted on 26 October 2015, provides for a reduction in the main rate of UK corporation tax to 19% effective from 1 April 2017 and 18% from 1 April 2020. These rate reductions have been reflected in the calculation of deferred tax. The rate is expected to further reduce to 17% from 1 April 2020, although this reduction was not substantively enacted at the balance sheet date.

The table below shows a comparison between the amount funded within the final determination (FD) and the tax charge within the regulatory accounts showing a small difference between the two of £247k.

### Tax reconciliation

	2012-13 Prices £000	2015-16 Prices £000
Final determination Indexation	2,600 0,157	
Final determination		2,757
Actual in regulatory accounts		3,004
Difference		247

#### The reconciliation of current appointed tax is as follows:

	2016 £000
Profit before tax	37,411
Taxation at 20%	7,482
Expenses not deductible	472
Capital allowance exceed depreciation	(3,182)
Prior year adjustment	96
Fair value of swap	(1,161)
Pension movements	(692)
Other	(11)
Current tax charge for the year	3,004

South East Water

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### 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. The data assurance that we have undertaken for the contents of the annual performance report section of the annual report covers all contents in our new Performance, People and Planet report.

Our governance and assurance process for the preparation of our annual performance report was 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 team, and heads of department and manager level sign off.

The assurance structure 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 is checked by a separate individual
- Manager review/sign off data and information is checked by the line manager responsible for the individual completing the submission

#### 2 امیرو ا

 Internal data and process audit – data validity is tested through taking a sample and verifying the data

- The methodology document is reviewed to ensure that the process and internal controls are complete and being followed
- External 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

#### 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

Annual reporting has a clear ownership structure with relevant 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 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 for the generation of the 2015-16 annual reporting. The audit and risk committee also scrutinised the annual performance report and related narrative and the risk and compliance statement. This committee reported to the Board before the Board approved the annual performance report and the risk and compliance statement.

A summary on the performance of the company in 2015-16 against ODIs including comments and recommendations received from Strategic Management Consultants (SMC) and Jacobs were reviewed by the committee. The committee and board also reviewed the draft annual performance report section of the Annual Report, the draft risk and compliance statement and the Performance, People and Planet reports. 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 F 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 SMC, Jacobs and from the company's auditors Deloitte.

SMC and 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.

In 2015-16 we appointed new assurance partner Jacobs and in this year there is a transition phase with a combination of SMC and Jacobs undertaking audits. We undertook half year audits for all areas being audited by Jacobs. This provided us with additional assurance around the robustness of our internal processes and the information that we provide to our stakeholders. We will undertake the same approach for the remaining areas which will be transferred in 2016-17.

SMC and Jacobs have reviewed all of our performance commitments and the following annual performance report tables:

- · 2C operating cost analysis for the 12 months ended 31 March 2016 - retail
- · 3A outcome performance table
- 4A non-financial information for the 12 months ended 31 March 2016
- · 4B wholesale totex analysis
- 4C forecast impact of performance on RCV
- 4D totex analysis for the 12 months ended 31 March 2016 - wholesale water
- 4F operating cost analysis for the 12 months ended 31 March 2016 – household retail

### Our customer panel

Following the last Ofwat price review, our customer challenge group was converted into a customer panel which comprises of an independent chair, residential and business customers plus representatives of the Consumer Council for Water, Environment Agency and charities.

The main aim of the customer panel is to monitor our performance against our outcomes during 2015 to 2020 and to provide challenge on our other business-as-usual activities.

Each quarter throughout 2015-16 we have provided our independent customer panel with a report on our outcome delivery incentive performance and we discuss the plans that we have in place to meet our commitments. At the end of 2015-16 we provided the customer panel with an in-depth report which explained how the outcomes are measured, the targets, how we have performed and the initiatives that we have undertaken and the plans that are in progress.

Our independent customer panel has produced its own annual report for 2015-16 which can be found at: southeastwater.co.uk/about-us/our-business/customer-panel/customer-panel-document-library

### Our on-going assurance

To ensure that we continue to report reliable, robust and complete information we will be producing an updated company monitoring framework and data assurance plan for 2016-17. This document sets out in detail:

- · How we assess risks
- · How we undertake assurance
- Published information we have included in this review
- · The outcomes we are targeting
- Our risk assessment
- · Engagement of stakeholders
- Strengths, risks and weaknesses statement
- Assurance plan

The findings from annual audits will be incorporated into the process of updating our company monitoring framework which will be published in summer/autumn 2016.

### 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

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.

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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].

**South East Water** 

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 deliver incentives. This review has not identified any material deviation from or non-compliance with these obligations in 2015-16. We will continue our efforts to improve the awareness of business units of the obligations they contribute to deliver and to further embed compliance within "business as usual" processes.

Our innovative approach on outcomes is based on customer satisfaction and we describe how we measure customer satisfaction in our strategic report. For further information about our customer satisfaction outcomes and the approach we have taken in 2015-16 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.

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 2016, and in making this statement we have taken account of the other statements made in compliance with our obligations under conditions F 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, its 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; and
- has appropriate systems and processes in place to allow it to identify, manage and review its risks.

Approved by the Board and signed on its behalf by:

### Nick Salmon

#### **Paul Butler**

Chairman 15 July 2016 Managing Director 15 July 2016

### To the Water Services Regulation Authority ("WSRA") and Directors of South East Water Limited

In our opinion, South East Water Limited's regulatory accounting statements within the annual performance report:

- fairly present in accordance with Condition F, the regulatory accounting guidelines issued by the WSRA (RAG1.06, RAG2.05, RAG3.08, RAG4.05 and RAG5.06) and the accounting policies set out on page 135 (including the accounting separation methodology), the state of the Company's affairs at 31 March 2016 and its profit and cash flow for the year then ended; and
- have been properly prepared in accordance with Condition F, the regulatory accounting guidelines and the accounting policies (including the accounting separation methodology)

### Basis of preparation

Financial information other than that prepared on the basis of International Financial Reporting Standards as adopted by the European Union ("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 annual performance report is separate from the statutory financial statements of South East Water Limited and has not been prepared under the basis of IFRSs.

In forming our opinion on the regulatory accounting statements within the annual performance report, which is not modified, we draw attention to the fact that the annual performance report has been prepared in accordance with Condition F, the regulatory accounting guidelines, the accounting policies (including the accounting separation

methodology) set out in the statement of accounting policies and under the historical cost convention.

The regulatory accounting statements on pages 145 to 154 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 (GAAP) in the company's statutory financial statements is included in the tables on page 145 to 147.

#### What we have audited

The tables within South East Water Limited's annual performance report that we have audited ("the regulatory accounting statements") 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) and the net debt analysis (table 1E) and the related notes: and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of capital contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G) and the revenue analysis by customer type (table 21) and the related notes on pages 148 to 154

The financial reporting framework that has been applied in their preparation comprises the basis of preparation and accounting policies set out in the notes to the annual performance report.

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

We have not audited the Outcome performance table (table 3A) and the additional regulatory information in tables 4A to 4I.

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 WRSA, for our audit work, for this report or for the opinions we have formed.

### Respective responsibilities of the WSRA, the directors and auditors

As explained more fully in the statement of directors' responsibilities set out on page 137, the directors are responsible for the preparation of the annual performance report and for their fair presentation in accordance with the basis of preparation and accounting policies.

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142 (including the accounting separation performance report

Our responsibility is to audit and express an opinion on the regulatory accounting statements within the annual performance report in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"), except as stated in the section on 'What an audit of the annual performance report involves' below, and having regard to the quidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities' issued by the Institute of Chartered Accountants in England and Wales. Those standards require us to comply with the Auditing Practices Board's ethical standards for auditors.

### What an audit of the regulatory accounting statements involves

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

We have not assessed whether the accounting policies are appropriate to the circumstances of the company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the annual performance report are consistent with those used in the preparation of the statutory financial statements of the company. Furthermore, as the nature, form and content of annual performance report is determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under ISAs (UK & Ireland).

The company has presented the allocation of operating costs and assets in accordance with the accounting separation policy set out in its accounting separation methodology statement published on the company's website on 15 July 2016. 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, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

### 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.

#### Other matters

The nature, form and content of the annual performance report is 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 WRSA's purposes. Accordingly we make no such assessment.

Our opinion on the regulatory accounting statements within the annual performance report is separate from our opinion on the statutory financial statements of the company for the year ended 31 March 2016 on which we reported on 15 July 2016, 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

Chartered Accountants and Statutory Auditors London, United Kingdom 15 July 2016 The following tables are set out following the order defined in Appendix 1 of the regulatory accounting guidance 3.08.

### Financial performance

for the 12 months ended 31 March 2016

		Adjustments			
1A-Income statement	Statutory £000	Differences between statutory and RAG definitions £000	Non- appointed £000	Total adjustments £000	Total appointed activities £000
Revenue	214,430	5,992	5,168	824	215,254
Operating costs Other operating income	(146,123) 6,467	21 (6,397)	(2,733)	2,754 (6,397)	(143,369) 70
Operating profit Other income Interest income Interest expense Other interest expense	74,774 - 5,112 (37,501)	(384) 475 - (4,177) (164)	2,435 - - (126) -	(2,819) 475 - (4,051) (164)	71,955 475 5,112 (41,552) (164)
Profit before tax and fair value movements Fair value gains/(losses) on financial instruments	42,385	(4,250) 1,585	2,309	(6,559) 1,585	35,826 1,585
Profit before tax UK Corporation tax Deferred tax	42,385 (3,477) 7,530	(2,665) - -	2,309 (473) -	(4,974) 473 -	37,411 (3,004) 7,530
Profit for the year	46,438	(2,665)	1,836	(4,501)	41,937

		Adjustments			
1B - Statement of comprehensive income	Statutory £000	Differences between statutory and RAG definitions £000	Non- appointed £000	Total adjustments £000	Total appointed activities £000
Profit for the year	46,438	(2,665)	1,836	(4,501)	41,937
Actuarial gains/(losses) on post-employment plans Other comprehensive income	8,389	- -	- -	- -	8,389 -
Total comprehensive income for the year	54,827	(2,665)	1,836	(4,501)	50,326

The difference between statutory accounts and RAG definitions for total comprehensive income relates to interest capitalised for the year of £2.8 million less depreciation on cumulative capitalised interest of £0.01 million.

# Financial performance

for the 12 months ended 31 March 2016

			Adjustments		
1C - Statement of financial position	Statutory £000	Differences between statutory and RAG definitions £000	Non- appointed £000	Total adjustments £000	Total appointed activities £000
Non-current assets Fixed assets Intangible assets Investments - loans to group companies Investments - other Financial instruments Retirement benefit assets	1,412,184 11,046 190,013 - - 9,003	(1,918) (11,046) - - - -	- - - - -	(1,918) (11,046) - - -	1,410,266 - 190,013 - - 9,003
Total non-current assets	1,622,246	(12,964)	-	(12,964)	1,609,282
Current assets Inventories Trade & other receivables Financial instruments Cash & cash equivalents	185 66,085 - 16,360	- - - -	- 495 - -	(495) - -	185 65,590 - 16,360
Total current assets	82,630	-	495	(495)	82,135
Current liabilities Trade & other payables Capex creditor Borrowings Financial instruments Current tax liabilities	(64,652) (20,775) - -	- - - -	(495) - - - -	495 - - - -	(64,157) (20,775) - - -
Provisions	(10,637)	-	-	-	(10,637)
Total current liabilities	(96,064)	-	(495)	495	(95,569)
Net current assets/(liabilities)	(13,434)	-	-	-	(13,434)
Non-current liabilities Trade & other payables Borrowings Financial instruments Retirement benefit obligations Provisions Deferred income - G&C's Preference share capital Deferred tax	(2,589) (869,880) (87,226) (1,466) - (65,633) - (140,566)	- - - - -	- - - - - -	- - - - - -	(2,589) (869,880) (87,226) (1,466) - (65,633) - (140,566)
Total	(1,167,360)			_	(1,167,360)
Net assets	441,452	(12,964)		(12,964)	428,488
<b>Equity</b> Called up share capital Retained earnings & other reserves	49,312 392,140	(12,964)	-	(12,964)	49,312 379,176
Total equity	441,452	(12,964)	-	(12,964)	428,488

# Financial performance

for the 12 months ended 31 March 2016

The difference between statutory accounts and RAG definitions for fixed assets is:

	£000
Capitalised interest Depreciation on capitalised interest Historic RAG 5 intercompany adjustment	(11,387) 194 (1,771)
Sub-total Computer software transferred from intangible asset	(12,964) 11,046
	(1,918)

Under IFRS, computer software is recorded as an intangible asset in the statutory accounts. However, Ofwat require that computer software is reported as part of tangible fixed assets, hence the entire intangible balance of £11.0 million in the statutory accounts has been restated under tangible fixed assets in the above table.

1D-Statement of cash flows	Statutory £000	Differences between statutory and RAG definitions £000	Non- appointed £000	Total adjustments £000	Total appointed activities £000
Operating profit	74,774	(384)	2,435	(2,819)	71,955
Other income Depreciation Amortisation - G&C's Changes in working capital Pension contributions Movement in provisions Loss on sale of fixed assets	45,749 - 3,357 (3,626) - (70)	475 (91) (1,132) (4,674) (3,192) 8,998	- - - - -	475 (91) (1,132) (4,674) (3,192) 8,998	475 45,658 (1,132) (1,317) (6,818) 8,998 (70)
Cash generated from operations Net interest paid Tax paid	120,184 (30,136) (2,500)	-	2,435 (126) (473)	(2,435) 126 473	117,749 (30,010) (2,027)
Net cash generated from operating activities	87,548	-	1,836	(1,836)	85,712
Investing activities Capital expenditure Grants & contributions Disposal of fixed assets Other	(91,582) 878 142	- - - -	- - - -	- - - -	(91,582) 878 142
Net cash used in investing activities	(90,562)	-	-	-	(90,562)
Net cash generated before financing activities	(3,014)	-	1,836	(1,836)	(4,850)
Cash flows from financing activities Equity dividends paid Net loans received Cash inflow from equity financing	(9,000) (9) -	- - -	(1,836) - -	1,836 - -	(7,164) (9)
Net cash generated from financing activities	(9,009)	-	(1,836)	1,836	(7,173)
Increase/(decrease) in net cash	(12,023)	-	-	-	(12,023)

# 1E - Net debt analysis

at 31 March 2016

Interest rate risk profile	Fixed rate £000	Floating rate £000	Index linked £000	Total £000
Borrowings (excluding preference shares) Preference share capital	(166,991)	-	(792,514)	(959,505)
Total borrowings Cash Short-term deposits				(959,505) 5,460 10,900
Net Debt				(943,145)
Gearing (%) Adjusted Gearing			-	80.85
Full year equivalent nominal interest cost Full year equivalent cash interest payment	9,309 9,309	-	24,167 23,757	33,476 33,066
Indicative interest rates Indicative weighted average nominal interest rate (%) Indicative weighted average cash interest rate (%)	5.57 5.57	- -	3.05 3.00	3.49 3.45

# 2A - Segmental income statement

for the 12 months ended 31 March 2016

	Retail		Wholesale	Total
	Household £000	Non- household £000	Water £000	£000
Revenue - price control Revenue - non-price control Operating costs Other operating income	19,854 - (17,420) -	3,867 - (2,289) -	185,067 6,466 (123,660) 70	208,788 6,466 (143,369) 70
Operating profit before recharges Recharges from other segments Recharges to other segments	2,434 (142)	1,578 (13)	67,943 - 155	71,955 (155) 155
Operating profit	2,292	1,565	68,098	71,955

# 2B - Totex analysis

for the 12 months ended 31 March 2016 - wholesale water

	Water £000
Operating expenditure Power Income treated as negative expenditure Service charges/discharge consents Bulk supply/bulk discharge Other operating expenditure Local authority rates	16,130 - 2,964 4,822 40,273 14,637
Total operating expenditure excluding third party services Third party services	78,826 356
Total operating expenditure	79,182
Capital expenditure  Maintaining the long-term capability of the assets - infra  Maintaining the long-term capability of the assets - non-infra  Other capital expenditure - infra  Other capital expenditure - non-infra	13,302 18,499 38,667 13,479
Total gross capital expenditure (excluding third party) Third party services	83,947
Total gross capital expenditure	83,947
Grants and contributions (price control)	(10,308)
Totex	152,821
Cash expenditure Pension deficit recovery payments Other cash items	2,959
Totex including cash items	155,780

### 2C - Operating cost analysis

for the 12 months ended 31 March 2016 - retail

#### Household

Overall expenditure for household retail is below equivalent final determination (FD) expectations, with total operating costs (excluding third party services) at £17.4m, versus an FD of £18.6m. This has largely been achieved by maintaining customer service costs at 2013-14 levels despite an increasing measured customer base due to our metering programme. We have also reduced support costs for retail, as well as a reduction in doubtful debt, which reflects a successful year in cash collections allowing the release of amounts previously provided. Subsequently given the increased measured customer base we now calculate our measured cost to serve at £21.81, compared to FD target of £24.28. It should be noted we have updated our divisible customer numbers from our annual performance report (table RA3), whereas customer numbers for PR14 were using WRMP forecast. Unmeasured cost to serve, however, remains above FD expectations at £18.12 versus £17.54, but is a consequence of updated customer numbers.

#### Non-household

Overall expenditure for non-household retail tracks well against FD expectations, at £2.29m versus £2.26m respectively. As per household we have largely retained customer service costs at 2013-14 levels. We note that doubtful debts has lowered from our 2013-14 position due to the successful cash collections in the year allowing previously provided amounts to be released. Conversely, a notable increase in expenditure is due to developer service costs where we now include cost relating to administrative and contact activity with the customer (developer), as per RAG guidance.

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	Household £000	household £000	Total £000
Operating expenditure			
Customer services	5,505	670	6,175
Debt management	1,649	403	2,052
Doubtful debts	2,905	195	3,100
Meter reading	1,010	96	1,106
Service to developers	-	354	354
Other operating expenditure	6,209	558	6,767
Total operating expenditure excluding third party services	17,278	2,276	19,554
Third party services operating expenditure		-	-
Total operating expenditure	17,278	2,276	19,554
Depreciation	142	13	155
Total operating costs	17,420	2,289	19,709
Debt written off	1,888	336	2,224

### 2D - Historic cost analysis of fixed assets

wholesale & retail

	Wholesale		Retail	Total
	Water £000	Household £000	Non- household £000	£000
Cost At 1 April 2015 Disposals Additions	1,412,065 (3,078) 83,948	1,750 (91) 2,117	558 (6) 390	1,414,373 (3,175) 86,455
At 31 March 2016	1,492,935	3,776	942	1,497,653
<b>Depreciation</b> At 1 April 2015 Disposals Charge for the year	(44,677) 3,013 (45,503)	(141) 84 (142)	(14) 6 (13)	(44,832) 3,103 (45,658)
At 31 March 2016	(87,167)	(199)	(21)	(87,387)
Net book value at 31 March 2016	1,405,768	3,577	921	1,410,266
Net book value at 1 April 2015	1,367,388	1,609	544	1,369,541

The net book value includes £95.2 million in respect of assets in the course of construction.

# 2E - Analysis of capital contributions and land sales

for the 12 months ended 31 March 2016 - wholesale

		Capitalised		
	Fully	and		
	recognised	amortised	Fully	
	in income	against	netted off	
	statement	depreciation	capex	Total
	£000	£000	£000	£000
Grants and contributions - water				
Connection charges				
(s45)	2,070	3,187	-	5,257
Infrastructure charge receipts (s146)	3,582	-	-	3,582
Requisitioned mains				
(s43,s55 & s56)	-	1,469	-	1,469
Diversions	-	549	-	549
Other contributions		-	_	_
Total	5,652	5,205	-	10,857

	Water £000
Balance sheet	
Brought forward	62,692
Capitalised in the year	5,205
Amortisation (in income statement)	(1,132)
Carried forward	66,765
<b>Land sales</b> Proceeds from disposal of protected land	7

### 2F - Household

revenues by customer type

	Wholesale charges revenue £000	Retail revenue £000	Total revenue £000	Number of customers £000	Average household retail revenue per customers £
Unmeasured water only customers	50,732	4,142	54,874	229,353	18.059
Measured water only customer	87,893	15,712	103,605	608,069	25.839
Total	138,625	19,854	158,479	837,422	23.708

### 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 £
Default tariffs					
Metered and unmetered over 250 Mla	334	8	342	11	727.27
Metered 50 to 250 Mla	3,954	98	4,052	91	1,076.92
Metered 10 to 50 Mla	6,824	156	6,980	423	368.79
Metered 5 to 10 Mla	6,393	359	6,752	1,980	181.31
Metered 0 to 5 Mla	27,114	3,091	30,205	48,171	64.17
Unmetered	1,823	155	1,978	2,779	55.78
Total default tariffs	46.442	3.867	50.309	53455	72.34

### 2I - Revenue analysis

for the 12 months ended 31 March 2016

The wholesale revenue for 2015/16 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 2015/16.

The table below reconciles the allowed and actual wholesale revenues.

	£000
Allowed revenue for the year	197,112
Reduction due to lower consumption	(1,905)
Reduction due to mix of properties	(2,463)
Increase due to new connections	1,330
Increase due to infrastructure income	1,161
Increase due to capital contributions	140
Actual revenue for the year	195,375

### 21 - Revenue analysis (continued)

for the 12 months ended 31 March 2016

In future years we would not anticipate to have a revenue variance due to a different mix of property figures as experienced this year. However, 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 seem in future years.

	Household £000	Non-household £000	Total £
Wholesale charge - water Unmeasured Measured Third party revenue	50,732 87,893	1,823 44,619 -	52,555 132,512 -
Wholesale total	138,625	46,442	185,067
Retail revenue Unmeasured Measured Other third party revenue	4,142 15,712	155 3,712 -	4,297 19,424 -
Retail total	19,854	3,867	23,721
Third party revenue - non-price control Bulk supplies Other third party revenue Other appointed revenue			- 312 6,154
Total appointee revenue			215,254
	Water £000		
Wholesale revenue governed by price control	185,067		
Grants & contributions	10,308		
Total revenue governed by wholesale price control	195,375		
Amount assumed in wholesale determination	197,112		
 Difference	(1,737)		

In the above revenue analysis, the amount of £6.2 million reported under "Other appointed revenue" includes infrastructure receipts of £3.6 million. This income is a price control item but is included with the non-price control income to ensure completeness of the reported "Total appointee revenue".

### 3A - Performance summary

The following table shows the performance against the company's 25 outcomes for 2015-16.

#### 2014-15 performance

For outcomes that are new this price review period or the methodology is different, the performance shows as 'not applicable'.

#### 2015-16 performance

For commentary on our performance for the year please see our Performance, People and Planet report. Our performance commitment O2: We will monitor our abstraction at low flows at environmentally sensitive sites (in line with abstraction incentive mechanism (AIM)) is 'not applicable' due to the fact the guidance did not come into effect until April 2016, therefore reporting of this outcome will start in 2016-17.

#### 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.

#### 2015-16 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.

### Notional reward or penalty accrued at 31 March 2016 and £m absolute value

Where in year performance is better than target and above the reward deadband 'reward' 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 penalty deadband '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 'reward deadband' or 'penalty deadband' is selected, the adjacent column is then blank.

For service incentive mechanism (SIM) its reward or 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 ODI 'Not applicable' has been selected and the adjacent column is blank.

### Total AMP6 reward or penalty 31 March 2020 forecast

We are forecasting to hit are targets for the remainder of the AMP with no further reward or penalty. Our performance in interruptions this year has seen us hit our maximum penalty of £0.931m, this was due to one large incident that affected customers for nearly two days, this accounts for 23.01 minutes (72%) of our performance. Following the incident a review was undertaken, a lesson learnt document was produced with new procedures and initiatives being introduced to help mitigate the impact to customers should another event happen in the future.

We received a £0.846m reward due to outperforming our leakage target. This has been achieved by significant improvements in our performance across 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 received a £0.002m reward due to reducing the number of properties at risk of low pressure in our region due to continual investment in schemes which will affect these properties.

# 3A - Performance summary (continued)

Unique ID	Performance commitment	2014-15 performance level - actual	2015-16 performance level - actual	2015-16 CPLmet?	2015-16 reward or penalty (in-period ODIs)	Notional reward or penalty accrued at 31 March 2016	Notional reward or penalty accrued at 31 March 2016 £m absolute value	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m absolute value
PR14SEWWSW_A1	A1: Customer satisfaction - appearance of water	Not applicable	4.400	No	Blank	Not applicable		Not applicable	
PR14SEWWSW_B1	B1: Customer satisfaction - taste and odour of water	Not applicable	4.100	No	Blank	Not applicable		Not applicable	
PR14SEWWSW_C1	C1: Customer satisfaction - level of leakage	Not applicable	3.400	No	Blank	Not applicable		Not applicable	
PR14SEWWSW_C2	C2: Leakage (actual reported leakage per MI/d per year)	92.450	88.110	Yes	Blank	Reward	0.846266	Reward	0.846266
PR14SEWWSW_D1	D1: Customer satisfaction - direct interaction experience	Not applicable	4.200	No	Blank	Not applicable		Not applicable	
PR14SEWWSW_D2	D2: Service Incentive Mechanism (SIM)	Not applicable	81,950	Blank	Blank	Blank		Blank	
PR14SEWWSW_E1	E1: Customer satisfaction - bills are value for money and affordable	Not applicable	71.000	Blank	Blank	Not applicable		Not applicable	
PR14SEWWSW_F1	F1: Customer satisfaction - water supply is of sufficient pressure	Not applicable	4.200	No	Blank	Not applicable		Not applicable	
PR14SEWWSW_F2	F2: Number of properties at risk of low pressure, as recorded on the DG2 register	60.000	53.000	Yes	Blank	Reward	0.002000	Reward	0.002000
PR14SEWWSW_G1	G1: Customer satisfaction - frequency and duration of supply interruptions	Not applicable	4.600	No	Blank	Not applicable		Not applicable	
PR14SEWWSW_G2	G2: Average time lost per property (measured in minutes, per property served)	Not applicable	32.050	No	Blank	Penalty	-0.931840	Penalty	-0.931840
PR14SEWWSW_H1	H1: Customer satisfaction - frequency of water use restrictions	Not applicable	4.200	Yes	Blank	Not applicable		Not applicable	
PR14SEWWSW_H2	H2: Meeting the water resource deficit	Not applicable	0.000	Yes	Blank	Not applicable		Not applicable	

# 3A - Performance summary (continued)

Unique ID	Performance commitment	2014-15 performance level - actual	2015-16 performance level - actual	2015-16 CPLmet?	2015-16 reward or penalty (in-period ODIs)	Notional reward or penalty accrued at 31 March 2016	Notional reward or Total penalty AMP6 accrued at reward or 31 March 2016 31 March £m absolute value forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m absolute value
PR14SEWWSW_I1	I1: Mean zonal compliance (MZC)	99.960	99.960	No	Blank	Penalty deadband	Penalty deadband	
PR14SEWWSW_J1	J1: Number of breaches of abstraction licences, discharge consents and environmental permits	Not applicable	25.000	Yes	Blank	Not applicable	Not applicable	
PR14SEWWSW_J2	J2: Number of pollution incidents (category 1-2)	Not applicable	0.000	Yes	Blank	Not applicable	Not applicable	
PR14SEWWSW_K1	K1: Number of breaches of health and safety regulations, as defined by the Health and Safety Executive	Not applicable	0.000	Yes	Blank	Not applicable	Not applicable	
PR14SEWWSW_L1	L1: Number of breaches of National Security obligations (Security and Emergency Measures Direction)	Not applicable	0.000	Yes	Blank	Not applicable	Not applicable	
PR14SEWWSW_M1	M1: Number of compliance breaches with statutory obligations and licence conditions, not already reported in performance on outcomes I through to K	Not applicable	0.000	Yes	Blank	Not applicable	Not applicable	
PR14SEWWSW_N1	N1: Discolouration contacts	1.190	0.980	No	Blank	Penalty deadband	Penalty deadband	
PR14SEWWSW_N2	N2:Above ground asset performance assessment	Stable	Stable	Yes	Blank	Not applicable	Not applicable	
PR14SEWWSW_N3	N3: Number of company sites at risk of flooding	Not applicable	55.000	Blank	Blank	Not applicable	Not applicable	
PR14SEWWSW_N4	N4: Water mains bursts	2,372.000	2,307.000	Yes	Blank	Blank	Blank	
PR14SEWWSW_01	O1: Kg of carbon emissions per customer per year	Not applicable	36.800	Blank	Blank	Not applicable	Not applicable	

### 3A - Performance summary (continued)

Unique ID	Performance commitment	2014-15 performance level - actual	2015-16 performance level - actual	2015-16 CPLmet?	2015-16 reward or penalty (in-period ODIs)	Notional reward or penalty accrued at 31 March 2016	Notional reward or penalty accrued at 31 March 2016 £m absolute value	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m absolute value
PR14SEWWSW_02	O2: We will monitor our abstractions at low flows at environmentally sensitive sites (in line with AIM)	Not applicable	Not applicable	Blank	Blank	Not applicable		Not applicable	
PR14SEWHHR_A1	A1: Customer satisfaction - appearance of water	Not applicable	4.400	No	Blank	Not applicable		Not applicable	
PR14SEWHHR_B1	B1: Customer satisfaction - taste and odour of water	Not applicable	4.100	No	Blank	Not applicable		Not applicable	
PR14SEWHHR_C1	C1: Customer satisfaction - level of leakage	Not applicable	3.400	No	Blank	Not applicable		Not applicable	
PR14SEWHHR_D1	D1: Customer satisfaction - direct interaction experience	Not applicable	4.200	No	Blank	Not applicable		Not applicable	
PR14SEWHHR_D2	D2: Service Incentive Mechanism (SIM)	Not applicable	81.950	Blank	Blank	Blank		Blank	
PR14SEWHHR_E1	E1: Customer satisfaction - bills are value for money and affordable	Not applicable	71.000	Blank	Blank	Not applicable		Not applicable	
PR14SEWHHR_F1	F1: Customer satisfaction - water supply is of sufficient pressure	Not applicable	4.200	No	Blank	Not applicable		Not applicable	
PR14SEWHHR_G1	G1: Customer satisfaction - frequency and duration of supply interruptions	Not applicable	4.600	No	Blank	Not applicable		Not applicable	
PR14SEWHHR_H1	H1: Customer satisfaction - frequency of water use restrictions	Not applicable	4.200	Yes	Blank	Not applicable		Not applicable	

### 4A - Non-financial information

for 12 months ended 31 March 2016

Retail - household	Unmeasured £000	Measured £000
Number of households billed ('000s)		
Water only connections	229,353	608,069
Number of void households ('000s)	6,804	10,499
Per capita consumption (excluding supply pipe leakage) I/h/d	163,018	159,704
Wholesale		Water
Volume (MI/d)	_	
Bulk supply export		2,119
Bulk supply import	_	34,021
Distribution import	_	534,237

# 4B - Wholesale totex analysis

At the start of the new regulatory period we set up a new integrated team, representing our assets, operations and engineering delivery functions, with the aim of identifying opportunities for efficiency within the programme by either:

- Providing earlier information to our construction partners so they can plan their resources
- · Identifying innovation
- · Reviewing scope

To date the team has identified a potential range of savings across the AMP. The most significant of these is a security of supply index scheme, set out in our Water Resources Management Plan, for increasing the deployable output of one of our key sites. The team identified £1.6m of efficiencies in Year 1 on this scheme while still delivering the required outputs.

Other efficiencies included:

- · We have developed a new leakage strategy and have successfully delivered this programme for £0.1m less than expected
- · Changing our district metered area metering policy so that we can improve operability but lower the cost of our programme (£0.3m)
- Incentivising our contractors to improve overall delivery efficiency with our "above ground" contractors (£0.4m)

	Water £000
Actual totex Menu totex	151,916
Items excluded from the menu Pension deficit recovery payments Third party costs Other adjustments	2,959 356 549
Total costs excluded from the menu	3,864
<b>Actual totex</b>	155,780
Actual totex - base year prices	146,918
Allowed totex - base year prices	150,800

### 4C - Forecast impact of performance on RCV

#### Table content summary

This table tracks year on year changes to the regulated 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	RCV determined at FD	RCV at 31 March 2016 as reported in Table A2.9 of SEW's FD company specific appendix (p28). £1,093.2m (2012-13 av prices RPI = 244.7) This is inflated to March 16 prices using the issued RPI of 261.1.
2	RCV element of Totex over/underspend	This line is calculated as the difference between the actual totex and the baseline totex (inflated to current year prices using the actual RPI used in the calculation of line 1. This difference in totex is multiplied by (1-FD PAYG%) in order to calculate the RCV element of totex.  Note that the actual totex and baseline totex are compared in the same price base (March-16 prices as specified by table guidance).  Actual totex (menu) is net of any disallowables (eg pension contributions) is from Table 4B line 1 and is on a consistent basis with the FD baseline totex.  The source and choice of PAYG ratio is discussed in the following section.
3	Allowance (Rewards/penalties - ODI	There are no projected ODI adjustments to the RCV for 2015-16.

### Table completion methodology discussion

The line definitions specify that the RCV is to be inflated to March 2016 using the March RPI. This reports the RCV at a 'year end' position.

The line definitions for line 2 refer to the difference between actual totex and baseline totex. It is our view (and that of our external assurance) that this difference should be calculated using menu totex, which is net of excluded items that are not considered valid for going through to the cost sharing mechanism with customers. We have calculated this difference using the menu totex from the Table 4B line 1.

The line definitions also specify that the difference between the actual totex and the baseline totex should also be calculated using the actual RPI as for the calculation of Line 1. This places the baseline totex at March 16 'year end' prices whereas the actual totex is reported in Table 2B as 2015-16 'year average' prices. In order to be at a consistent price base for calculating the difference between allowed and actual totex, the actual totex also needs to be inflated from 2015-16 average prices to Mar-16 year end prices.

There are three possible sources of FD Pay as you go (PAYG) per cent. There is the year by year PAYG ratio reported in Table A2.5 of SEW's FD company specific appendix (p26). FD Table A2.5 South East Water's wholesale water PAYG rates (p26)

### 4C - Forecast impact of performance on RCV

2015-16	2016-17	2017-18	2018-19	2019-20	Total
61.6%	58.2%	56.4%	59.7%	64.1%	60.0%

- There is also a single total (simple average) PAYG rate presented in this table
- The totex menu reconciliation model issued by Ofwat as part of the PR14 rulebook uses a weighted average PAYG ratio in its calculations of 59.9 per cent.

Ofwat has not specified which PAYG ratio is to be used. For the purposes of this table the in year PAYG ratio 61.6 *per cent* from the final determination has been used.

#### Table calculations

Line	Description	Unit	2015-16					
	Price base RPI index		2012-13 av 244.7	2015-16 av 259.433	Mar-16 y/e 261.1			
1	FD RCV	£m	1,093.200		1,166.575			
	Baseline Totex	£m	147.900		157.829			
	Actual Totex (Menu)	£m		151.916	152.892			
	Difference	£m			(4.936)			
	FD PAYG %	%			61.6%			
2	RCV element of Totex	£m			(1.896)			
3	ODI rewards/penalties	£m						
4	'Shadow' RCV	£m			1164,679			

#### Changes in methodology since prior years

This is the first year that ODIs and totex have been reported and the shadow RCV calculated.

### Risks to data accuracy and robustness

None.

	£000
RCV determined at FD RCV element of Totex over/underspend Allowance (Rewards/penalties - ODI)	1,166,575 (1,896)
Projected 'shadow' RCV	1,164,679

# 4D - Totex analysis

for the 12 months ended 31 March 2016 - wholesale water

	Water re	Water resources Raw water distri		Raw water distribution			
	Abstraction licences	Raw water abstraction	Raw water transport	Raw water storage	Water treatment	Treated water distribution	Total
	£000	£000	£000	£000	£000	£000	£000
Operating expenditure Power		4,248	68		9,419	2,395	16,130
Income treated as	-	4,240	-	-	5,415	2,333	10,130
negative expenditure Abstraction charges/	-	-	-	-	-	-	-
discharge consents Bulk supply/bulk	2,847	-	-	-	117	-	2,964
discharge Other operating	-	606	-	-	4,216	-	4,822
expenditure	6	3,387	155	4	11,452	25,269	40,273
Local authority rates		1,090	-	-	1,206	12,341	14,637
Total operating expenditure excluding	2.252	0.004	222		20.440	40.005	T0 000
third party services Third party services	2,853	9,331	223	-	26,410	40,005 356	78,826 356
Total operating expenditure	2,853	9,331	223	4	26,410	40,361	79,182
Capital expenditure Maintaining the long- term capability of the							
assets - infra Maintaining the long- term capability of the	-	63	17	-	421	12,801	13,302
assets - non-infra Other capital	-	1,567	46	-	12,246	4,640	18,499
expenditure - infra Other capital	-	2,074	3	-	209	36,381	38,667
expenditure - non-infra		2,230	18	-	6,698	4,533	13,479
Total gross capital expenditure (excluding							
third party) Third party services	-	5,934 -	84	-	19,574 -	58,355 -	83,947 -
Total gross capital expenditure		5,934	84	-	19,574	58,355	83,947
Grants and contributions	-	_	_	-	-	(10,308)	(10,308)
Totex	2,853	15,265	307	4	45,984	88,408	152,821

	Water resources		Raw water distribution				
	Abstraction licences	Raw water abstraction	Raw water transport	Raw water storage	Water treatment	Treated water distribution	Total
	£000	£000	£000	£000	£000	£000	£00
Totex	2,853	15,265	307	4	45,984	88,408	152,821
Cash expenditure Pensions deficit recovery payments Other cash items	2 -	419 -	- -	11	1,061	1,466	2,959
Totex including cash items	2,855	15,684	307	15	47,045	89,874	155,780

Unit cost information (operating expenditure)	Licenced volume a available Mls	Volume abstracted Mls	Volume transported Mls	Average Volume stored Tonnes	Distribution input from water treatment Tonnes	Distribution input volume M³
Volume	281,322	197,213	9,303,995.21	_	199,490,105.187	199,490,105.187
Unit cost (£/Ml)/ (£/Tonne)	10.14	47.314	0.024	_	0.132	0.202

# 4F - Operating cost analysis for the 12 months ended 31 March 2016 - household retail

	Household unmeasured water £000	Household measured water £000	Total
Operating expenditure			
Customer services	1,215	4,290	5,505
Debt management	452	1,197	1,649
Doubtful debts	796	2,109	2,905
Meter reading	-	1,010	1,010
Other operating expenditure	1,653	4,556	6,209
Total operating expenditure excluding third party services	4,116	13,162	17,278
Depreciation	39	103	142
Total operating expenditure excluding third party services	4,155	13,265	17,420

Household	£000
Demand-side water efficiency - gross expenditure Demand-side water efficiency - expenditure funded by wholesale	154 (106)
Demand-side water efficiency - net retail expenditure	48
Customer-side leak repairs - gross expenditure Customer-side leak repairs - expenditure funded by wholesale	910 (645)
Customer-side leak repairs - net retail expenditure	265

# 4G - Wholesale Current cost financial performance

for the 12 months ended 31 March 2016

	Water £000
Revenue Operating expenditure Capital maintenance charges Other operating income	191,533 (79,182) (46,711) 70
Current cost operating profit Other income Interest income Interest expense Interest expense Interest expense related to the unwinding of discounted liabilities	65,710 475 5,112 (41,552) (164)
Current cost profit before tax and fair value movements Fair value gain/(losses) on financial instruments	29,581 1,585
Current cost profit before tax	31,166

# 4H - Financial metrics

	Metric £m
Net debt	943.145
Regulated equity	223.430
Regulated gearing	80.85
Post tax return on regulated equity (%)	15.46
RORE (return on regulated equity) (%)	5.99
Dividend yield (%)	1.83
Retail profit margin - Household (%)	1.63
Retail profit margin - Non household (%)	3.16
Credit rating	BBB
Return on RCV (%)	6.05
Dividend cover (number)	10.258
Funds from operations (FFO)	87.029
Interest cover (cash) (number)	3.63
Adjusted interest cover (cash) (number)	2.47
FFO/Debt (number)	0.09
Effective tax rate (%)	8.38
Free cash flow (RCF)	79.865
RCF/capex (number)	0.87
	£m
Revenue (actual)	208.788
EBITDA (actual)	112.210
	%
Proportion of borrowings which are fixed rate	17.40
Proportion of borrowings which are floating rate	0.00
Proportion of borrowings which are index linked	82.60
Proportion of borrowings due within 1 year or less	0.00
Proportion of borrowings due in more than 1 year but no more than 2 years	0.00
Proportion of borrowings due in more than 2 years but no more than 5 years	29.49
Proportion of borrowings due in more than 5 years but no more than 20 years	42.97
Proportion of borrowings due in more than 20 years	27.54

# 4I - Financial derivatives

	Nominal value by maturity	Total value			Interest rate (weighted average)		
	2 to 5 years	Nominal value (net)	Mark to Market	Total accretion	Payable	Receivable	
	£m	£m	£m	£m	%	%	
xed to/from dex-linked	(87,226)	(87,226)	(87,226)	(82.923)	4.22	5.38	