south east water

2019/20
GROUP ANNUAL REPORT

FINANCIAL STATEMENTS
AND ANNUAL PERFORMANCE REPORT

Pure know $h_2$ow

OUR BUSINESS

We supply top quality drinking water to 2.2 million customers in the south east of England. Through a network of 14,780 kms of pipe, we deliver around 520 million litres of water every day. The skill and expertise of our employees ensures our customers' water meets the highest of standards.

OUR VISION

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

521 million
litres of water a day – that's how much water we supplied in 2019/20 to 2.2 million people

83
Water treatment works, that's how we ensure our water is of the highest quality

14,780 kms
of water mains – that's how we bring fresh drinking water direct to your tap

500,000
water quality tests each year – that's how we ensure your water meets the highest standards

959
employees – that's how we make sure your water supply runs 24 hours a day, 365 days a year

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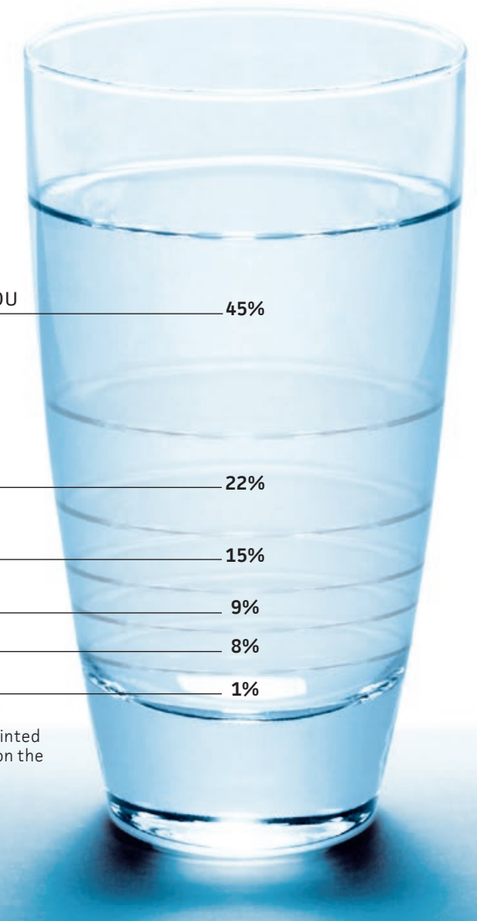
CONTENTS

HOW WE INVEST IN YOUR WATER

WHERE EACH £1 OF YOUR BILL IS SPENT
BY THE APPOINTED WATER BUSINESS



GETTING THE WATER TO YOU	45%
WATER TREATMENT	22%
INTEREST & TAX	15%
WATER EXTRACTION	9%
CUSTOMER SERVICE	8%
DIVIDENDS*	1%

* Dividends allocated to the appointed business less interest received on the parent company loan

FINANCIAL HIGHLIGHTS

REVENUE
£243.5m
Increase of 2.2 per cent on last year

OPERATING PROFIT
£81.3m
Decrease of 5.9 per cent on last year

CAPITAL EXPENDITURE
£104.5m
Stable year-on-year

CASH GENERATED FROM OPERATING ACTIVITIES
£134.4m
Increase of 7.5 per cent from last year

DIRECTORS

NICK SALMON
INDEPENDENT CHAIRMAN

JOHN BARNES
INDEPENDENT NON-EXECUTIVE DIRECTOR

CHRISTOPHER GIRLING
INDEPENDENT NON-EXECUTIVE DIRECTOR

CÉLIA PRONTO
INDEPENDENT NON-EXECUTIVE DIRECTOR

RACHEL DREW
NON-EXECUTIVE DIRECTOR

MARISSA SZCZEPANIAK
NON-EXECUTIVE DIRECTOR

PAUL BUTLER
MANAGING DIRECTOR

ANDREW FARMER
FINANCE DIRECTOR

DAVID HINTON
ASSET AND REGULATION DIRECTOR

NICOLAS TRUILLET
COMPANY SECRETARY

COMPANY'S BANKERS
HSBC BANK PLC,
60 QUEEN VICTORIA STREET,
LONDON EC4N 4TR

COMPANY'S AUDITOR
DELOITTE LLP STATUTORY AUDITOR
LONDON, UNITED KINGDOM

REGISTERED OFFICE
ROCFORT ROAD, SNODLAND,
KENT ME6 5AH

REGISTERED NO. 02679874
COUNTRY OF DOMICILE AND INCORPORATION: ENGLAND AND WALES

Our teams know the immense responsibility and part they play in providing an essential service to millions of people

MAINS FLUSHING

Engineers working 24/7 across the region to keep clear water flowing - such as here where we are carrying out work to reduce discoloured water

CHAIRMAN'S INTRODUCTION

NICK SALMON
CHAIRMAN

Welcome to our group annual report and the audited financial statements for the year ended 31 March 2020.

This year saw the culmination of our 2015 to 2020 business plan, with excellent performance across our business commitments, and significant focus on the preparations for the next five years.

During the last five years South East Water has invested £437 million in the water infrastructure of the South East of England. A key success has been reducing demand for water, which must continue if we are to balance the needs of customers and the environment in the longer-term. We completed our Customer Metering Programme with 90 per cent of customers now metered. Working with these customers we have encouraged water efficiency, including through our innovative use of behavioural science and delivering a "my water report" which has seen per capita consumption in our region reduce by seven per cent compared to the previous five-year period. Side by side with customers we have also continued to reduce our own leakage levels and each year met or exceeded our regulatory target – an important signal that we are taking our responsibilities to save water seriously too.

Further successes include maintaining our high water quality standards throughout the period achieving on average above 99.95 per cent mean zonal compliance. Work included installing three new microfiltration treatment plants in Kent and East Sussex along with a programme of water mains flushing. Our award-winning environmental programme goes from strength to strength taking an industry leading approach, particularly to catchment management as we aim to improve water quality right from the source.

Our household retail team has continued to improve the service offerings for our customers. Over the last five years we have introduced a new responsive website, including the My Account service which enables customers to manage their account online, and an online map to keep people updated with work in their region.

CHAIRMAN'S INTRODUCTION continued

The team also completed a significant billing project in 2018 introducing 'One Bill' meaning we now bill wastewater charges to over 465,000 customers on behalf of Southern Water.

A huge effort through the year has been put into the final stages of agreeing the Price Review 2019 (PR19) with Ofwat, with close involvement of the board throughout. Ofwat's Final Determination announced in December, which defines the prices we can charge and what we are expected to deliver over the five year period, will be extremely challenging and is forecast to result in minimal returns to shareholders. Further it did not, in our opinion, adequately reflect our customer's priorities in areas such as resilience and investment for the future. The board gave careful consideration to appealing this Determination to the Competition and Markets Authority, weighing the significant costs and diversion of resources involved in the appeal process versus the risks and uncertainty of the outcome. After much deliberation we decided not to appeal. We have now finalised a very detailed Corporate Plan for the next five years to meet the challenges as far as is possible. This will require a step change in performance and cost efficiency in all areas. The plan includes building on our innovative customer satisfaction programme, delivering high performance levels far beyond any we have committed to previously and enhanced focus on our responsible business commitments. The Managing Director's report provides details of the activities we have planned.

In the final months of the financial year these plans have had to be put on hold to a large extent with the arrival of Covid-19 which has required us to urgently adapt our operational priorities and ways of working.

None of us have ever experienced an event like the Covid-19 pandemic, however our business has worked relentlessly to deal with the emerging and ongoing threat. At all times, we have worked hard to ensure that our vital water service was maintained and at the same time ensuring that we have supported all our customers, our supply chain, the community and our employees.

Our essential role in society has never felt more important.

South East Water has drawn on the enormous strength and commitment of each and every employee. All have stepped up with professionalism and determination to confront a fast-changing and uncertain situation. Over the last few months the teams have not only moved to new ways of working but also had to manage our water network to ensure we have been able to keep up with very high levels of demand due to changing habits in water use as more people are at home due to the lockdown restrictions. The hot weather in May exacerbated this demand situation and this important work will have to continue throughout the summer. With the heavy rainfall last winter our water resources are in a good position but with the finite installed capacity of our treatment works and network there is a limit to how much fresh water we can produce and distribute on a daily basis.

We have therefore been enhancing communications to the public to use water responsibly at this time to ensure there is enough available to the NHS and other critical services. "Clean hands, brown lawn and dirty car – protect the NHS and save lives".

ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)

Over the last year we have made further progress with our Environmental, Social, Governance (ESG) framework. We set up a responsible business committee to help the board in defining the company's strategy in this area and to review our approach to ensure it remains relevant and effective. In September 2019 we achieved the highest award of five stars in the GRESB global ESG benchmarking, demonstrating our commitment to industry leading performance.

We have also developed a clear purpose statement which we are in the process of embedding in our articles of association:

"To provide today's public water service and create tomorrow's water supply solutions, fairly and responsibly, working with others to help society and the environment to thrive."

A clear purpose is a key step in our move to focus the business on what matters most to customers, the community and society and is integral to our plans for the 2020 to 2025 period and beyond.

We will continue to engage with customers, communities, employees, regulators and shareholders to ensure we make a positive impact today and for the future.

To provide today's public water service and create tomorrow's water supply solutions, fairly and responsibly, working with others to help society and the environment to thrive

CHAIRMAN'S INTRODUCTION continued

OUR PEOPLE

This year, possibly more than ever, we have seen just how important our great team spirit is.

Our employees have been exceptional in their response to Covid-19 and quite rightly, our people are proud of the roles they undertake and of their expertise in this vital social contribution. This is on top of the contribution everyone has made to the business, delivering such a good overall performance this year.

We seek to support all our employees throughout the organisation. South East Water is recognised as an Investors in People organisation, an accredited Living Wage employer and a Disability Confident Committed employer.

We are working to provide fulfilling employment opportunities across our community. This year we are signing up to the Social Mobility Pledge where we have committed to do more to boost opportunities for all through outreach, access and recruitment.

The mental health and wellbeing of our employees has been given particular focus this year. Our Mental Health Strategy, launched at an event for managers across the organisation and supply chain, ensures that colleagues know how we will support them. Working in partnership with MIND, we now have 30 mental health first aiders who are there for employees in times of crisis and can help support them to find the appropriate professional help they may need.

This year we were the first water company to sponsor the Women's Utilities Network. Women make up nearly half our workforce and we are dedicated to progressing leadership talent through the company and supporting their recruitment into senior roles.

ENVIRONMENT

As a major landowner and guardian of some of the region's most precious environmental resources, our teams work hard to maintain and improve many of the region's flora and fauna. This work has resulted in the successful conclusion of a ground-breaking programme to increase biodiversity at a number of our sites and improving the quality of the water catchments as part of the Water Industry National Environment Programme (WINEP). I am proud to say we have committed to almost trebling the investment in this area over the next five years.

Our Environment team won two Green Apple awards at the Houses of Parliament for their Pesticide Amnesty and Woodgarston Markets project. The awards recognise and promote environmental excellence, and as winners, we automatically become a Green World Ambassador and will be put forward to represent the UK in the Green World Awards.

We are continually reviewing how we can minimise our carbon emissions which this year included an in-depth energy management review and assessment of potential renewable options. We will build on our work so far to align our reporting with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

GOVERNANCE

We have carried out an in-depth review of our corporate governance and compliance this year.

Alongside the articulation of our company purpose, we have adopted a revised corporate governance framework which has been an important part of defining our strategy in the five-year corporate plan. This helps us demonstrate that South East Water can be trusted as a provider of an essential public service into the future.

The proposed amendment to our articles of association and revised directors' duties mark our commitment to become a purpose-led organisation and promote a culture of public service and inclusiveness. This demonstrates our ambition to develop a model of corporate governance that achieves a fair balance between our interests and those of our customers, other stakeholders and the environment.

During the year there was one change to the board membership with Rachel Drew joining the team as Non-Executive Director representing our 50 per cent shareholder, UTA. She replaces Stephen Jordan, who stepped down in December 2019. I would like to thank Stephen for his service since joining the board in August 2018.

We are now preparing for Managing Director Paul Butler to retire in July 2020, having served in the role at South East Water and previously Mid Kent Water for 18 years. This is a significant moment as Paul has overseen three price reviews since the merger of South East Water and Mid Kent Water in 2007 and his strategic leadership has developed a company which puts customer satisfaction at its heart and his legacy is an organisation with a strong future. On behalf of the board and shareholders of South East Water I would like to thank Paul for his dedicated service, not just to the company, but the water industry as a whole.

David Hinton, has been promoted from the role of Asset and Regulation Director to replace Paul as CEO. He has many years' experience within the organisation and was instrumental in developing the 2020 to 2025 plan and our responsible business strategy.

In addition to David as CEO and Andrew Farmer as CFO, the top leadership team now comprises Tanya Sephton – Customer Services Director, Oliver Martin - Asset and Regulation Director and Douglas Whitfield -Operations Director. All three were promoted internally to these roles over the past several months. They each have considerable experience in the business and it is good to see we have a refreshed but experienced team to lead the business.

FINANCIAL PERFORMANCE

Our financial performance has been in line with expectations this year. Group turnover has increased from £238.3 million to £243.5 million. The increase of £5.2 million includes an increase in our tariffs which is permitted under the regulatory settlement mechanism, an allowance for RPI increases, offset by a reduction in water consumption this year. Group net operational costs, including charges for doubtful debt, have increased in the year to £174.3 million compared to £164.8 million in the prior year, an increase of £9.5 million. Included in this increase are additional costs of £3.3 million relating to depreciation on new assets, £3.8 million in increased supplier costs for energy, bulk water supplies and contractors and £2.6 million of additional bad debt provision to reflect an increase in our older debt and the potential impact of Covid-19.

When assessing the appropriate level of dividend, considerations are given to the company's actual and forecast level of gearing, the need to maintain the company's credit rating, the allowed cost of capital, and the performance of the business. The net dividend paid in the year, being the gross dividend of £11.0 million less the interest on the loan to parent of £4.5 million, was £6.5 million (2019: £22.7 million).

OUTLOOK

Innovation is driving our company forward as we pursue first class customer service, sustainability and resilience, not only for today's customers but also for generations to come.

We have some very stretching commitments to deliver in the next five years and beyond. Our responsible business approach to governance will help us deliver our commitments to those we serve.

I look forward to the start of the new five-year chapter for South East Water and the year ahead. I have confidence in the ability of our people, our new but experienced leadership team and the strength of the business.

On behalf of the board, I would like to thank all the employees, the management team and our business partners for all their achievements during 2019/20, but especially for the passion and purpose displayed in the face of the Covid-19 challenge. We wish Paul all the best for his retirement and we will work throughout the year to continue to build an organisation where everyone can thrive.

NICK SALMON
CHAIRMAN
15 JULY 2020

During 2019/2020 we invested £104.5 million in new and existing assets as part of the £437 million invested in the period from 2015 to 2020

£104.5 million

FUTURE PROOFING WATER

During the year we have installed more than 35 kilometres of new water mains

MANAGING DIRECTOR'S INTRODUCTION

PAUL BUTLER
MANAGING DIRECTOR

This annual report is a particularly personal one for me and an opportunity to reflect on the achievements of this year and the 2015 to 2020 period. I will be retiring at the end of July after more than 25 years with South East Water and formerly Mid Kent Water, this is also a chance to look forward to the future too.

We have focussed on striving to realise our vision and deliver on the commitments within the 2015 to 2020 business plan which puts customer satisfaction at the heart of everything we do. The team has made excellent progress and ended this five year period in a very good position to deliver our 2020 to 2025 commitments. We continued significant investment in new and existing assets and environmental projects while dealing with the day-to-day operational challenges associated with providing a first class drinking water service to our 2.2 million customers. We have also been working with our suppliers and other industry partners to make contingency plans for the UK's exit from the EU. At the same time, we continued planning for the long-term with our 60-year Water Resources Management Plan (2020 to 2080).
The year saw us strengthening our services for vulnerable customers and undertaking a number of ground-breaking environmental initiatives.
With my departure and in line with our succession management plan, a new Executive Team, made up of experienced leaders is now in place to ensure the company continues its progression during 2020. Our future plans build on this commitment to the environment and to the communities in which we work.

MANAGING DIRECTOR'S INTRODUCTION continued

OUR COVID-19 RESPONSE

We completed the last year of the 2015 to 2020 regulatory period as the country was going into lockdown due to the Covid-19 outbreak. This presented many challenges but also provided opportunities for us to support essential services such as hospitals and schools during the crisis. Our teams – designated key workers by the government – worked around the clock to keep vital water supplies flowing and to undertake critical maintenance work and emergency repairs to the network. Our contact centre and office based teams moved to home working, with almost 75 per cent of the organisation relocated in under two weeks to enable us to continue to support our customers, including vulnerable customers, while our specially trained advisers are able to offer advice to those struggling to pay their water bills as a result of the financial impact of the crisis. I am very proud of the way our employees pulled out all the stops to let customers know we were still there for them during the unprecedented situation we are experiencing.

Collaboration is a key principle for South East Water and it was important we came together with others to help support our communities. The business did this in many ways. Across the organisation we worked closely with colleagues in the industry, whether that be by preparing emergency plans, mutual aid support to those in need, communication activities or to respond to the pressures faced by the retail sector while business water use reduced. We are proud to be part of an industry that will work together to do the right thing for society.

Our determination to play our part as a responsible business was a reason we joined 300 global businesses in signing the Covid-19 Business Pledge, a commitment to support customers, community and our employees during this period and for the future recovery. Our business has been resilient during this crisis, with an agile team who quickly adapted to new ways of working, careful monitoring of our network and assets to protect the vital water service and supporting our supply chain. We are committed to continuing to do all we can to support the recovery of our communities and are now planning for the future to ensure we continue to be a service that all our customers can rely on no matter the situation we face.

CUSTOMERS AT THE HEART OF AMBITIOUS FIVE-YEAR PLAN

Our business plan for the next regulatory period, commencing April 2020, is the most ambitious plan that South East Water has ever produced. The plan sets out our most challenging performance levels to date and a commitment to deliver them at an efficient cost. This commitment is set against a backdrop of operating in a region that is in serious water stress with a growing population.

The plan has been subject to extensive scrutiny and challenge by Ofwat as part of the Price Determination process which is now complete. We reviewed Ofwat's Draft Determination in July 2019 and provided further evidence in support of our plan. Ofwat announced its Final Determination in December 2019 setting out the prices we can charge our customers as well as the investments and targets that we are committed to achieving over the next five years. Over this period household customers will be charged an average of £190 per year, a 7.2 per cent bill reduction, excluding inflation.

We put our customers at the heart of the five-year plan and their priorities and views, together with feedback from our Customer Challenge Group, helped to shape all aspects of it. Our package of Outcome Delivery Incentives (ODIs) reflects the emphasis and importance our customers place on critical aspects of our performance and service.

We are now focussed on delivering these ambitious plans for 2020 and beyond, to ensure we deliver a first class service for customers, protect the environment and invest in a reliable and resilient water service for the future. This year has involved lots of preparations to enable us to be well positioned as the new investment period begins and we work to achieve these tough targets. We have an excellent team at South East Water and I am confident that together they can deliver the plan.

With 38 key performance commitments and 10 responsible business measures in areas that customers and stakeholders want us to lead on, our plan is to create a step-change in trust for the water sector.

KEY ACTIVITIES PLANNED INCLUDE:

- INCREASING PRIORITY SERVICE REGISTER SIGN-UP TO SERVE CUSTOMERS DURING SUPPLY INTERRUPTIONS TO 110,000
- SIX WATER QUALITY SCHEMES
- INVESTING £433 MILLION TO IMPROVE OUR INFRASTRUCTURE OVER THE FIVE YEAR PERIOD
- EXTENDING FINANCIAL ASSISTANCE TO 75,000 ELIGIBLE CUSTOMERS
- REDUCING AVERAGE WATER USE BY 7.2 PER CENT TO 137.4 LITRES A DAY
- OUR LARGEST ENVIRONMENTAL PROGRAMME EVER INCLUDING REDUCING GREENHOUSE GAS EMISSIONS BY 80 PER CENT

- BRINGING 33 OF OUR SITES OF SPECIAL SCIENTIFIC INTEREST TO FAVOURABLE CONDITION
- REDUCING LEAKAGE BY A FURTHER 15 PER CENT

MANAGING DIRECTOR'S INTRODUCTION continued

10-OUT-OF-10 CUSTOMER SERVICE

Across the business we have strived this year to achieve our customer commitment to deliver a 10-out-of-10 service by:

- reducing interruptions to supply by 4.2 minutes per property
- developing a new Customer Relations Management system
- keeping more than 57,000 customers informed about work taking place through the "In Your Area" section of our website
- reducing discolouration contacts per 1,000 population to 0.53 against a target of 0.58
- expanding our social media presence, we now have more than 16,000 followers across our Twitter, Facebook, LinkedIn and newly implemented Instagram channels
- establishing a new customer engagement, insight and vulnerability team
- broadening our vulnerability services, including an expansion of our Priority Services Register and the development of a Vulnerability Strategy
- engaging with more than 4,500 people through our community events, open days and schools programme
- developing our website aiming to achieve AA standard for accessibility
- reducing overall complaints by 33 per cent

We have maintained our British Standards Institution (BSI) accreditation to BS 18477 for a second year, in recognition of the work we do to identify and respond to vulnerable customers. We were very proud to become the first water company to receive this accreditation. In September we organised and hosted a Stakeholder Vulnerability Day for partner agencies and community groups in Maidstone. The event brought more than 60 stakeholder groups together to collaborate on how best to identify and support vulnerable customers in the communities in which we all operate.

> **OUR NEW FIVE-YEAR PLAN CONTINUES TO FOCUS ON OUR CUSTOMERS' PRIORITIES AND ALSO PUTS THE SPOTLIGHT ON LONGER-TERM RESILIENCE**

A new customer experience measure (C-MeX) has been developed by Ofwat, replacing the previous service incentive mechanism (SIM) survey. Much like our customer satisfaction measures developed for our 2015 to 2020 plan, C-MeX randomly surveys customers, including those who have not contacted the company, to assess their satisfaction with the service they receive. Our overall C-MeX score rose over the last year, steadily ending in a score of 73.36. This score correlates very closely to our positioning in the previous SIM measure. Our new five-year plan continues to focus on our customers' priorities and also puts the spotlight on longer-term resilience.

Broadening our vulnerability services, including an expansion of our Priority Services Register and the development of a Vulnerability Strategy

MANAGING DIRECTOR'S INTRODUCTION continued

LONGER-TERM WATER RESILIENCE AND SUSTAINABILITY

We are developing innovative solutions which will build greater levels of resilience into the services we provide to customers. In August 2019 we published our action plan for a systems-based approach to resilience. This will evolve our understanding of our supply systems, from source to tap, including any reliance on other parties, such as our power suppliers. This allows us to better monitor how our systems are performing and identify and mitigate risks ensuring we continue to deliver resilient services into the future.

Every five years we update our water resources management plan (WRMP), which takes a long-term view of how we will secure water supplies for customers over the next 60 years. The plan, which was approved by the Secretary of State and published in August 2019, outlines how we will do this in normal weather conditions and during periods of drought. It takes into account population and housing growth forecasts and the potential impact of climate change as well as the need to protect the natural environment. The plan has been developed with our customers, communities, other water providers and stakeholders, and contains stretching levels for demand management. Over 50 per cent of the new water generated through the plan will come from reduction in demand, with the remainder to be met through the development of a small number of new water resource schemes.

One scheme of strategic importance in the WRMP took a step forward this year as we acquired the Aylesford Newsprint site in Kent. This purchase enables the development of a brand new water treatment works that will produce 18.2 million litres of water a day and will secure future water supplies to Maidstone and the surrounding areas.

Over the 60-year planning period our plan will increase the supply of water by around 260 Ml/d (52 per cent) to secure the long-term resilience of water resources across our area.

We are very grateful to stakeholders and individuals who contributed their time towards the development of our plan, including members of our Environmental Scrutiny Group, Customer Challenge Group, the Water Resources in the South East (WRSE) Group and all those who took part in our public consultation, customer research and in formal representations.

We are also proud to be a part of Interreg, a programme which aims to address the impacts of climate change and enhance the availability of raw water. This four-year cross-border project, called PROWATER, has a budget of more than €5.5 million. It is funded by the European Regional Development Fund and by project partners. The overall objective of the PROWATER project is to build resilience against droughts by restoring water storage in the environment through catchment management and other natural Ecosystem-based Adaptation (EbA) measures.

OPERATIONAL SUCCESSES FOR THE YEAR

Operating in a designated area of water stress we recognise that climate change and the impacts on our environment affect our business and therefore our plans are always looking to these long-term implications and how we can adapt and ensure our assets and teams are resilient.

In June 2019 our teams contended with storms and localised flooding, brought on by a plume of Saharan air over the South East of England. We also experienced an extremely wet winter, with the worst winter floods in recent times. Storm Dennis followed immediately on from Storm Ciara in February and our technicians were called upon to restore water supplies when the storms caused power outages across the region.

Despite these challenges we saw a decrease in burst water mains during the year, 2,289 compared with 2,826 in 2018/19. Maintaining more than 14,500 km of water mains is a never ending job to ensure we keep our customers with a continuous supply of top-quality water. The teams have worked hard to reduce the length of time of any customer interruptions and I am pleased to report a strong performance throughout the year with the average time lost per property of 10 minutes outperforming the 2018/19 performance of 14.2 minutes.

Our water quality performance for the year was also excellent with 99.96 per cent mean zonal compliance on our water samples tested at our laboratory in Farnborough. Customers contacting us due to discoloured water also fell during the year with 0.53 contacts per 1,000 customers received in 2019/20 compared to 0.59 last year. Improvements at our water treatment works and our extensive flushing programme and targeted communications have delivered the anticipated benefits. This has seen a 55 per cent reduction in customer contacts since 2015.

During 2019/20 we invested £104.5 million in new and existing assets as part of the £437 million investment planned for the period from 2015 to 2020. We are committed to continuing this level of investment in our 2020 to 2025 business plan to continue to improve services for our customers and to support our efforts to safeguard the environment.

We celebrated the 100th anniversary of Aldershot's water treatment hub at Boxalls Lane this year, at the same time looking to the next one hundred years as we progressed the construction at the Keleher Water Treatment Works.

This £21 million investment is our largest single project to date and will increase the capacity of the treatment works from 45 million litres per day to 68 million litres per day.

In Sevenoaks, Kent we have progressed with two significant schemes to ensure we can cater for the town's growing population. The first scheme currently underway is the expansion of Solefields Service Reservoir. The existing drinking water tank holds 3.7 million litres and was built in 1928 but has reached the end of its usable life and will be replaced with a larger reservoir, holding 5 million litres with a lifespan of 100 years, to meet the growing demand for water in the area. We also held an extensive consultation and engagement programme with the local community during the year to agree the route for a new £1.8 million water main which will support the existing pipe running through Sevenoaks High Street. Work is due to start in 2020 and both schemes will secure future water supplies in the area.

During the year a full competitive tender process was completed for our network maintenance contract. Clancy Docwra emerged as the winning bidder and we look forward to building on our 18 years' experience of working together. The successful appointment as sole contracting partner for network maintenance is both innovative and forward-thinking, benefitting both companies and our 2.2 million customers. Clancy will deliver all repairs, maintenance and planned mains renewals, new mains and new connections across our supply area. We are now looking forward to working towards a single collaborative culture that will achieve our joint vision of delivering a great customer service while looking after the health, safety and wellbeing of our teams.

MANAGING DIRECTOR'S INTRODUCTION continued

INNOVATION TARGETS OUR CUSTOMERS' AND STAKEHOLDERS' PRIORITIES

At South East Water we are constantly working to improve the way we do things. To successfully deliver our stretching performance commitments, we will need to collaborate and innovate.
We have created an Innovation Strategy and developed Innovation Champions across all areas of the business to help drive the performance improvements set out in our new business plan.

During the year we implemented a company-wide innovation platform to encourage ideas from all of our people to ensure we improve our performance. Engagement has been strong with more than 400 active users and generating almost 300 ideas with 130 successful projects now under development. The team is now looking to develop this further to enable stakeholders and our supply chain to access it so we can collaborate widely on the key challenges we face.

Innovation includes using the latest technology to revolutionise the way we find and fix leaks. This will help us to drive leakage down, with a target of a further 15 per cent reduction by 2025, and a 50 per cent reduction by 2050.

In April 2019 we launched a year-long digital water meter trial to inform our future plans to reduce leakage on our network. The trial focussed on 2,000 properties in north Kent and used the latest sensor technology and analytics, as well as Narrowband Internet of Things (NBIoT), fixed radio and traditional cellular networks. Its aim was to find out if a collaboration of nine specialist companies could create a smarter network and deliver leak reduction, together with wider customer benefits. While we await the final results of the trial, early indications suggest that the project could help us to reach our ambitious leak reduction target. The pilot was the first time digital water meters, sensors and loggers have brought together data into one central area for advanced analysis, exploring artificial intelligence techniques. It involved switching existing water meters – many put in as part of our 10-year Customer Metering Programme – to digital meters. It also involved adding loggers and sensors on the underground network to transmit data in near real time.

During the trial the analytics system consolidated more than 25 million data points from various meters, loggers and sensors deployed across the network and transmitted by three different communication networks. This level of insight has enabled us to find and fix leaks faster, and to quickly identify customer side leaks.

In Kent we continue to pioneer the use of a new satellite technology to help us find and fix leaks on our vast network of underground pipes. This technology, which is normally used to look for water on other planets, creates images which cover 2,200 square miles. Our technicians have apps on their phones which show the location of any suspected leaks. In another industry first, we have offered 800 of our customers the chance to sign up to a free 12-month trial of the Hive Leak Sensor, enabling customers to monitor flow of water around their homes. The sensors detect possible leaks and send alerts directly to customers' smartphones.

I am pleased to report that the leakage team has beaten our target of 88.1 million litres a day (Ml/d), achieving 86.4 Ml/d during 2019/20 – another good step towards our commitment of reducing leakage by a further 15 per cent by 2025. South East Water is committed to continuing to use innovation to maintain our industry-leading position for leakage detection and reduction.

INNOVATING TO WORK SMARTER
Using state-of-the-art technology to transform how we operate

MAKING OUR NETWORK SMARTER

Technology and data is set to transform how we reduce leaks on our network after a year-long pilot study.

The Smart Network Trial focused on 2,000 properties in north Kent, using the latest sensor technology and analytics as well as utilising NBIoT, fixed radio and traditional cellular networks.

MANAGING DIRECTOR'S INTRODUCTION continued

BUILDING A RESPONSIBLE FUTURE

Our business is intrinsically linked to the environment and between 2015 and 2020 we have delivered £16 million of environmental improvements and are set to almost triple our investment for the next five years with £49 million and 60 schemes planned. We rely upon our streams, rivers and underground aquifers to supply both our current and future customers with safe, reliable supplies of drinking water so we need to ensure that our supplies are sustainable now and for decades to come. We face many challenges through climate change, growing population and the expectations that our customers and regulators place upon us. However, we are leading the industry with our approach to ensuring we have sustainable and resilient catchments. For instance, we were the first water company to create a partnership with Natural England and Catchment Sensitive Farming to deliver our current Water Industry National Environment Programme (WINEP). WINEP includes many different types of environmental improvement schemes, including ground and surface water catchment management, sustainable abstraction and biodiversity.

Our supply area is rich in biological diversity, protected landscapes and rare species and we are proud of our achievements to protect our local environment. As a responsible landowner, we work in partnership with many environmental organisations, including Natural England, the Environment Agency, Bug life, the Wildlife Trusts and the South Downs National Park Authority, to ensure we manage, protect and enhance the natural environment. We are also grateful for the support of many volunteers who assist us with projects. In 2019/20 we completed 10 pilot biodiversity projects, covering a total area of approximately 78 hectares across Sussex and Hampshire. These focussed on priority habitats and species and have included bat, butterfly, reptile and botanical surveys. Full details of these projects can be found in our Performance, People and Planet report.

In other environmental successes, we sponsored an anonymous pesticide amnesty which resulted in the safe removal of more than a tonne of unused and out-of-date pesticides from 23 farms in Kent. We also completed delivery of our Eel Regulations project, making us the first water company to have all our intakes Eel Regulation-compliant.

We were pleased to obtain the highest possible rating of five stars in the 2019 GRESB survey – a global benchmarking of environmental, social governance (ESG) practice. We achieved two Green Apple Awards which recognise, reward and promote environmental excellence, one for the pesticide amnesty and another for our Woodgarston Markets project - a farmer-led idea exploring the opportunities for new markets and approaches to sustainable farming practices. Its primary focus is nitrate reduction, but it also aims to deliver wider environmental improvements, social benefits, profitable agricultural businesses and economies within the catchment. At the time of going to press, we had also been shortlisted for five Water Industry Achievement Awards including Water Company of the Year.

In July 2019, South East Water joined more than 40 environmental groups, charities, water companies and regulators in a national campaign aimed at raising awareness of the importance of water and the role everyone plays in protecting it. The Love Water campaign was part of the Government's Year of Green Action. South East Water also joined the award-winning Refill campaign as a partner. This scheme aims to encourage the use of tap water as a sustainable alternative to bottled water.

Our communications campaigns have raised awareness of water efficiency and led to customers actively seeking to use less water – we delivered more than 32,000 devices to help customers save water in their homes and gardens. More than 2,600 children from 53 schools across Kent, Sussex, Surrey, Hampshire and Berkshire received a World of Water educational talk from South East Water during the last school year. The interactive talks are aimed at 8- to 11-year-olds and help children to learn about the importance of conserving water. By engaging with customers to promote water efficiency measures, we can reduce average customer water use. We aim to save 151.6 Ml/d by 2080.

Our new five-year business plan builds on our clear commitment to the environment and to the communities in which we work, with 10 new responsible business commitments. These reflect the actions and behaviours that customers expect a responsible business to display. We have also this year joined with all the UK water industry to make five additional public interest commitments, where we will collaborate across the sector to ensure we meet promises that will benefit the environment and society.

ENVIRONMENTAL EXCELLENCE

We're leading the way in the water industry with this exciting, innovative work which Natural England has acknowledged.

CREAM OF THE CROP

Our trials at a farm in Woodgarston are reaping the benefits

MANAGING DIRECTOR'S INTRODUCTION continued

FINANCIAL RESULTS

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

This year we had a strong financial performance, having generated a group operating profit of £81.3 million for the year to 31 March 2020, compared with £86.4 million for the year to 31 March 2019. Our turnover was £243.5 million for the year compared to £238.3 million in the prior year. This additional revenue of £5.2 million is primarily due to the allowed price increase in the year and an RPI increase, offset by a reduction in consumption in comparison to the high demand in the summer of 2018.

Group net operational costs, including charges for doubtful debt, have increased in the year to £174.3 million compared to £164.8 million in the prior year, an increase of £9.5 million. Included in this increase are additional costs of £3.3 million of additional depreciation, £3.8 million increases in supplier costs for energy, bulk water supplies and contractors, and an increase of £2.6 million in our bad debt provision. We have seen an increase of £1.9 million in respect of older debt and have recognised an additional £0.7 million to reflect our assessment of the impact on our current debt of the potential downturn in the economy arising from the Covid-19 pandemic. Whilst there is currently no discernible trend, we have started to see early signs of a reduction in cash collection from some of our customers who are directly impacted by the Covid-19 pandemic. We will continue to monitor our level of cash collections and, if we deem it appropriate, may increase our bad debt provision as the year progresses or at the end of the next financial year.

Profit before tax has reduced by £2.6 million to £33.8 million. Net finance costs reduced by £2.5 million in the year to £47.5 million. During the year the refinancing of £200 million of bonds and the termination of the related interest rate swap arrangement resulted in a reduction in finance charges of £2.4 million.

THIS YEAR WE HAD A SOLID FINANCIAL PERFORMANCE, HAVING GENERATED A GROUP OPERATING PROFIT OF £81.3 MILLION FOR THE YEAR TO 31 MARCH 2020

Further reductions in indexation charges on index linked bonds totalled £1.1 million. These savings were offset by the fall in interest income on the company's loan to its parent company of £0.8 million as a result of the partial repayment of the loan in the year following the decision to inject additional capital into the business by the shareholders.

In its budget statement in March 2020, the Government announced that corporation tax would remain at 19 per cent from 1 April 2020 and not change to 17 per cent as previously planned.

The change in future tax rates has resulted in deferred tax charges in the year of £15.0 million.

This has been offset by a reduction in the deferred tax charge for the year due to additional group relief being available compared to the prior year.

Profit for the year has reduced from £38.7 million to £16.9 million, which is driven by the operational performance, financing and tax impact detailed above together with the £9.3 million profit on the sale of the company's non-household business being included as a discontinued operation in the prior year.

In September 2019 we completed the refinancing required to facilitate the repayment of £311 million of index linked bonds and related interest rate swap, which matured at that time. The new financing consists of a variable rate loan linked to LIBOR of £120 million and the issuing of two series of fixed rate loan notes totalling £175 million.

OUR PEOPLE

People matter at South East Water. This year more than ever before we have seen just how important our teams are and they have been exceptional throughout. An integral part of our vision is to ensure that our company is "the water company people want to work for" and having great colleagues around you is key to making this vision a reality.

Health and safety is a priority for our company. Our commitment to this and the wellbeing of our staff is enshrined in our Thrive 365 strategy which promotes the need for safe people and safe working. Wellbeing took centre-stage at a conference for employees in November when we launched our Mental Health Strategy. In February and March we followed this up with Mental Health for All events. As part of our Thrive 365 strategy we have trained 30 employees from across the business to be mental health first aiders. These trained colleagues wear a yellow lanyard to make them instantly recognisable to colleagues who may want someone to talk to. We will continue to put the importance of mental health on a par with our employees' physical health.

Nearly half of our workforce are women and most are employed within our customer service teams and our directly employed call centre function. We are dedicated to progressing women through the company and supporting their opportunities for recruitment into senior roles. We have a Women at Work group and have sponsored the Women's Utilities Network, being the first water company to do so. In addition, we have reviewed recruitment processes and our policies, provided coaching and mentoring for those on our talent development programme and reviewed our job evaluation system to ensure there is a clearer career progression path. We have also set ourselves a target of reducing our current gender pay gap of 25 per cent to 10 per cent by 2025. Looking ahead, we have developed a new five-pillar People Plan to ensure we continue to attract, support, develop, reward and retain the best people.

Our teams have volunteered their time and effort to help lots of charitable organisations throughout the year. WaterAid is our company's nominated charity. In June 2019 WaterAid's annual appeal, which South East Water has included as an insert in its bills for the past 21 years, reached the £3 million mark. In August, South East Water colleagues took part in a 170-mile Bucket Brigade relay challenge to transport five litres of water across the South East by foot, bicycle and paddleboard to raise money for WaterAid. Our staff also supported charities close to their own hearts during the year, including cancer and foodbank charities, through raffles, cricket matches and cake sales. During the Covid-19 crisis they have supported community groups with food deliveries and providing skills to support charities in need.

I hope that you find this report both interesting and informative. Further information is available in our Performance, People and Planet report.

I would like to thank all South East Water employees, suppliers and our board for their ongoing dedication, enthusiasm and support. As we head into a new and exciting five-year investment period, with customer engagement and satisfaction at the heart of our business promise, I am proud to say we have an exceptional team at South East Water. This team will help us to deliver on the commitments we have made to all our customers in our five-year plan and to ensure we continue to operate as a responsible business.

I will be retiring from South East Water at the end of July 2020. I am very proud of the way our company has delivered improved year-on-year performance, since our successful merger with Mid Kent Water back in 2007. Innovation is driving our company forward as we pursue first class customer service, sustainability and resilience, not only for today's customers but also for generations to come. I look forward to following the start of an exciting new five-year chapter for South East Water and I would like to wish my successor, David Hinton, and all my colleagues all the very best for the future.

PAUL BUTLER
MANAGING DIRECTOR
15 JULY 2020

OUR BUSINESS

OUR PURPOSE

To provide today's public water service and create tomorrow's water supply solutions, fairly and responsibly, working with others to help society and the environment to thrive.

OUR VISION AND STRATEGY

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

OUR COMMITMENTS – ACHIEVING OUR VISION

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

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

OUR CORE VALUES

Core values support our vision and commitments, and reflect what South East Water is all about. Through workshops and interviews with employees talking about what it's like to work here, what our people stand for and what characterises the way we deliver our service, we created and defined our own set of core values:

TRUST	Dependable, safe and sound, as a team always delivering on our commitments. Guardians of the environment
PASSION	Dedicated to delivering a safe, reliable service, always caring for our customers and each other
AGILITY	Responsive, flexible and adapting quickly to change
CREATIVITY	Fresh thinking, improving, never standing still
EXCELLENCE	Striving at all times to be the best and deliver the best

OUR BUSINESS STRATEGY

Planning for water is a long-term business, which is why it is important we set out the opportunities and challenges we face in the future. There are some considerable challenges for companies such as ours, which operate in a region which has been designated as being in serious water stress.

The biggest of these is the need to meet the demand for water, from customers of today and the customers of tomorrow. It is vital we look a long way ahead to anticipate the changes and challenges that could impact our work in the future.

The challenges we face include:

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

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

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

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

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

Read more
southeastwater.co.uk/businessplan2020

OUR BUSINESS continued

2020 TO 2025 BUSINESS PLAN – CUSTOMER SATISFACTION RESPONSIBLY DELIVERED

In December 2019, Ofwat published its Final Determination of our business plan. This has given us the go-ahead to progress with finalising our plans and preparing for our new five-year investment period.

The plan we have developed continues to have customer satisfaction as a core theme of our 2020 to 2025 plan. We have taken this further and developed a wide range of responsible business measures and targets. We believe our plan is the right one for our customers and society, now and in the future. We are driven by the same values of trust as our customers. We are a business made up of dedicated water people who want to make a difference – to customers, communities, the environment and society – so that everyone and everything thrives as a result of what we collectively do.

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

The result is a plan which:

- remains built around customer satisfaction, but which has improved from measuring average satisfaction across seven service elements, to measuring satisfaction by attitudinal segments so we meet the expectations of all our customers – whatever their needs or circumstances.
- strengthens the link between satisfaction and resilience by making customers part of the solution by giving them targeted information, and as such, greater control over their water use. We have used recent supply challenges in 2018 – such as the freeze/thaw and heatwave events – to develop this further through our resilient customer concept.
- has a focused innovation strategy which targets our customers' and stakeholders' priorities; and where we can make the most difference to lead the industry, not least using our toolboxes to deliver greater customer satisfaction.
- has 10 new responsible business commitments to reflect the actions and behaviours that customers expect a responsible business to display; and, in conjunction with great service, have the potential to create a step-change in trust of the water sector.
- challenges us to deliver performance levels well beyond anything we have delivered before and new ones too, such as our performance commitments relating to vulnerable customers, the environment and customer satisfaction.
- the plan commits to all this at a price that is lower than today (before inflation), the challenge of doing more for less should not be underestimated. We have included 38 new performance commitments in our plan.

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

CUSTOMER CHALLENGE GROUP

The Customer Challenge Group is an independent group whose overarching aim is the delivery of the best possible experience for customers. The group, comprising of water regulators, customer representatives and key stakeholders focuses on the:

- quality of the company's engagement and insight
- extent that insight is driving decision making
- extent to which the company is delivering against the business plan promises

The group was fundamental in scrutinising and challenging our strategic direction, including our latest business plan. Ofwat requested that our Customer Challenge Group write a report which sets out how well we've engaged with our customers, and whether their views have been adequately reflected in the plan.

Read more
Find out more about the Customer Challenge Group at **customerchallenge.co.uk**

YOUR WATER, YOUR SAY

Our 2020 to 2025 business plan is based on feedback from thousands of our customers and stakeholders both before and during our business plan creation. We will continue these conversations to ensure we can deliver this plan in collaboration with others as we have built customer and stakeholder engagement into the way we do business. If you have any feedback on our plans, or our work please contact us.

Read more
Find out more at **southeastwater.co.uk/businessplan2020**

OUR BUSINESS continued

WATER RESOURCES FOR THE FUTURE

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

Since we published our previous plan in 2014 we have:

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

Previously these plans looked 25 years into the future, but because the south east faces a number of unique challenges, as detailed on page 28, in our latest plan, published in August 2019 we've looked forward 60 years to 2080. By doing this we can make sure the work we do now lays the best foundation for future generations.

Over the next 60 years the population in our supply area is set to increase by 49 per cent to 3.29 million. To ensure all existing and new customers continue to receive a reliable tap water supply we need to increase the amount of water available by an extra 221 million litres a day by 2080.

Our latest plan will make what water we already have go further – by reducing leaks on our pipes and developing water efficiency programmes. Although this will help, these measures alone won't be enough to meet the predicted shortfall in water.

COMPLICATED REPAIR
A burst water main in Canterbury required careful work to repair in a wooded area

TARGETING LEAKS

Reducing the amount of water lost through leaks, exceeding our target.

OUR BUSINESS continued

> **THE PRIORITIES WE HAVE DEVELOPED AIM TO EXCEED CUSTOMERS' EXPECTATIONS FOR US TO ENSURE HEALTH AND WELLBEING THROUGH A QUALITY, RELIABLE WATER SERVICE**

Our proposals for 2020 to 2045 include:

- encouraging greater water efficiency amongst our customers, working with our customers to reduce per capita consumption from 148 litres per person per day to 90 litres per person per day by 2080, helping to save an additional 151.6 million litres of water a day
- halving the level of leakage from current levels by 2050, saving an additional 42.7 million litres of water a day
- construction of a new water treatment works at the former Aylesford Newsprint site via a new licence trade arrangement. This will provide an additional 18.2 million litres of water a day
- developing and improving an existing water treatment works at Bewl Water in Kent, providing eight million litres of water a day
- creating a new reservoir at Broad Oak, Kent by 2033 to provide 19.6 million litres of water a day
- building a new reservoir adjacent to our existing Arlington Reservoir, East Sussex, by 2035 to provide 16.1 million litres of water a day
- developing a regional water transfer scheme from SES Water to provide nine million litres of water a day by 2042
- improving the levels of connectivity and resilience within our water supply network system to meet demand and manage extreme events

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

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

Collaborative regional water resources planning is a long established and integral part of how our own water resources management plans are prepared. Since 1997 South East Water, along with the other five South East of England water companies has prepared regional plans as the Water Resources in the South East (WRSE) group. This collaboration ensures each individual company plan is integrated with regional solutions, to provide the most cost effective and resilient plans for both customers and the environment.

The latest guidelines prepared by Government seek to expand and build on the regional approach adopted by the WRSE group, by creating an additional four regional groups to cover the whole of England and Wales, supported by a national framework to help deliver consistency and co-ordination up to national level.

South East Water will continue to play an active and vocal role in the work of the WRSE group and national work, to ensure our own company water resources management plan remains coherent with those plans.

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 260 as part of our annual performance report. We have also published our Performance, People and Planet report 2019/20 which provides much more detail on each of the ODIs, the challenges we face and our future plans to ensure we continue to improve, and further develop our focus on customer and stakeholder outcomes.

We engaged with customers to help us set our future priorities and prepare our outcomes for the next business plan that covers the period 2020 to 2025 (see page 28). The priorities we have developed aim to exceed customers' expectations for us to ensure health and wellbeing through a quality, reliable water service, and improving the environment to secure a resilient service for the future.

They also include commitments to ensure we are supporting all our customers, including those who are vulnerable.

OUR BUSINESS MODEL

We deliver water to our customers. We do this by applying our pure know $h_2$ow to the process of collecting, storing, abstracting, treating and transporting water using the infrastructure (reservoirs, treatment works, pipes and pumps) that we build and maintain.

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

All our activities are regulated by Ofwat which is our economic regulator and has a duty to protect the interests of consumers. We operate under an instrument of appointment issued under the Water Industry Act 1991. Every five years under the terms of our licence and as part of the industry price review we submit a business plan to Ofwat. Our business plan sets out the costs that we expect will be required to run the water network and the capital investment we expect will be required to maintain a high quality of service to our customers. These business requirements are used to determine appropriate tariffs for our customers which are set out in our charges schemes. Our revenues and costs are regulated by Ofwat, as are our returns to investors. There are two price controls, being for the wholesale business and the retail household business.

HOW WE DO BUSINESS

OUR PURPOSE

"To provide today's public water service and create tomorrow's water supply solutions, fairly and responsibly, working with others to help society and the environment to thrive."

1

VISION

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

2

VALUES

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

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

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

AGILITY
Responsive, flexible and adapting quickly to change

CREATIVITY
Fresh thinking, improving, never standing still

EXCELLENCE
Striving at all times to be the best and deliver the best

3

COMMITMENTS

Five strategic themes help us to focus on achieving our vision

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

4

CONTINUOUS ENGAGEMENT

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

PARTNERS
EMPLOYEES
INVESTORS
REGULATORS
COMMUNITY
CUSTOMERS

5

MEASURING SUCCESS OUTCOMES

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

6

CUSTOMER SATISFACTION OUTCOMES

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

7

BUSINESS ENVIRONMENT

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

OUR BUSINESS continued

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

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

CREATING VALUE BY BEING A RESPONSIBLE BUSINESS

Our business creates value in a variety of ways:

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

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

TAKING THE LONG VIEW

We have a rich history of taking a long-term view: making decisions that balance meeting the needs of customers today with ensuring we can provide a quality service for our customers of the future. We design and build our infrastructure to meet expected changes in demand and environmental conditions. We raise money for our investment programme from financial institutions like pension funds who take a long-term view and seek steady, reliable and reasonable returns on their investment.

The price that we charge our customers is regulated by Ofwat and set for a five-year period at a level that reflects the expected cost of running our business and funding our investment programme. Customer bills are inflation linked and thus provide some protection from the impact of increased operating costs, but we have to think about how best to manage the risks to the business of events not included in the prices set by Ofwat. Increasingly, these risks may arise from environmental and societal factors beyond our control such as extreme weather events or is currently the case with the Covid-19 pandemic.

Our response to the Covid-19 pandemic has illustrated how we need to continually adapt our business model to accommodate the sudden demands on the business which are typically outside of our normal activities. The response to the outbreak since March has enabled us to assess our capabilities and provided valuable insight into our long term planning.

The next five-year price period runs from 2020 to 2025 and our business planning has been based on a good understanding of the medium to long-term business and external environment.

ENGAGING WITH STAKEHOLDERS

To help prepare our business plan for 2020 to 2025 we developed a comprehensive engagement programme to ensure we capture all the differing views of our customers and other stakeholders about their priorities and expectations both now and in the future. This programme has seen us engage with 13,000 stakeholders to help us shape our plans. We worked closely with our stakeholders, including customers and employees to build our responsible business strategy that identified emerging risks and opportunities relating to the long-term success of the business and environmental and societal needs.

BEING PART OF THE SOLUTION

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

FINANCING OUR BUSINESS RESPONSIBLY

GROUP STRUCTURE

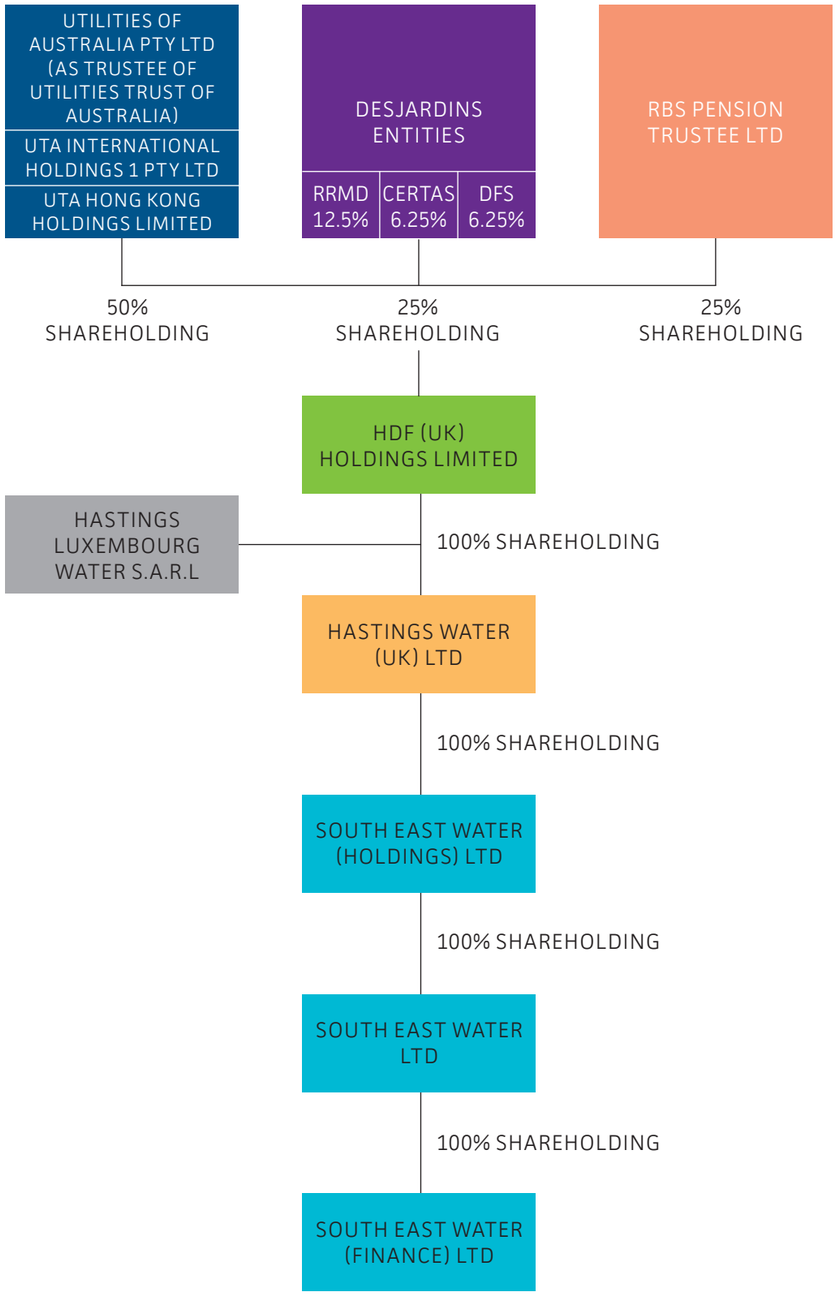
South East Water Limited is the main operating company in the group of companies headed by HDF (UK) Holdings Limited ("HDF"). There are two intermediate holding companies between South East Water and HDF: South East Water (Holdings) Limited and Hastings Water (UK) Limited, both of which, together with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

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

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

OUR BUSINESS continued

GROUP OF COMPANIES



SUSTAINABILITY FINANCE FRAMEWORK

South East Water has developed a Sustainability Finance Framework to finance a range of activities, not only environmental projects, but also ones which will benefit society such as improving drinking water quality. The framework highlights how our activities are supporting five of the United Nation Sustainable Development Goals, including climate action and sustainable cities and communities.

In order to ensure this Sustainability Finance Framework is followed correctly, we have set out that we will comply with the ICMA Green Bond Principles (GBP), Social Bond Principles (SBP), Sustainability Bond Guidelines (SBG) and LMA Green Loan Principles. These principles are each a set of voluntary guidelines that recommend transparency and disclosure and promote integrity in the development of the sustainable finance market by clarifying the approach for Sustainable Finance issuance.

We will publish a dedicated report during 2020 to demonstrate the impact this finance has made.

Read more
southeastwater.co.uk/sustainability-finance-framework

ICMA GBP /SBP CATEGORY	BRIEF DESCRIPTION OF SOUTH EAST WATER ELIGIBLE SUB-CATEGORIES LIST	EXAMPLES OF ELIGIBLE PROJECTS	UN SDG*
Sustainable water and wastewater management / Affordable basic infrastructure (Clean drinking water)	- Water demand-side management and customer-side growth - Water supply schemes - Water quality - Raw water environmental works - Capital maintenance: replacement and enhancement on a proactive basis of existing assets - Network extension: To provide a sustainable supply of clean drinking water to all new properties - Resilience	Investment and operating expenditures in, but not limited to: · Improved-metering for more frequent data to identify and address issues such as leakage · Water efficiency programmes · Water Resources Management Plan-A twin track plan to ensure sustainable supply of water 60 years into the future, through demand reduction and new supply options · Restoring sustainable abstractions · New infrastructure to replace unsustainable resources · New infrastructure to replace ageing water mains · Groundwater and surface water catchment management · Water treatment works refurbishment that improve efficiency (water/energy/chemical) · Connections of water supply from network to new property · Flood defences at treatment works, boreholes and pumping stations to ensure resilience and we can maintain clean water supply at times of flood	6 CLEAN WATER AND SANITATION 9 INDUSTRY, INNOVATION AND INFRASTRUCTURE 11 SUSTAINABLE CITIES AND COMMUNITIES 13 CLIMATE ACTION
Terrestrial and aquatic biodiversity conservation	- Protecting wildlife and increasing biodiversity	Investment and operating expenditures in, but not limited to: · Invasive Non-Native Species (INNS) projects included in Water Industry National Environment Programme (WINEP) · Delivery of biodiversity enhancements on water company landholdings · Management of company owned Sites of Special Scientific Interest (SSSIs)	15 LIFE ON LAND

*United Nations Sustainable Developments Goals

OUR BUSINESS ENVIRONMENT

EXTERNAL ENVIRONMENT

POLITICAL AND REGULATORY

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

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

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

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

ENVIRONMENTAL

Our business relies on a secure supply of our natural resource – water. We must protect both the quantity and quality of our key resource. With rainfall lower than in other parts of the country, the South East of England is officially designated as an area of serious water stress. Our water resources management plan (see page 30 for details) is key to the management of our precious resource. As well as ensuring we have the supplies we need, now and into the future, we can also protect the quality of that water and reduce energy use through more efficient treatment processes.

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

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

OUR BUSINESS ENVIRONMENT continued

Our planning into the future includes considering the effects of climate change, working to protect the environment from pollution caused by others as well as our own activities and reducing our carbon footprint. See page 49 for more information about our disclosures relating to climate change.

We have a challenging ODI target to reduce our greenhouse gas footprint to 58 $kgCO_2e$/Ml by the close of 2024/25 (our 2019/20 was at 225 $kgCO_2e$/Ml). We are committed along with the UK water companies to become a net-zero industry by 2030 as part of the Public Interest Commitment.

Our education programme continues to introduce pupils to the "wonderful world of water" and we spoke to 2,635 pupils during 2019/20 and gave out more than 32,000 water efficiency devices to customers across our region to help encourage a sustainable use of water.

Our careful stewardship of the 2,000 hectares of land we own ensures our groundwater sources produce a top quality product as the natural filtering through underground aquifers means minimal additional treatment is needed. Where our water is sourced from surface water, such as rivers and reservoirs, we are working with local communities to improve the quality of the water within the catchment. Our water and farming partnership sees us work together with Natural England to support farmers with the management of the water catchment in their areas.

We realise, as significant landowners, we have a tremendous responsibility in looking after our 33 sites which are within areas of Special Scientific Interest, including the national nature reserve at Lullington Heath in East Sussex, two nature reserves at Arlington Reservoir and Ardingly Reservoir in Sussex and numerous other areas of outstanding natural beauty. How we do this is the result of many years of careful and sensitive management of a wide variety of flora and fauna flourishing on our sites and we often work in partnership with Natural England and various wildlife trusts.

WE HAVE INVESTED £16.7 MILLION IN OUR NATIONAL ENVIRONMENTAL PROGRAMME BETWEEN 2015 TO 2020, COMPLETING 42 SCHEMES THAT COVER VARIOUS ASPECTS OF OUR OPERATIONS

We have invested £16.7 million in our national environmental programme between 2015 and 2020, completing 42 schemes that cover various aspects of our operations. These include biodiversity, surface and groundwater catchment management, abstraction, the installation of flow meters and the implementation of new eel regulations which seek to protect an endangered species at risk from water treatment processes. This year we have implemented 10 pilot biodiversity plans which are being monitored and active conservation is being delivered.

The aim of our pilots has been to establish the current value of the sites and to proactively manage the sites to develop rare, priority chalk grassland habitat. To deliver this work our environmental team has delivered 80 invertebrate, three bat, 28 reptile and seven botanical surveys during the year.

We're proud to be a part of Interreg, a programme which aims to address the impacts of climate change and enhance the availability of raw water. This cross-border project is called PROWATER, (Protecting and restoring raw water sources through actions at the landscape scale). The four-year project has a budget of more than €5.5 million. It is part funded by the European Regional Development Fund, which contributes €3.3 million, and part by project partners.

Read more
corporate.southeastwater.co.uk/about-us/ourenvironment/interreg-partnership

SOCIAL

We have many people that care about our business, including our customers, our communities and our employees. Our Performance, People and Planet report for 2019/20 summarises how we are working to meet the different requirements of these diverse groups.

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

Our engagement with customers shows us that this is too simplistic and therefore we have the ability to segment our customers based on their attitudes to and awareness of water and usage, an approach we have developed over several years. Successful retail businesses do this as a matter of course and through ongoing research with customer segments we believe the results will enable us to develop tailored communications and services that meet the differing needs and expectations of these groups for the future.

Thinking about future generations, the impact we have on them as a business and how we will ensure we are sustainable is important. We take our corporate social responsibility very seriously as we plan for the future. Clearly the drinking water we supply is fundamental to the health and quality of life of our customers. The quality of the drinking water we supply is monitored at every stage of the treatment process through to when it flows from our customers' taps. We take samples every day, which are analysed in our state-of-the-art laboratory in Farnborough to ensure that the water is safe to drink and that we are fully compliant with water quality regulations. We must supply water that complies with these regulations, exceeding these standards where possible. The quality of water for domestic purposes is also monitored by the independent Drinking Water Inspectorate.

Our communities also benefit from the provision of educational, recreational and amenity opportunities that come from being able to access our land and from the contributions we make through donations, organised charitable events and the support of our employees in their voluntary activities. In 2019/20 we provided support to the volunteers organising promotions of "Refill", an online app to encourage people to refill bottles with tap water rather than buying single-use plastic.

Our intention is to be a good neighbour and we take account of the views of our customers and the community in which we work to ensure we minimise any negative impact of our activities, 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. See our Corporate Governance Report on page 88.

The average household water bill from 1 April 2020 fell by 0.1 per cent to £210 (including inflation), which works out at 57 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.

OUR BUSINESS ENVIRONMENT continued

We offer extra help for those struggling to pay their bill or who are in debt. Our customer care team assist customers who are on a low income or in receipt of specific benefits. We understand that customers may have difficulty with paying their bills and our team has found the right assistance for 33,575 people by transferring them to our social tariff. In addition, we assist customers with a wide range of support tariffs, payment schemes and financial assistance through our charitable trust, "Helping Hand". We expect the number of customers who are struggling to pay their water bills to increase as a result of the Covid-19 pandemic.

We work closely with Citizens Advice and other organisations to share good practice in debt management and our customer care team worked constantly with external partners to ensure that harder to reach customers did not miss out on support available to them. We want to ensure the bills our customers receive for their water services are accurate and easy to understand. There is a postcode checker which allows customers to quickly check their charges on our website. An interactive online bill is also available to help people understand their bill better.

We know the value of our employees and the importance of engaging individuals in the decision-making of the business. We firmly believe that engaged employees go the extra mile to deliver a great service. How we do this is by embracing the Investors in People ethos of continuous improvement and measuring performance against our corporate objectives. This framework enables us to channel resources more effectively and harness the talent of our people towards achieving our company goals. We are proud to be accredited to the Silver Investors in People standard. Developments in our journey so far include improved training opportunities, better internal communications and ensuring all employees receive the living wage. We also require our contractors to receive the living wage – the sum above the minimum wage and we are accredited by the Living Wage Foundation.

TECHNOLOGICAL

Technology is always progressing and it is important as a business we keep up with these ever-changing innovations. Our Business Information Systems (BIS) team has implemented a number of new capabilities to provide better service to both our internal and external customers.

Enhancements to our Customer Relationship Management (CRM) system include screen-popping, whereby customer details are automatically "popped up" on the contact centre agent's screen based on the caller's phone number. This means customers don't need to wait for the agent to look up their details. New functionality around customers' bills and payment plans has transformed the ease with which agents are able to inform and advise customers over the phone, helping agents to provide the target "10 out of 10" service.

Customers can now report a leak by submitting a photo of the leak via the South East Water website. The software captures the location details and, after verification by our technical centre, the leak is published on the "In Your Area" section of our website to provide visibility to all interested parties.

Following the outbreak of Covid-19, a new form was added to the website enabling vulnerable customers to register for Priority Services. The website's accessibility also has been upgraded – now accredited as 'AA' according to the Web Content Accessibility Guidelines (WCIG).

New functionality added to our operational systems has focused around working smarter and improving performance. A new Method Statement and Risk Assessment application simplifies information capture and streamlines the approval process by removing the need for paper and wet signatures. The Operational Calendar View system provides live visibility of all works at all operational sites for everyone who needs to know – employees or contractors – reducing site outages, aborted trips to sites and ensuring that operators don't impact on each other's work.

OUR BUSINESS ENVIRONMENT continued

The new Asset Data Exchange (ADE) enables the Engineering and Asset functions to systemise the capture of data for assets that are due for replacement or site refurbishment. It captures the assets within a 'storeroom' once they have been delivered, identifies any available spares and highlights any maintenance needed before the asset is commissioned.

To help manage communications to our key stakeholders, a layer was built on our geographical information system (GIS) to provide a spatial view of stakeholders in our area. Using this visualisation tool enables us to know which stakeholders to update on events and major works.

In our quest for a paperless office and seamless business processes, new features have been added to our HR and recruitment systems to completely digitise the on-boarding process for new starters.

New cyber and information security measures were implemented in the year to ensure that our customers' data is kept safe, secure, up-to-date and accessible only to those who have a need to know.

Covid-19 provided the biggest challenge of the year for BIS as South East Water moved to reduce office occupancy by 80 per cent by enabling home working in the latter half of March. Using existing technology and a new cloud-based contact centre platform for outbound calling, this target was achieved in two weeks.

INTERNAL FACTORS (KEY RESOURCES)

PEOPLE

We know that we can only achieve our ambitions for customers with a thriving and creative team of people to deliver our promises. That is why we ensured our vision was as much about the people we work with as it is about those we work for. Protecting the interests of our employees and partners and ensuring that they are respected, fairly treated and highly motivated is a key objective through our "everyone counts" commitment. The health, safety and wellbeing of our employees is vital to our business.

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

This year there has been a focus on mental health and in November we held a company-wide management conference which served as the launch pad for the new mental health strategy. Expert speakers included the charity Mind and the Health and Safety Executive with a keynote speech by Clarke and Carrie Carlisle. Supporting events were held at cinemas throughout the region to ensure that all employees could engage with the strategy.

Executive and Senior Management Team site tours have been undertaken throughout the year. These tours took in a variety of workplaces within South East Water and provided members of the senior management team with an opportunity to engage directly with the teams at the coal face on the health and safety issues most important to them.

Examples of activities undertaken during the year to improve diversity across the organisation include:

- signing up to the Government Disability Confident Committed Employer initiative
- becoming the first water company to partner with the Women's Utility Network (WUN), an organisation dedicated to encouraging greater industry diversity and better career progression for women in the utilities sector
- adapting our interview process such that all roles at Grade D and above must have an interview panel including both men and women

Our employee performance management framework, called iReview, supports the business objective of employee self-assessment. Developed in collaboration with managers and employees through focus groups, iReview provides a continuous approach of regular feedback from managers and recognition of achievements. Employees are able to assess their own performance against objectives as well as the new behavioural framework, tied to our values.

In 2019/20 we completed, achieved and gained:

- number of training hours: 14,734
- number of apprentices: 12
- number of apprentices recruited last year: 6 (in 2018/2019)
- number of apprentices recruited this year: 8 (in 2019/2020)

Our Performance, People and Planet report details the work we are doing to continue to ensure we are the water company people want to work for.

ASSETS

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

In August 2019 we published our resilience action plan, a suite of additional activities that we are undertaking to further enhance how we manage our physical assets and infrastructure to ensure we maintain our water supply and distribution systems effectively and provide a resilient wholesome supply of water for our customers.

Gross capital investment in the year was £104.5 million (2019: £104.7 million).

We have worked with our strategic partner, Jacobs, to deliver our capital programme which has seen us invest £38.9 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 £22.4 million on renewing and replacing more than 35 kms of our underground mains infrastructure (the pipes that transfer water to our customers). We have spent approximately £43.1 million as part of our strategic objective to improve our supply and demand management. This includes delivering all of our environmental improvements, and upgrading the physical security on our sites up to new standards defined by Defra. This year we have agreed a new licence trade arrangement following the purchase of the Aylesford Newsprint site. The water source, formally used in the production of paper, will secure an additional 18.2 million litres of water a day to the Maidstone area.

OUR BUSINESS PERFORMANCE

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

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

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

Our customer satisfaction performance has remained stable for the majority of measures this year. The average score for the year is 4.3 out of 5 across our suite of measures. This means that the majority of our customers are either satisfied or very satisfied with the service we provide.

The Service Incentive Mechanism (SIM) is a water industry customer satisfaction measure designed to encourage companies to provide a better service to their customers.

In the year we reported a final SIM score of 78.43 as a proxy measure to Ofwat and a key indicator of our performance, despite this no longer being an ODI. During 2020 to 2025 this has now transitioned to the new Customer Measure of Experience Score (C-MeX) and during the last year we have been participating as part of a shadow year to better understand this new measure.

While SIM was a measure of customer satisfaction, the new C-MeX measure covers a broader range of customer measurement and not only measures the satisfaction of customers who have contacted us but also adds the additional lens of surveying customers who have not contacted us. Our overall C-MeX score rose over the last year, steadily ending in a score of 73.36 out of 100. This score correlates very closely to our positioning in the SIM measure. This new measure will be linked to financial incentive reward and penalty during 2020 to 2025.

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

For further information on all of our outcomes and targets please refer to our Performance, People and Planet report and table 3A in our Annual Performance Report on page 260.

ENERGY, CARBON AND CLIMATE RELATED REPORTING

We measure and report our emissions under scope 1, 2 or 3 using the methodology described below and we integrate climate change risks into our long-term plans and business plans.

We provide below mandatory and voluntary reporting on our emissions as well as information on our strategy to manage climate change risks and reduce our emissions and impact on the environment.

STREAMLINED ENERGY AND CARBON REPORTING (SECR)

The information set out below is provided as required under Part 7A, Schedule 7 large and medium sized companies and groups (accounts and reports) regulations 2008.

	GHG EMISSIONS	2019/20	UNIT
1	Annual quantity of GHG emissions for the purposes of transport No gas is used for the purpose of transport. The consumption of fuel for the purpose of transport falls into several categories: fleet vehicles, company cars.	1,785	tCO_2e
2	Annual quantity of GHG emissions resulting from the purchase of electricity for own use (including for the purpose of transport) Electricity was not used for the purpose of transport in the reporting year. The electricity usage is divided into three categories: pumping, treatment and administration.	36,255	tCO_2e
3	Aggregate equivalent kWh for emissions under 1 and 2 above	149,143,179	kWh
4	GHG emission intensity metric Operational GHG emissions per mega litre of treated water based on the emissions set out under 1 and 2 above.	198	$kgCO_2e$ /Ml

ENERGY, CARBON AND CLIMATE RELATED REPORTING continued

METHODOLOGY

We use the UKWIR Carbon Accounting Workbook (CAW) provided for all UK water companies to give a consistent and transparent approach for accounting greenhouse gas (GHG) emissions from annual operational activities.

The CAW provides estimates of the GHGs identified in the Kyoto Protocol, which are produced as a result of the operational activities of water and wastewater companies, including water treatment and distribution, wastewater collection and treatment, and sludge management. Estimates are made following guidance published by Defra and BEIS, as well as international guidance where required.

The tool is used by UK water companies to report progress internally and prepare information for reporting performance to regulatory bodies, voluntary reporting schemes and customers. The tool is updated annually as required in line with UK publication of conversion factors used for estimating GHG emissions. The report is therefore a suitable tool to report SECR requirements.

The data is compiled from various sources across the business and placed into a carbon accounting information pack before being transcribed into the appropriate areas of the CAW. This allows the CO_2e figures for the Company to be compiled which are then externally audited. This data is then used to calculate the total associated kWh for purchased energy and transport using recent year emission factors.

PRINCIPAL MEASURES TAKEN IN 2019/20 FOR INCREASING THE COMPANY'S ENERGY EFFICIENCY

We continually review how we can minimise our carbon emissions which includes assessing potential renewable options, an in-depth energy management review, extended metering, and our capital maintenance programme replacing older assets such as pumps with newer more efficient pumps which will reduce our energy consumption and carbon emissions.

We are also exploring more advanced analytics surrounding energy, identifying sites that are inefficient based on energy trends and would therefore benefit from a revised process or improved assets.

Most of the Company's carbon intensity (81 per cent) is driven by the use of electricity for water pumping and distribution. In 2019/20, we achieved approximately a 30 per cent reduction in power consumption in peak demand times. Our total energy usage saw a reduction during the year of over 1,280,821 kWh.

With 12 per cent of the remaining carbon intensity from transport (4 per cent) and outsourced contractors (8 per cent) we are working at improving our analytics on our fleet. We have moved to BP's cloud based portal containing our fleet fuel usage which will help us identify inefficient vehicles as well as exploring the potential for electric vans.

We provide more details on further initiatives and on our strategy in relation to carbon emissions and climate change on page 49.

SCOPE 1, 2 AND 3 ENERGY AND CARBON REPORTING

Using the methodology described above we measure and report on all our scope 1, 2 and 3 emissions annually and a summary is provided below.

Scope 1 (direct) emissions are emissions from activities owned or controlled by the company that release emissions into the atmosphere.

Scope 2 (energy indirect) emissions are emissions associated with our consumption of purchased electricity, heat, steam and cooling.

Scope 3 (other indirect) emissions are emissions that are a consequence of our actions and that occur at sources that we do not own or control, and that are not classed as Scope 2 emissions (for example, emissions from business travel by means not owned or controlled by us or emissions associated with our supply chain).

			2019/20	UNIT
Scope 1	1	Direct emissions from burning of fossil fuels (including natural gas CHP* generated onsite)	484	tCO_2e
	2	Process and fugitive emissions*	1,106	tCO_2e
	3	Transport: Company owned or leased vehicles	1,785	tCO_2e
Scope 2	4	Total grid electricity used by company (including CHP** electricity purchased)	36,255	tCO_2e
Scope 3	5	Business travel on public transport and private vehicles used for company business	41	tCO_2e
	6	Outsourced activities (if not included in Scope 1 or 2) Energy and other	3,935	tCO_2e
	7	Total grid electricity used by company (including CHP electricity purchased) – Transmission and Distribution***	3,078	tCO_2e
Gross emissions	8	Gross operational emissions	46,683	tCO_2e
Intensity metric	9	Operational GHG emissions per mega litre of treated water This metric includes all scope 1, 2 and 3 emissions for energy for pumping and treatment except energy emissions relating to administration. (This metric includes emissions from diesel generators used at sites and from ozonation at sites.)	209	$kgCO_2e$ /Ml

*Process emissions are a consequence of physical or chemical processes (for example in our water treatment). Fugitive emissions include intentional and unintentional releases (for example refrigerant in air conditioning units).

**CHP - Combined Heat and Power – a process that captures and utilises the heat that is a by-product of the electricity generation process.

***Electricity which is lost in the transport and distribution system used for delivering purchased electricity.

ENERGY, CARBON AND CLIMATE RELATED REPORTING continued

OUR AIM IS TO DEVELOP A COMPREHENSIVE AND INTEGRATED APPROACH TO THE MANAGEMENT OF CLIMATE CHANGE RISKS THAT IS AT THE CORE OF OUR LONG-TERM PLANNING AND OUR RELATED DISCLOSURES

INTEGRATING CLIMATE RISKS AND CLIMATE ADAPTATION INTO OUR LONG-TERM STRATEGIC PLANNING

Our core responsibilities include planning for future water resources and for events such as droughts while investing efficiently and protecting the environment.

To fulfil these responsibilities we prepare strategic statutory plans and in particular our Water Resources Management Plan (WRMP) and Drought Plan. The impact of climate change is a central consideration in the development of these plans both to calibrate our scenarios and assumptions and to select the most appropriate solutions and investments to develop water resources, improve the resilience of our supply system and manage demand.

We also maintain a resilience action plan which helps us ensure the resilience of our assets and services, not only to face incidents and weather events but also to face the long-term change to climate patterns caused by global warming.

We have already prepared two Climate Change Adaptation Reports which provides strategic direction and context to our long-term planning activities and we will be updating our Climate Change Adaptation Report ready for publishing in advance of December 2021.

EXTENDING OUR REPORTING IN LINE WITH THE TCFD RECOMMENDATIONS

We are building on our existing work in relation to energy and carbon reporting and climate adaptation to develop our strategy and reporting following the recommendations of the Task Force on Climate Related Financial Disclosures (TCFD).

Our aim is to develop a comprehensive and integrated approach to the management of climate change risks that is at the core of our long-term planning and our related disclosures. We are developing a plan of action for 2020/21 for the implementations of the TCFD recommendation as well as for the update to our Climate Change Adaptation Report and in particular for the development of scenarios that will support a consistent approach for our long-term strategic planning and our future financial disclosures under TCFD.

We summarise below our current approach to climate related risks and opportunities following the four thematic areas set out in the TCFD recommendations: governance, strategy, risk management, and metrics and targets.

GOVERNANCE

Our board has effective oversight of climate-related risks and opportunities. Climate-related risks are included within our Corporate Risk Register which is regularly reviewed by the Executive Directors and annually by the board. The Corporate Risk Register includes details of any appropriate controls and mitigating actions.

Any relevant targets related to climate change are agreed by the board and specifically our target to reduce carbon emissions, are included within our published performance commitments each year.

Our Climate Change Adaptation Plan has identified priority risks from climate change and how these impact our functions and activities across the business. We have identified mitigations and monitoring plans to adapt to climate change impacts. Our WRMP includes consideration of different climate change scenarios on our security of water supply and we have incorporated measures to address climate change impacts into our plans as appropriate.

STRATEGY

We have a statutory requirement through our WRMP to be resilient to climate change and will publish an updated Climate Change Adaptation Plan in advance of the deadline of December 2021.

Included in our business plan for 2020-25 is an ambitious target to reduce our emissions to 58 $kgCO_2e$/Ml by 2025, including all scope 1, 2, and 3 emissions. This represents a reduction of our emissions of 80 per cent by 2025 (when compared to 2017/18). We have adopted a carbon reduction strategy which sets out our roadmap for meeting this target.

The water industry has also adopted a voluntary commitment to become net carbon zero by 2030 as part of the Public Interest Commitment (PIC) and our carbon reduction strategy is designed to contribute to meeting this target.

RISK MANAGEMENT

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.

Our risk management framework is 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. The adoption in our business plan of a performance commitment for the reduction of our emissions by 2025 ensures that our systems of controls and external assurance relating to our regulatory reporting will be applied equally to our emissions reporting.

We maintain a formal risk register and risk management system for the identification, evaluation and mitigation of risks. Significant risks from climate change, and their impacts on functions and activities across the business, have been incorporated into our Corporate Risk Register and we are able to report specifically on these risks – providing additional focus and scrutiny of risks, controls and mitigating actions.

Read more on our risk management systems and principal risks on page 59.

METRICS AND TARGETS

We report our performance annually in our Performance, People and Planet report.

For the current period, up to 2020 our target has been to reduce carbon emissions to 37.7 $kgCO_2e$ per customer. We have outperformed this target and our actual emissions figure for 2019/20 is 35.9 $kgCO_2e$ per customer.

As highlighted above we have an ambitious target to reduce our greenhouse gas emissions by 80 per cent by 2025 (when compared to 2017/18) and have also committed to achieve an industry level Public Interest Commitment of net carbon zero by 2030.

FINANCIAL PERFORMANCE

Our financial performance in the year has been strong and we have delivered on the key financial metrics both for the year itself and for the final year of the Asset Management Period (AMP). During the year we have continued with a strong service commitment to our customers, strengthened our network to improve resilience and prepared ourselves for the challenges of the new Asset Management Period. We have also invested further in becoming a responsible business.

The impact of Covid-19 and consequences of the lockdown restriction issued by the UK government at the end of March 2020 has not had a material impact on our water consumption or revenue in the final weeks of the year, nor has the cost base seen any significant increase in this very short period to the end of the financial year. As we have moved into the new financial year we have seen a material reduction in wholesale supply to businesses as the lockdown has continued, offset by an increase in additional water use by our domestic customer base. We expect the impact on wholesale supply to ease off as the restrictions are lifted and domestic consumption and revenue to remain variable throughout the summer period. In the new financial year, whilst is difficult to predict the future impact on our cost base, we do belive that there may be a requirement for our provisions for bad debt to increase as we see an increase in the potential number of customers who are unable to pay their water bills. In addition, we are also seeing an impact within our supply chain which may have a direct cost impact, the timing and scale of which are uncertain. Further details are set out in the Long Term Viability Statement on page 71

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

In addition, we monitor profitability, capital expenditure and cash performance, further details of which are set out in the table on page 55.

The group financial statements are set out on pages 146 to 207. The group accounts are prepared under International Financial Reporting Standards (IFRS) and report the results for the consolidated South East Water group. The group accounts include the results of South East Water (Finance) Limited.

REVENUE

The turnover for the year was £243.5 million compared to the previous year of £238.3 million. Under the regulatory price control mechanism, our revenue is allowed to increase each year. In 2019/20 our tariffs increase was five per cent. Additional revenue generated from an increase in prices of £11.9 million.

The increased turnover was offset by:

- lower consumption of £4.2 million, compared to the high demands in the summer of 2018
- lower revenue from the switch from unmeasured to measured supply of £1.7 million
- additional social tariff allowances given to customers of £0.8 million

Other income has shown a small reduction of £0.8 million which is partly due to the prior year containing a £0.4 million discount on the purchase of the debt book from Invicta Water Limited following the transfer and subsequent sale of the non-household business in summer 2018. The balance of £0.4 million related to additional income earned on the Southern Water One Bill contract in 2018/19 as part of the set-up of the initial contract.

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

In the Key Performance Indicators (KPI) table below:

- the interest cover ratio is the multiple times the cash generate from operations covered the cash interest paid in the year
- the Regulated Capital Value (RCV) for the company is published on the Ofwat website and represents the value of the company before deducting long term debt
- net debt is the loan finance borrowed less the cash and authorised investments
- the ratio of net debt to RCV is the percentage of RCV owed in loan financing

KPI	MEASURE	2019/20	2018/19
Credit rating	Standard & Poors	BBB	BBB
	Moodys	Baa2	Baa2
Interest cover	multiple	3.3	3.3
RCV	£m	1,413.2	1,365.0
Net debt to RCV	%	74.5	78.6
Turnover	£m	243.5	238.3
Operating profit	£m	81.3	86.4
Profit before tax	£m	33.8	36.4
Capital expenditure	£m	104.5	104.7
Cash	£m	13.0	12.8

OPERATING EXPENDITURE

Our operating costs for the year, including charges for doubtful debts, have increased from £164.8 million to £174.3 million, an increase in costs of £9.5 million. The most significant impact on costs in the year was additional depreciation of £3.3 million in respect of new assets introduced to operations during the year, including £0.1 million in respect of 'right-of-use' leased assets as a result of the adoption of IFRS 16 on 1 April 2019. There was also an additional charge for doubtful debts of £2.6 million to reflect an increase in older debt (£1.9 million) and provision for the impact of a downturn in the economy (£0.7 million). Other increases include £1.3 million of additional energy and bulk water supply charges due to increased prices in the year, £1.7 million of additional contractor costs, including higher maintenance costs and £0.7 million costs associated with the impact of the UK's exit from the European Union. Furthermore, there were additional inflationary cost pressures of £0.6 million. Whilst the impact of the Covid-19 outbreak has not materially impacted our cost base in 2019/20, there is the potential for an economic downturn in 2020/21 which may mean that we need to make further provision against our customer debt incurred next year.

Partly offsetting this were lower debt collection fees of £0.5 million following additional charges incurred in 2018/19 following the exit from the non-household retail market.

OPERATING PROFIT

Operating profit has decreased from £86.4 million to £81.3 million, a reduction of £5.1 million, as detailed above.

FINANCE COSTS

We hold a number of listed bonds and indexed linked loans. The maturity dates of the loans range from 2023 to 2042 and further details with respect to these loans are set out in note 22 to the accounts.

In September 2019 the group repaid £200 million bonds that had reached maturity, together with an associated interest rate swap arrangement, giving a total repayment of £311.5 million. This was replaced by the drawdown of a variable rate loan facility, which was entered into in December 2018, of £120 million and the issuing of two series of loan notes totalling £175 million. Also during September 2019, the company's parent company repaid £54 million of its variable rate loan to the company.

FINANCIAL PERFORMANCE continued

Further, the group took the opportunity to reduce the amount drawn down on its working capital facility with the net repayment of £25 million during the year.

The associated finance costs of these loans are £52.9 million in the year compared with £56.1 million in the prior year. The reduction in costs are largely due to the lower finance costs of the new loans replacing the bonds that matured in September 2019 (£2.4 million) and lower indexation charges in the year on the remaining index linked loans (£1.1 million).

Offsetting the loan costs is interest receivable of £5.3 million (2019: £6.1 million) mainly from South East Water Limited's parent, South East Water (Holdings) Limited. The lower interest received on the loan to the company's parent company is due to the part-repayment of the loan in September 2019.

PROFIT BEFORE TAX

Profit before tax for the year was £33.8 million compared to £36.4 million in the previous year. This reduction in profit reflects the operating performance described above. The profit on the sale of the company's non-household business of £9.3 million was a discontinued operation and has been excluded from the profit before tax for the prior year.

PROFIT AFTER TAX

Profit after tax for the year has reduced from £38.7 million to £16.9 million. The principal drivers are the operational performance and financing detailed above of £5.1 million and an increase in our tax charge of £10 million from £7 million to £16.9 million.

The tax charge in the year of £16.9 million includes the effect of changes in the future tax rates announced in the budget by the UK Government in March 2020. Our tax charge of £16.9 million for the year comprises:

- current tax of £1.9 million (2019: £0.8 million). The increase in current tax is due to a marginal increase in taxable profit after allowing for appropriate tax deductions
- deferred tax of £15.0 million (2019: £6 million). The increase in deferred tax is due to the reversal of the corporation tax rate from 17 per cent to 19 per cent from April 2020 by the UK government of £12 million partially offset by a reduction in the origination and reversal of temporary differences

Further details on the current and deferred tax calculations are set out in note 12 to the accounts.

TREASURY

Our treasury policy seeks to ensure that sufficient funding is available to meet foreseeable requirements and maintain appropriate headroom for contingencies. We manage the financial risks of the business through a series of hedging policies and ensure that our short and long-term facilities are appropriate to the strategic objectives of the business. Our policy considers inflation risk, interest rate risk, currency risk and investment criteria. The policy is underpinned by the obligations of our securitisation structure. Our assessment of the associated risks are set out in note 26 and details of our long-term loans are set out in note 22.

PENSIONS

The company pays contributions to the South East Water and Mid Kent Water defined benefit schemes which both closed on 31 March 2015 to future accrual. During the year £3.9 million was paid to the South East Water scheme and £1.4 million was paid to the Mid Kent Water scheme.

These contributions are broadly in line with the prior year. Further details on these schemes are set out in note 27 to the accounts. In addition the company operates and funds a stakeholder pension scheme which is a defined contribution scheme. During the year approximately 900 employees contributed to the scheme and the company made payments of £2.4 million by way of employer contributions to this scheme (2019: £2.1 million).

NET DEBT AND CASH FLOW

We use a combination of long-term funding and short-term working capital to finance the extensive capital programme and to fund the ongoing operations of the business. During the year the net operating cash generated was £134.4 million (2019: £125.0 million). Net payments in respect of capital expenditure in the year totalled £98.2 million compared to £90.2 million in the prior year. Net payments in respect of interest and other finance costs were £37.2 million in the year. This is higher than the previous year's net payment of £31.5 million due to a full year's interest being paid on the maturing bonds in September 2019 together with six months interest on the new replacement loans. The refinancing of the group's £200 million bonds that matured in September 2019 are detailed above and resulted in a net cash outflow of £2.5 million.

The group statement of cash flows on page 152 shows an increased cash balance, from £12.8 million at the beginning of the financial year to £13.0 million at the end of the year.

The interest rate benchmark LIBOR is expected to cease at the end of 2021 and will no longer be published from this time. It is expected that LIBOR will be replaced by a reformed version of the Sterling Overnight Index Average (SONIA).

The group has a number of financial instruments which interest rates are linked to LIBOR. A review is currently being undertaken to assess the impact of the new rate on the affected financial instruments and the implications for the loan documentation of these specific loans.

DIVIDEND

We must pay dividends to our shareholder only in accordance with our dividend policy and the principles that the dividends do not impair our ability to finance our business and that dividends are expected to reward efficiency and the management of economic risk.

The company's dividend policy is to pay out an appropriate proportion of cash earnings so as to provide a suitable return to our shareholders, while ensuring that we are able to finance our business and meet the requirements of our instrument of appointment, both as at the date of the proposed dividend and prospectively. When assessing the appropriate level of dividend considerations will include the company's actual and forecast level of gearing, the need to maintain South East Water's credit rating, the allowed cost of capital, any outperformance achieved or forecast by the company and the level of any equity injections received by South East Water.

Dividends are considered in the context of the overall performance and financial resilience of the company which also depends on our performance against our commitments and the level of reward or penalty under the outcome delivery incentives. Dividends are also considered by reference to forecast financial and operational performance to ensure that they would not compromise the future performance of the company.

During our recent refinancing we took steps to reduce the level of debt to improve the financial resilience of the business.

Performance against key operational performance commitments (other than SIM) which include leakage, low pressure, interruptions, discoloration contacts, water resources deficit, mean zonal compliance, above ground asset performance, burst mains and breaches of abstraction licenses or discharge permits was either in reward or did not attract penalties resulting in a net reward position.

FINANCIAL PERFORMANCE continued

Our final position on SIM was 9th equal with another company attracting a small penalty but still corresponding to a year-on-year improvement in performance which matched the expectations we set at the beginning of the period. The penalty is also the result of the methodology adopted by Ofwat in the determination at PR19 which removed a deadband that had been used in previous years. Our satisfaction measures taken together have generated a modest penalty as the overall improvement from 2015 to 2020 was not of the amplitude we had targeted even if there was an overall improvement in satisfaction over the period against increasing customer expectations.

Our performance on key service delivery to customers was overall satisfactory and in a net reward position and the penalty incurred remained such that the amount of dividend payment in the year was sustainable and in accordance with our policy and regulatory obligations.

The overall level of dividend paid compared with the level of dividend deemed reasonable in Ofwat's assessment of the allowed return on equity is also considered.

The dividend yield in FY20 is 3.4 per cent, but after deducting non-appointed contribution and intra-group interest, the dividend yield is 0.5 per cent, which is well below the allowed nominal cost of equity of 8.25 per cent (real cost of equity of 5.66 per cent plus inflation of 2.59 per cent).

CREDIT RATING

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

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

GEARING

The company operates a securitisation structure. Our long-term funding at the end of March 2020 was £1,036.9 million which represents 74.6 per cent of our regulated capital value. Our securitisation requirements are that we should maintain a level of gearing of 85.0 per cent or less. We monitor the gearing closely and there is sufficient headroom as at 31 March 2020. Our gearing levels have not been impacted by Covid-19. Further details of the potential impact of Covid-19 on our future financial ratios and future gearing have been set out in the Long-Term Viability Statement on page 71.

TAXATION AND TAX POLICY

Our taxation policy is set out in the Directors' Report and the regulatory Annual Performance Report. A more detailed explanation of our tax policy is available on our website. We have a significant capital programme and as such hold significant capital allowances to offset current tax liabilities, coupled with losses generated elsewhere in the group.

Read more
southeastwater.co.uk/ourgovernance

RESILIENCE, RISK MANAGEMENT AND BUSINESS VIABILITY STATEMENT

HOW WE MANAGE RISKS

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

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

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

Ofwat has not undertaken a formal review of the Industry's publications in 2019/20, but they have sent out informal reviews to each company. Ofwat identified a small number of concerns which we have reviewed in detail and put in place actions and quality control processes to ensure these issues are not repeated.

Our targeted status in January 2019 means that we are required to publish a full analysis of the strengths, risks and weaknesses in relation to data and information provision and we need to publish a summary of the outcome of the assurance that has been carried out. In practice we have always published this for these elements, while self-assured (though not required to), so the format of our company monitoring framework remains unchanged.

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

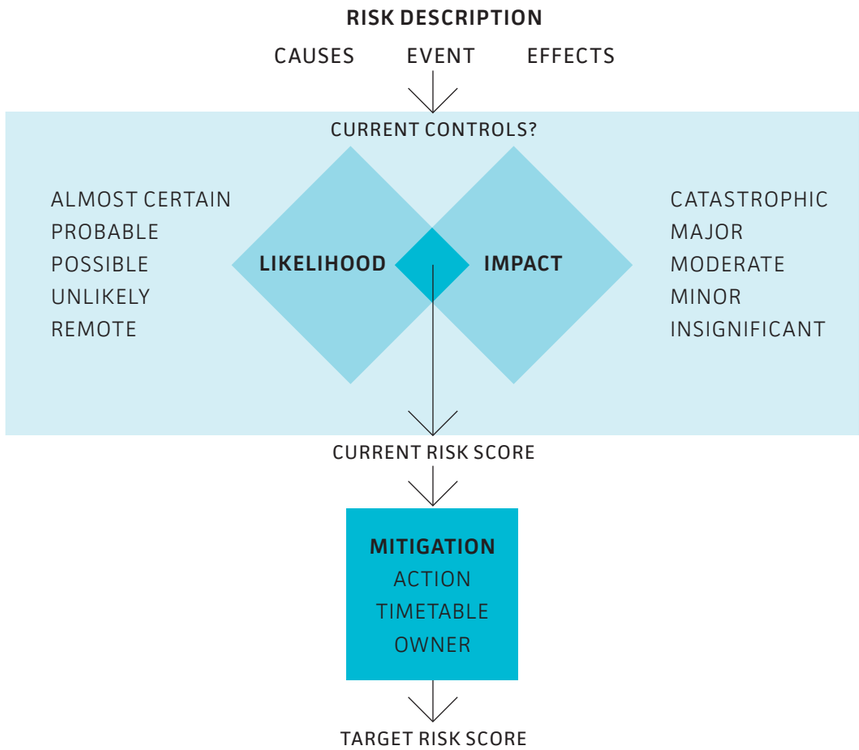
We maintain a formal risk register and risk management system for the identification, evaluation and mitigation of risks. The board defines South East Water's risk management framework and reviews the risks on the register and the effectiveness of the relevant mitigation measures at least once a year. The board also reviews monthly, quarterly and annual reports on performance which highlight risks and business or operational issues as they arise. Please see page 106 for a summary of the board activities in the year. The audit and risk committee monitors the effectiveness of our systems of risk management and internal controls on an ongoing basis. Please see page 117 for the report from our audit and risk committee.

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

Read more
southeastwater.co.uk/cmf

RESILIENCE, RISK MANAGEMENT AND BUSINESS VIABILITY STATEMENT continued

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

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

Risks are reviewed regularly by the executive team and the board and our risk profile remains stable. To reflect the current national response a number of our risks have been impacted by Covid-19, and subsequently controls and actions have been strengthened or brought into place to mitigate these risks as much as possible.

While the corporate risk register identifies risks that exists in the present and short-term we have also extended the register to assess potential risks to outcome delivery incentive (ODI) success in the 2020 to 2025 price control period. In total 111 risks were identified as potentially having a direct impact to one or more ODI performance measures. Identifying these risks now ensures we are able to provide early mitigation to optimise performance across our commitments.

This year we have also undertaken a review of the corporate risks with a responsible business lens on the register, these are reviewed with the responsible business board committee on a quarterly basis.

To supplement the corporate risk register we are also currently undertaking an exercise to evaluate future risks – broadly targeting a rolling 10-plus year horizon span. Consideration of long-term risk planning involves an element of blue-sky thinking and future consideration of where political, social, and economic factors may take the business. An understanding of these risks will allow the business to plan, and build resilience to the future threats that these identified risks may pose. The intention is that risks identified to have no immediate solution can be channelled through our innovation programme – to establish if as yet untested (or unused) technology/processes can be sought to reduce or control future 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 the following pages. These principal risks have been considered in the context of our business model and strategy. We have reflected the impact of Covid-19 which affects a number of our principal risks based on our current experience to date and our work as a company and with the water industry to assess the future potential impact on our company, the water sector and the UK economy.

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

OUR PRINCIPAL RISKS

CATEGORY	RISKS DESCRIPTION	MITIGATION
HEALTH & SAFETY	Our activities and assets present risks to the health and safety of our employees, contractors and the public. Failure to prevent accidents could have tragic implications for individuals and their families. There are severe criminal sanctions and civil sanctions for failing to have appropriate safety measures and failure to meet health and safety standards.	We have comprehensive processes in place including policies, standard operating procedures, risk assessments and toolbox talks involving our employees, partners and contractors. We continuously take actions on training and awareness to ensure that our employees and contractors always adopt safe practices. We have continued to build on our Thrive 365! safety strategy designed to support the company vision and provide clear direction and a road map for continuous improvement of our health, safety and wellbeing performance with the roll out of a new mental health strategy. We have made significant changes to the way our business operates during the Covid-19 pandemic and lockdown to protect our workforce and the public. We will continue to review and adapt our working practices to ensure we maintain the safety and wellbeing of our workforce as required by the evolution of the pandemic and in line with Government recommendations in 2020/21. Our Directors review health and safety performance at each board meeting.
WATER QUALITY	A water quality incident could lead to a failure to supply wholesome water and public health incidents which would significantly affect customer trust. This may also result in investigations and enforcement actions and potential prosecutions from the Drinking Water Inspectorate. Water quality events may also lead to significant costs being incurred and have a significant impact on our revenue, and prevent us from meeting our performance commitments. This could relate to our own water treatment facilities or to bulk supplies of treated water we receive from other water companies.	We control water quality risk through the operation of our treatment works and distribution network which are constantly monitored. We carry out extensive sampling of our water every day at our accredited laboratory. We follow the World Health Organization (WHO) water safety plan approach which includes risk assessments and management of all aspects of our water supply chain from catchment to customers' taps. We invest in our treatment works to improve water quality and actively manage our catchments to reduce the discharge of chemicals by third parties. We have emergency plans for the deployment of alternative supplies if necessary. We have implemented a programme of flushing, network management and investment in our treatment works to meet our targets on discolouration contacts. We share lessons learnt with other companies which we use to update and improve our own practices and procedures. We have maintained all our essential water quality activities during the Covid-19 pandemic and lockdown to ensure the safety of the water supply to our customers and the critical facilities we supply. We have put in place special measures for the protection of our employees in our laboratory as well as to improve the resilience of our laboratory in case some of our employees become infected.

CATEGORY	RISKS DESCRIPTION	MITIGATION
OPERATIONAL PERFORMANCE	Strategic asset failures and significant operational incidents (such as bursts, severe weather events, ground movements and naturally occurring sink holes or water quality events) may affect our ability to deliver a safe and uninterrupted water supply to a large number of customers or cause damage to third parties. This can lead to penalties and legal action and impact customers' perception and satisfaction. This also leads to additional compensation costs. These risks may affect our own water infrastructure or those of other water companies that provide us with a bulk supply of treated water.	We have established procedures and emergency plans for dealing with incidents and targeted investment to address specific operational risks when identified. We have put in place a dedicated operational steering group to identify potential risk and work on prevention and mitigation. We have put particular emphasis on this area to improve our performance on interruptions which was affected by a small number of large bursts at the beginning of the regulatory period and by the freeze/thaw in 2017/18. Following the freeze/thaw, we used our reports on lessons learnt to prepare and deliver a comprehensive action plan to improve our readiness, resilience and our response capabilities in case of severe weather events. We tested and adapted our operational plans in response to the Covid-19 outbreak to be able to protect the supply to critical facilities, to ensure the safety of our workforce and the public and to maintain social distancing when responding to incidents and especially supply interruptions due to bursts. We implemented changes to the monitoring and management of our water supply system to be able to limit the risk of outages and face unprecedented water demand during the lockdown.
MARKET REFORMS	The extension of competition on the non-household retail market, the evolution of the new connections market, the introduction of competition for water resources, demand management and leakage services and the introduction of direct procurement at PR19 as well as the potential introduction of competition for household retail customers in the future create new risks of disruption to our business model and operations. There are implementation risks in establishing new methods of working and processes. They could also create new business opportunities. We could face reputational damage and possible enforcement action if we do not demonstrate compliance with the new market arrangements. We must also ensure continued compliance with competition law as the environment in which we operate evolves.	We are keeping the proposals from Ofwat and government under review and contributing actively to ensure that risks are identified and taken into account in the definition of policy. We maintain up to date compliance processes in response to changes to regulation and market codes and we monitor our performance against market metrics. We are reviewing and anticipating the potential impact of regulatory changes on our ability to secure finance at no less favourable terms. We keep our commercial strategy and the structure of our business under review to be able to adapt to changes and to take advantage of new opportunities.

OUR PRINCIPAL RISKS continued

CATEGORY	RISKS DESCRIPTION	MITIGATION
ADVERSE CHANGES TO THE REGULATORY FRAMEWORK AND POLITICAL RISKS	Decisions to change the approach to established aspects of the regulatory framework have an impact on our overall risk profile and on our medium and long-term planning. This included Ofwat's decision to reduce the RCV and the use of CPI instead of RPI for the indexation of the RCV. Potential nationalisation (or renationalisation) of water companies has the potential to cause significant disruptions to our operations. It would potentially affect our existing financing structures. This creates uncertainty relating to our long-term planning and our ability to maintain the investment required to meet our long-term service obligations. Nationalisation could lead to the business being acquired below fair value.	We are assessing the implications of political risks including the risk of nationalisation. We work with the industry and stakeholders to anticipate the potential effects of the proposals and to contribute actively to the debate to ensure that risks are identified and taken into account in the definition of policy proposals. We monitor changing expectations and perception by stakeholders of the role of business and utilities in society to align our culture, governance and strategy to the political and social environment in which we operate.
PRICE DETERMINATION	The latest final determination by Ofwat introduces separate water resources and network plus wholesale price controls. It maintains the use of totex and outcome delivery incentives (ODIs) with reference to upper quartile performance and with the introduction of in-period reward/penalty adjustments. The final determination also introduced new customer satisfaction measures (C-MeX) and new developer services satisfaction measures (D-MeX). These changes bring new compliance requirements related compliance risks and additional risks of performance penalties. Successive final determinations determine our ability to carry out the investment necessary to be able to meet our long-term future obligations to maintain an efficient water supply system and to prepare for the impact of population growth, pressure on water resources and the environment, and the impact of climate change. There is a risk that the need for necessary investment in successive price determinations may not be fully demonstrated or recognised resulting in difficulties in the future to meet our obligations as long-term challenges such as climate change materialise.	We have detailed processes to ensure compliance with our price determination and to ensure that we operate within the assumptions of the price determination (including ODIs and investment). We have processes to monitor and report on our compliance with regulatory obligations. We are continuously assessing the deliverability and financeability of the final determination and any risk it may create for the company for the next regulatory period. The nature, scale and timing of any intervention from Ofwat to mitigate the financial impact arising from Covid-19 is not known at this stage.

CATEGORY	RISKS DESCRIPTION	MITIGATION
DELIVERY OF BUSINESS PLAN AND PERFORMANCE AGAINST ODIs	There are financial and reputational risks associated with a failure to deliver our business plan commitments and ODIs and our position at the next price determination may also be impacted. The introduction of in-period ODI adjustments could have an impact on our revenue during 2020-25. There is an increased risks of performance penalties due to Ofwat's approach to risk and return in its final determination. Our ODI performance could also be affected by incidents affecting other companies that provide us with a bulk supply of treated water.	We have taken a number of business improvement initiatives to deliver our ODIs and ensure customer and employee engagement. Dedicated steering groups monitor key measures such as interruption, water quality, customer services, customer perception and leakage. We are implementing a resilience and innovation action plans to help achieve stretching performance commitments. Our corporate plan for 2020 to 2025 has been prepared on the basis of the final determination to achieve stretching performance improvements recognising the challenges brought by the final determination and the increased risk of performance penalty introduced by Ofwat's approach to risk and return. We identified and started the early implementation of business changes required to deliver our performance commitments. We are continuously monitoring and forecasting the impact of the Covid-19 pandemic on our ability to deliver our performance commitments, invest efficiently and maintain our financial resilience throughout the rest of the five-year period to 2025, taking account of the operational and economic impact of the pandemic on our ability to plan for and commence the delivery of our performance commitment delivery plans in 2020/21 and the ongoing impact it will have on the economic environment, our supply chain, delivery partners and our customers. We anticipate that Covid-19 will affect our performance against our commitments due to potential shortages of staff, delays in materials production, the impact of social distancing on our operations and those of our contractors and partners, and initial delays in implementing our action plans.

OUR PRINCIPAL RISKS continued

CATEGORY	RISKS DESCRIPTION	MITIGATION
INVESTMENT PROGRAMME DELIVERY	We need to ensure that we efficiently deliver the investment necessary to maintain and improve our services to customers and to meet our long-term future obligations. 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, supply chain risks or significant events affecting the wider economy.	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 identify risks and opportunities for innovation and savings. Our priority and that of our supply chain is to protect our workforce which will have a significant impact on our ability to deliver our capital programme in 2020/21. We are continuously monitoring and forecasting the impact of the Covid-19 pandemic on our ability to deliver our investment and have reviewed our investment programme to take account of the impact of the lockdown and the persistent effect the illness will continue to have in 2020/21. We are reviewing how we may achieve our efficiencies recognising that the unprecedented challenges we and our supply chain face will have an impact on our ability to deliver our targeted efficiencies and result in additional contract costs. A potential increase in input costs as the supply chain seeks to recover would also affect our efficiencies.

CATEGORY	RISKS DESCRIPTION	MITIGATION
WATER RESOURCES AND CLIMATE CHANGE	Failure to develop our infrastructure, to improve its resilience and to manage demand would mean that we would not be able to meet our statutory duties and meet future demand. Climate change will increase instances of severe flooding and drought which affect the availability of resources and the operation of our infrastructure and result in additional costs which will affect the financial resilience of the company in the long term. Our ability to deliver the investment needed to meet our future obligations also depends on external factors such as the outcome of successive final determinations and how climate change is addressed in our political and regulatory environment and by other sectors on which we rely for our operations.	We operate in an area of serious water stress and manage demand through our metering programme which was completed by 2020. We have an ambitious programme to drive behavioural changes from customers for 2020 to 2025 We have also consistently met our leakage targets and have committed to significant leakage reductions at PR19. Our Water Resources Management Plan is developed to take account of opportunities for cooperation between water companies in the south east. We also invest in flood protection at our operational sites and to improve our resilience to power outages, and manage drought risks through a dedicated team. We have a significant programme of environmental schemes including to manage the impact of our water abstraction. We are planning for climate change adaptation and incorporate climate change scenarios in our long-term water resources and drought planning. We have adopted an emission reductions target by 2025 supported by our carbon reduction strategy and have adopted the public interest commitment to achieve net zero carbon emissions as a sector by 2030. We are progressively adopting the recommendations of the Task Force on Climate Related Financial Disclosure (TCFD) to ascertain and quantify the financial impact of climate change on the company.
REGULATORY AND LEGAL COMPLIANCE	Our business operates within a specific legislative and regulatory framework and many of our activities have an impact on the environment. Failure to ensure compliance with regulatory and legislative requirements may lead to criminal and civil liability, regulatory enforcement actions and disruption to the business and loss of management time. It would also affect the perception of South East Water by customers, regulators and other stakeholders and affect the trust they have placed in us as a provider of an essential public service.	We have a wide range of policies, processes and controls to ensure that we meet our duties and obligations. We also monitor compliance with our statutory obligations for the purpose of reporting on our performance and for the purpose of our ODIs. We review annually compliance performance and processes with the relevant department. We monitor changes to compliance requirements in order to adapt our processes and policies when required.

OUR PRINCIPAL RISKS continued

CATEGORY	RISKS DESCRIPTION	MITIGATION
SECURITY AND INFORMATION SECURITY	The security and resilience of our information infrastructure is essential to maintain our service to the public. We must protect ourselves from loss of data and systems and cyber-attacks and keep customers' data up-to-date and safe. Failure to protect personal data may lead to fines, enforcement actions and legal actions and would cause reputational damage. Loss or corruption of data would result in disruption to the business and additional costs. We must ensure compliance with the new requirements imposed by the General Data Protection Regulation (GDPR) and the EU Directive on the security of Network and Information Systems.	Our corporate security steering group continuously monitors all physical and data security aspects and data protection to identify new risks and the effectiveness of our security processes. We have department champions who are specially trained on these issues and we continuously promote awareness of risks, highlighting how unsafe behaviour could be exploited by external threats. We maintain disaster recovery systems and facilities which are regularly tested. We invested in security measures against unauthorised access to our systems and in software to help us monitor activity on our network. We achieved recognised cyber security certifications. We work with relevant external organisations to test the effectiveness of our resilience and security measures and review the maturity of our security systems and procedures. We maintain this risk as a high level risk due to the constant emergence of new threats and the risk of exploitation of vulnerabilities that may not have yet been fixed by software providers. We have implemented an extensive programme to achieve readiness for GDPR and continue to develop our GDPR compliance. Our reliance on IT systems to manage the activities of our front line staff and to maintain our normal activities through home working has meant that the security and resilience of our IT systems and the impact of any downtime is much greater than before Covid-19. We have updated our risk management process and practices to recognise this change in our risk profile in this area.
FINANCING	Unfavourable market conditions (including the impact of Covid-19 and of "Brexit") and regulatory changes may affect our ability to obtain financing or low interest rates. We must ensure that we comply with covenants in our agreements with our debt providers and maintain our credit rating.	We continuously monitor and report regularly to our board on compliance with our financial covenants. We have successfully completed the refinancing of a significant part of our debt in 2019 and have maintained our credit rating in 2019/20. Our refinancing has allowed us to reduce gearing and also gives us additional flexibility to further gearing reduction. The next steps of our refinancing will be due in 2026 and 2029 and we will continue to monitor markets and the impact of Covid-19 as we plan and prepare for these.

CATEGORY	RISKS DESCRIPTION	MITIGATION
BAD DEBT	Customer bad debt and increased collection costs is an issue faced by all water companies which affects cash and liquidity and the cost incurred to recover income.	We maintain strict processes for the collection of debt and take steps to encourage payments through direct debits. We have maintained a good performance on collection of bad debt but keep the effectiveness of our recovery process under constant review. We also offer a social tariff and other similar tariffs to assist customers who may struggle to pay. We have reviewed our approach to customer engagement and are implementing a number of new initiatives on affordability and vulnerability led by a new dedicated team. Depending on the severity and the longevity of the pandemic, domestic customers more directly affected by the impact of the lockdown and social distancing measures on the economy may face difficulties paying their bills which will increase the level of bad debt. We have suspended our debt collection practices in the first part of 2020/21, extended our social tariff and adapted payment terms to support our customers affected by the economic impact of the pandemic. We will continue to monitor the level of bad debt and the needs of our customers in 2020/21 and beyond. As some business sectors are severely negatively impacted by reductions in demand driven by the lockdown and social distancing measures, this could lead to an increase in bad debt. This can become more focussed in the non-household retail market and trigger retailer default where cash flows are already constrained by market arrangements.
HUMAN RESOURCES AND CULTURE CHANGES	Employee retention and talent management is important to deliver performance and maintain company knowledge especially in operational areas with a more mature workforce and the need to manage planned retirements.	We have implemented a successful apprenticeship scheme in operations and the "Steps to Leadership" programme is developing managers over four levels. We have extensively communicated our values and objectives with employees to ensure their support and their involvement in cultural changes required to deliver the next step of performance improvements. We will continue this change programme to embed our purpose and values into our day to day activities throughout the next five years. Our people plan includes a number of initiatives on diversity, talent management and succession planning. Our response to Covid-19 has been guided by two priorities: the need to maintain the water supply to our customers and critical facilities and the need to protect and support our front line employees as well as enabling home working for all those able to. Our human capital has allowed us to adapt and to continue to provide our service and we have been consulting with our workforce about the lessons we can learn from this and how our methods of working may evolve in the future.

OUR PRINCIPAL RISKS continued

CATEGORY	RISKS DESCRIPTION	MITIGATION
ECONOMIC ENVIRONMENT, COVID-19 AND BREXIT	Changes to the economic environment of the UK due to the lasting effects of Covid-19 and the impact of "Brexit" depending on the outcome of the negotiations between the UK and the EU will affect our business. The UK economy and the world economy will be significantly and durably affected by the Covid-19 pandemic which will impact the company and its customers. The risk of a temporary disruption and of a negative economic impact of a "no-deal" Brexit remains even if there will be more time for preparation.	We are working to anticipate the impact of macro-economic changes on our business and the other impact on our operations. We are monitoring changes in the economic environment as well as considering the impact of future tax changes. We are considering the potential direct impact on our operation and financial position as more detailed information becomes available on the expected long-term impact of Covid-19 on the UK economy. Our current assessment has been based on the "Impact of Coronavirus on the UK water industry" report commissioned by Water UK which was developed to assess the potential impact on the regulated business on a sector-wide basis of the Covid-19 pandemic; the implications of the Covid-19 pandemic we have observed to date; and our initial risk analysis taking into account the characteristics of the business and the nature of the pandemic. Our forecast is based on different assumptions on the longevity and severity of the pandemic. We anticipate that the economic impact of Covid-19 will affect: (i) domestic and business customers with increased levels of bad debt in the future, (ii) liquidity and consequent additional borrowing costs; (iii) input costs which may rise as the supply chain seeks to recover, (iv) ODI penalties due to external factors affecting our operations and performance, (v) new development activities and non-regulated business activities due to the downturn. We monitor the impact of these factors on our business and on our credit ratings and the risk of downgrade. We are in contact with rating agencies to understand how they will interpret the position of water companies in the context of Covid-19. We continue to monitor the development of the negotiations between the UK Government and the EU relating to Brexit and to maintain contingency plans prepared in relation to a no-deal Brexit. The water industry has developed a national readiness and risk mitigation plan to prepare for a "no-deal" Brexit in consultation with Defra, the Drinking Water Inspectorate, the Environment Agency, public health bodies and other relevant authorities. An incident management manual for operating in these circumstances has been developed by the industry. Emergency planning exercises were also carried out. The industry and our own plans include the creation of additional stocks of chemicals by both companies and their suppliers to the extent permitted by shelf-life and safety requirements, the review of the suppliers' supply chains and their readiness, and the creation of additional stocks of materials and equipment. Our preparation is integrated with our incident management plans and our preparation is managed by a specific incident management team.

LONG TERM VIABILITY STATEMENT

LONG-TERM VIABILITY STATEMENT

To prepare our long-term viability statement, we have conducted our long-term viability assessment, taking into consideration our business model, our current financial position, and principal risks that can affect our business.

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

Our assessment of the current financial position is set out on page 148.

Our long-term viability assessment reviewed the Company's prospects and considered the principal risks and uncertainties, including the ongoing impacts of Covid-19. Downside sensitivities have been developed based on an assessment of the likelihood and financial scale of these principal risks. Stress tests have been performed based on these downside sensitivities (individually and in combination) to assess the potential impacts of these risks and uncertainties. The assessment also considered the mitigating actions that might be taken to reduce the impact of such risks and uncertainties and the likely effectiveness of mitigating actions. Additional detail on the downside sensitivities tested is set out below.

ASSESSMENT PERIOD

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

On the recommendation of the audit and risk committee, and in line with Ofwat's guidance, we have assessed the prospects of the Company over a period of 10 years to March 2030 (our medium term plan).

The analysis of resilience extending beyond 2025 remains subject to greater uncertainty surrounding the assumptions underpinning financial projections for the AMP8 price control period, with greater variability of potential outcomes.

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

LONG TERM VIABILITY STATEMENT continued

IMPACT OF COVID-19

The risks associated with the possible ongoing impact of the Covid-19 pandemic have been considered and factored into the AMP7 financial projections assumed under our medium-term plan as well as the scenarios and sensitivities modelled as part of our assessment.

We have modelled the likely impacts on our medium-term plan and developed an updated assessment of our prospects allowing for the estimated impacts of Covid-19 on the Company over AMP7. This assumes restrictions and social distancing extend through the summer of 2020; CPIH inflation reducing in the year to March 2021 and in the year to March 2022 before increasing back to longer term targets; a reduction in non-household business revenues, increased outcome delivery incentives (ODI) penalties driven predominantly by non-household voids, increased bad debts, lower non-appointed income and lower projected developer contributions, as well as an increase in revenue based on projected increases in household consumption.

This baseline plan is then subject to stress scenarios that take into account the potential impact of the Company's principal risks.

ASSESSMENT RESULTS AND MITIGATION STRATEGY

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

Our securitised financing arrangements include covenants with trigger thresholds which are reported bi-annually. The baseline plan, incorporating the expected impact of Covid-19, shows sufficient liquidity and clear headroom for debt covenants, when considering trigger thresholds.

However, in the absence of any mitigating action being taken, the most severe, but plausible, scenario modelled indicates a breach of the trigger threshold in the adjusted interest cover ratio covenant for the year to March 2021. This is not an event of default threshold. Any such breach of the trigger threshold would activate initial creditor protections under the terms of the securitised financing arrangements, which are designed to maintain the Company's creditworthiness without disrupting its ability to trade, such as restrictions on dividends and preventing further financial indebtedness.

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

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

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

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

STRESS TESTING

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

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

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

Our sensitivities combine qualitative and quantitative criteria and cover the following risk factors to assess their impact on liquidity and compliance with financial ratios until March 2030:

- **Outturn inflation under forecast:** Inflation risk primarily relates to the fact that the price control is in real terms and the allowed revenue moves up by a designated inflation figure (CPIH for PR19) while some of the costs are fixed in nominal terms. This means that when inflation is lower than assumed when the real-term costs were calculated, the Company will face the risk of underfunding on these elements
- **Interest rate above forecast:** Interest rate risk can result in an increase in borrowing rate for new debt raised, and it can increase the borrowing cost for any floating rate debt
- **Revenue losses/financial penalties:** Revenue risk may manifest itself as wholesale revenue under recovery as the amount that the vast majority of our customers pay depends on the amount of water they consume
- **Financial penalties:** We have also considered the risk of financial penalties in this category to capture the possibly of the Company receiving (non ODI) fines from regulators
- **Compensation payments:** Compensation payments can be due to one-off unexpected events, such as major incidents caused by severe weather events or critical asset failure. The 2018 freeze/thaw event provides a good example of the level of compensation payments the Company can incur
- **ODI penalties:** The effect of ODI penalties as a result of the Company being unable to meet the very challenging targets set by Ofwat or unexpected adverse conditions can materialise within the AMP7 period, which have been taken into account in our assessment
- **Totex overspend:** Totex overspend is a risk that we have assessed carefully, when considering scenarios of Company underperformance as well as unexpected costs due to severe weather-related incidents
- **Retail cost overspend:** Retail cost to serve forms a part of the allowed revenue, which the Company may underperform against for reasons such as cost escalation and bad debt

We have also performed COVID specific scenario analysis which considers the potential impact of a more severe and longer duration pandemic on SEW's financial position.

The COVID scenarios draw on the "Impact of Coronavirus on the UK water industry" report commissioned by Water UK, the Company's observations of the impacts of Covid-19 to date and our initial risk analysis taking into account the characteristics of the business and the nature of the pandemic. The modelled outcomes for our COVID scenarios are based on regularly updated assumptions, including:

- the longevity of the pandemic
- the expected macroeconomic impacts (GDP, inflation and unemployment rates) based on independent economic forecasts
- the impact on household cash collection and bad debt rates, based on observed data and using our experience during previous recessions
- an estimate of incremental operating costs and outcome delivery incentive penalties both during the incident and in the recovery phase
- the impact on our revenues in 2020/21 and subsequent years

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

LONG TERM VIABILITY STATEMENT continued

SENSITIVITY TESTED	SPECIFICATION OF SENSITIVITY	RELATED PRINCIPAL RISKS
COVID SCENARIO: A MORE SEVERE IMPACT FROM THE COVID-19 OUTBREAK RESULTING FROM A PROLONGED 'LOCKDOWN' PERIOD	Longer term, more severe impacts resulting from Covid-19, including unemployment and corporate failures affecting debt collection and resulting in higher levels of bad debt, increased totex costs, outcome delivery incentive penalties across the whole viability period. We have assessed a total impact equivalent to 2% of the Return On Regulated Equity (RORE), the calculation of which is detailed under table 4H in the Company's regulated accounts, before taking the impact of regulatory mechanisms and true ups into account.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs
MACROECONOMIC SHOCK - HIGH INFLATION AND INTEREST/LOW INFLATION AND INTEREST	The Company's revenues are linked to inflation. Low or negative inflation tends to adversely impact profits and cash flows as decreases in revenues exceed decreases in costs. We have assessed the effects of +/- 1.5% RPI, CPIH and interest rates in AMP7.	Economic environment and Financing
TOTEX UNDER-PERFORMANCE	Significant overspending could result in a deterioration in financial metrics and performance, which could impact on the Company's liquidity and credit rating. We have assessed the impact of a 5% overspend on capital and operating expenditure in each year of the plan.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs
ODI PENALTY	Failure to deliver performance at the committed level can lead to significant ODI penalties. We have assessed the impact of penalties equivalent to 2% of RORE.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs
SUSTAINED ADVERSE CONDITIONS	The Company's risk management process has identified a number of risks including a deflationary environment. This scenario considers a combination of low inflation and cost overspending. Significant overspending could result in a deterioration in financial metrics and performance, which could impact on the Company's liquidity and credit rating. We have assessed 5% wholesale totex under-performance and ODI equivalent to 0.5% RORE for the first three years of AMP7 alongside a reduction in RPI and CPIH of 1.0% in AMP7.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs Economic environment and Financing

SENSITIVITY TESTED	SPECIFICATION OF SENSITIVITY	RELATED PRINCIPAL RISKS
PERVASIVE UNDER-PERFORMANCE	The Company's risk management process has identified a number of risks including extreme weather events and failure of key assets and that might have a significant impact on the Company's operational and financial performance. This sensitivity will focus on shorter-term external shocks potentially caused by wider economy, weather conditions, or a combination of the two, leading to short-term adverse effect on multiple risk factors. We have assessed 5% wholesale totex under-performance and 10% under-performance on retail household costs for the first three years of AMP7 alongside an £10.0m ODI penalty applied in the final three years of AMP7 and first two years of AMP8.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs
SEVERE DOWNSIDE	The Company's risk management process has identified a number of risks including extreme weather events and failure of key assets and that might have a significant impact on the Company's operational and financial performance. The combined scenario represents a situation where several of the severe scenarios above occur simultaneously. We have assessed 10% wholesale totex under-performance and 10% under-performance on retail household costs for the first three years of AMP7 alongside under-collection of revenue equal to 1% of Wholesale and Retail Revenue applied in 2022/21 and a £7.0m ODI penalty applied in 2022/23.	Operational performance Investment programme delivery Water resources and climate change Delivery of business plan and performance against ODIs

LONG TERM VIABILITY STATEMENT continued

MITIGATING ACTIONS

In the event of more extreme but low likelihood scenarios occurring, there are a number of key mitigations available to the Company.

The regulatory framework includes mechanisms to adjust future revenues and RCV to partially offset under recovery when compared to the Final Determination. As well as the protections that exist from the regulatory framework, a number of actions are available to mitigate more severe scenarios, which include the raising of new finance; capital programme deferral or reduction of discretionary expenditure to cover costs relating to penalties; considering efficiency programmes which seek to reduce costs and bring costs in line with regulatory allowances; discussing the impact on debt covenants with lenders and seek a temporary waiver if necessary; the temporary restriction or re-phasing of dividend payments; and accessing additional equity.

For each scenario and sensitivity, we have considered and identified appropriate mitigations in the event that a severe scenario or sensitivity used for stress testing were to result in a significant deterioration in projected financial metrics. The table below illustrates the relevant financial mitigating actions which would be considered in each scenario.

TYPE OF SENSITIVITY	SENSITIVITY TESTED	POTENTIAL MITIGATING ACTIONS
COVID-19	Base case COVID Scenario	Regulatory mechanisms to adjust future revenues to offset under recovery when compared to the original price review Engagement with Ofwat to consider regulatory treatment of under-performance relating to Covid-19 Reduce discretionary expenditure to mitigate the impact of lower revenues Consider a temporary reduction in or re-phasing of dividends
CHANGE IN INFLATION OR INTEREST RATES	High inflation and interest rates Low inflation and interest rates	Reduce discretionary expenditure Reduce working capital to support cash flow Consider a temporary reduction in or re-phasing of dividends
UNDERPERFORMANCE ON ODIs	COVID Scenario ODI penalties All combination downside sensitivities	Reduce discretionary expenditure to cover costs relating to penalties Discuss the impact of debt covenants with lenders and seek a temporary waiver if required Consider a temporary reduction in or re-phasing of dividends
HIGHER COSTS THAN PR19 FD	COVID Scenario Totex underperformance All combination downside sensitivities	A reduction in discretionary expenditure in the short and medium term Consider efficiency programmes which seek to reduce costs and bring costs in line with regulatory allowances Consider a temporary reduction in or re-phasing of dividends Discuss the impact of debt covenants with lenders and seek a temporary waiver if required
SEVERE EVENT – RELATING TO WEATHER, OPERATIONAL FAILURE OR ANOTHER EXCEPTIONAL EVENT	COVID Scenario All combination downside sensitivities	Consider efficiency programmes which seek to reduce costs and bring costs in line with regulatory allowances Reduction of discretionary expenditure in the medium term Reduction in working capital to support cash flows Consider a temporary reduction in or re-phasing of dividends

VIABILITY STATEMENT

The board has assessed the viability of the Company over a ten-year period to March 2030, taking into account the Company's current position, principal risks and effectiveness of any potential mitigating actions. The board was satisfied that they had sufficient information to judge the viability of the Company and have a reasonable expectation that the Company will be able to continue to operate and meet its obligations over the period to March 2030.

GOVERNANCE AND ASSURANCE

The analysis underpinning this assessment has been through a robust internal review process. The board has reviewed and discussed the process undertaken by management, and also reviewed the results of the stress tests performed including the key credit financial ratios, the Company's liquidity and ongoing ability to meet its financial covenants.

The board also provides robust internal assurance by reviewing and challenging the stress test scenarios selected and risk mitigation strategies. As part of the assurance process, the Board has taken into account the principal risks and uncertainties facing the Company, and the actions taken to mitigate those risks.

The board has also since the beginning of the Covid-19 pandemic received regular updates on the likely financial impact of Covid-19 as well as the expected impact on projected cash flows and metrics.

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

The audit and risk committee support the board in performing this review. In addition, our external auditor, Deloitte, reviews this viability statement and the outputs of our stress testing as part of its normal audit procedures. It considers whether these are consistent with the directors' conclusion with respect to business viability, and if the processes undertaken are sufficient to support the statements made.

Their audit report, including comments on the viability statement, is set out on page 117.

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

The group finances its working capital requirements through cash generated from operations and committed facilities that can be called upon as required. The group has called an additional £40 million from its committed facilities, which is currently being held unutilised in reserve, to ensure against any potential liquidity issues during the on-going Covid-19 pandemic. The group has prepared an annual budget, which has been reforecast as appropriate to take account of the changed circumstances brought on by Covid-19. The revised forecast together with its five year corporate plan and longer term resources planning all indicate that the group should be able to continuing operating for the forthcoming twelve months. On this basis the Directors considered it appropriate to adopt the going concern basis in preparing the financial statements.

SECTION 172 STATEMENT

STATEMENT ON HOW THE DIRECTORS HAD REGARDED TO THE MATTERS IN SECTION 172(1) AND ON ENGAGEMENT WITH EMPLOYEES AND SUPPLIERS, CUSTOMERS AND OTHERS IN BUSINESS RELATIONSHIP WITH THE COMPANY

The board's main responsibility is to set the company's strategy and monitor its delivery in alignment with the company's purpose. The two main aspects of our core purpose are to provide today's public water service and to create tomorrow's water supply solutions. Our purpose is also to help society and the environment to thrive. In this context most decisions taken by the board need to balance the long-term and short-term interests of the company, its customers, employees, the environment, the interest of maintaining key relationships with other stakeholders and partners, as well as current and future regulatory requirements. Most decisions of the board at a strategic level require balancing all these considerations and we see the long-term success of the company as achieving a fair balance.

Other parts of this strategic report include a number of examples of how the board has regard to each of the matters in section 172(1) of the Companies Act 2006. This is achieved within a general decision framework combining governance, internal systems of control and risk management, and engagement with stakeholders.

This is also done in respect of each decision the board considers. We provide a summary of the activities of the board in 2019/20 on page 106.

Our decision framework is designed to ensure we consider all the matters in section 172(1) CA06.

RELEVANT ASPECT OF OUR DECISION FRAMEWORK		READ MORE
Our corporate governance framework, corporate governance code, and culture (purpose and values) and board practices	• A corporate governance framework focused on engagement, stakeholder inclusiveness, integrated thinking (i.e. balancing all relevant considerations in our decision making including those in section 172(1) CA06). • A purpose and values focused on delivery to customers, planning for the future, protecting the environment and contributing to society. • A corporate governance structure that ensures that all aspects of the business receive the appropriate scrutiny including matters in section 172(1) CA06.	Board leadership and company purpose on page 93. Long-term sustainable success on page 102. How our board, committees and executive team operate on page 104.
Our vision and strategy	• A vision and strategy focused on our customers, our people and the protection of the environment.	Our vision and strategy on page 26.
Our long-term planning	• Long-term water resources planning is a second key core function to ensure we can meet future demand for water and also encourage our customers to save water.	Water resources for the future on page 30.

RELEVANT ASPECT OF OUR DECISION FRAMEWORK		READ MORE
Stakeholders' participation	• An engagement which ensures that stakeholders are directly involved in our decision process: including our Customer Challenge Group, our Environmental Scrutiny Group and partnerships for the delivery of our environmental programme, our employee and stakeholders engagement programme. • Extensive engagement and consultation for all our key plans.	Our 2020 to 2025 business plan on page 28. Water resources for the future on page 30. Our employee and stakeholder engagement programme on page 37.
Our business model and our external environment	• A business model focused on value creation through responsible business, a long-term focus, engagement with stakeholders and collaboration.	Our business model on page 95. Our external environment on page 40.

Consideration of the matters in section 172(1) also determine the regular activities of the b oard such as the monitoring of the performance against our commitments to ensure that we deliver the targeted outcomes for customers, the environment and the investment in the infrastructure needed to support our communities.

When setting out our charges we take account of customers' preference, for example for bill stability, and seek to control increases in bills and the impact on customers or where appropriate put in place mitigation measures. We are required to consult with developers when defining our charges and this year following consultation with them we put in place payment by instalments to address their concerns with the impact of changes introduced by Ofwat in the new connection charging rules.

We provide examples of how the board has had regard to relevant matters in respect of key decisions made this year below.

OUR RESPONSE TO COVID-19

Our response to the Covid-19 outbreak is an example of how our management of the crisis considered all relevant matters together, while ensuring the continuity of our essential public service as our first priority and as we adapted quickly to support our customers, employees, communities and the national mobilisation during the lockdown.

HOW WAS OUR WORKFORCE CONSIDERED

As provider of an essential service our employees were designated as key workers. Our priority was to ensure their safety and wellbeing providing the support they needed while they adapted to extraordinary working conditions to maintain the public water service throughout the crisis.

We carried out multiple employee pulse surveys and responded rapidly to concerns raised by our field, laboratory and other employees who were not able to work from home and also put in place a number of measures to support those who were able to work from home.

We had regular dialogue with the Employee Staff Council to share feedback and to understand themes and issues, especially for those continuing to operate out in the field.

OUTCOMES:

- we revised and then suspended with the support of the DWI water sampling in customers' premises. We stopped non-essential visits, reviewed our appointment process with pre-visit and doorstep questions and safety measures and carried out some activities remotely with customers where possible. Our Operations Director also issued specific Q&A and held regular briefing sessions by videoconference to respond to questions from our field teams. We ensured our people could easily be identified as key workers by the public. We issued face coverings to those who are not working from home and are interacting with others, whether customers, colleagues or contractors.

SECTION 172 STATEMENT continued

- we supported those who had childcare or caring issues with the ability to take time out of work to organise alternative arrangements, with no financial loss and have promoted interim flexible working where possible.
- we implemented health and safety recommendations on social distancing at work and changed the way of working and generalised work from home in a very short time also limiting the risk of contamination for those unable to work from home. We reorganised working patterns and methods of working and communicating to limit risks of contacts between employees or with the public.
- we put in place special measures to protect vulnerable employees and those caring for vulnerable persons.
- we provided a number of guidance documents to help our workforce protect themselves and adapt to new working conditions in particular on health and safety putting in place hygiene stations, revising risks assessments, increasing cleaning and disinfection, and issuing guideline on working from home and work stations self-assessment. We issued information to promote wellbeing and mental health by email and on our intranet.
- we kept our workforce informed with frequent communication by email, briefing and Q&A video conferences at CEO and all other management levels and distributed government advice.
- we put in place measures to report any cases of Covid-19 to be able to take measures to protect employees that would have been in contact with declared cases.

HOW WERE CUSTOMERS AND CRITICAL FACILITIES CONSIDERED

We were guided by our core purpose to provide the essential public water service which became even more crucial during the pandemic. Our focus was also on ensuring that our supply would be maintained to critical medical and care facilities on the frontline. We also needed to ensure that our customers could rely on our supply during lockdown for all their usual needs and were able to follow all the hygiene recommendations necessary to protect themselves from the virus despite the unprecedented increase in demand.

OUTCOMES:

- we systematically tested our existing resilience plans for supplies to hospitals and smaller medical facilities that could be used in support.
- we adapted our bottled water station emergency plans during interruptions to the water supply to meet the specific requirements applying during lockdown on social distancing and support to vulnerable customers including drive-thru bottled water station where possible.
- we maintained our call centre operational at normal capacity by setting up our systems and procedures to allow our agents to work from home. This allowed us to provide the support needed by our customers who faced economic difficulties. We provided help with payment plans, suspended debt recovery and extended our social tariff. We provided payment facilities to retailers on the water market for businesses. We also suspended disconnection activities and provided advice to retailers and their customers on returning supplies that had been vacated during lockdown.
- we issued extensive messaging on water saving as we faced extraordinary levels of demand in line with the concept of resilient customer developed in our business plan.

HOW WERE SUPPLIERS, STAKEHOLDERS AND COMMUNITIES CONSIDERED

Our main contractor participated in our crisis management meetings to ensure the coordination and coherence of our measures for the protection of our entire workforce and our operations.

We engaged with our key suppliers to identify their challenges and coordinate our actions to maintain key supplies.

We consulted with stakeholders and employees on ways we could utilise our resource and skills to assist the community.

OUTCOMES:

- we involved our contractors in the planning of our new methods of working and in the ongoing crisis management. We used their feedback on their own operational issues when making our own operational decisions.
- we helped local organisations with welfare counselling. This work was undertaken by employees whose roles could not be carried out at home. We provided joint funding with other utilities in the south east region to support our Community Foundations. We also made some of our resources available for food deliveries to vulnerable people.
- we worked with local resilience forums and supported them by providing data to help support vulnerable customers where possible.
- we kept our key stakeholders including our regulators informed of our actions and challenges and we created a stakeholder webpage where they could have easy access to our information.
- we promoted and matched payroll giving for our employees designated charities for the month of June.

BUSINESS PLAN AND CORPORATE PLAN

Our business plan and corporate plan set our strategy for 2020 to 2025 and have been prepared following significant engagement. They set out how we will deliver our performance commitments and fulfil our purpose.

HOW WERE STAKEHOLDERS CONSIDERED

Our overall strategy as set out in our business plan and corporate plan for 2020 to 2025 was based on extensive engagement with customers and customer segmentation which we used to draft our business plan and select priorities that had the support of customers.

Our engagement process itself and our research were scrutinised by our Customer Challenge Group (CCG).

OUTCOMES:

Our corporate plan is centred on delivery for customers. It also covers all the different aspects of our business and is particularly focused on the matters set out below.

As a result of the engagement with the CCG, the board adopted recommendations from the CCG to embed continuous customer engagement in our decision making throughout the 2020 to 2025 period. This resulted in a new Insight Team being created, improvement to stakeholder mapping and engagement and influenced (together with other stakeholders' input) the development of our vulnerability strategy.

This year the board approved the continuation of the CCG as an engagement panel, which will provide feedback to the company on its continuous engagement.

SECTION 172 STATEMENT continued

This year the board considered the implications of Ofwat's final determination for the company, its customers, its ability to invest for the future, the environment, its shareholders and investors and other stakeholders drawing on the engagement and the various considerations that informed the development of the business plan. When considering a possible referral to the CMA, the board balanced all these considerations to reach its conclusion.

CUSTOMERS

- a comprehensive customer engagement and vulnerability strategy with a significant increase in customers supported through our social tariff and priority services register
- stretching core services performance targets requiring significant improvement compared with AMP6

EMPLOYEES

- a comprehensive people plan to ensure our people and culture are focused on delivering our public service and that our people are motivated and feel supported by the company
- a continued focus on health, safety and wellbeing with an increased emphasis on mental health

ENVIRONMENT

- a focus on environmental excellence relying on an inclusive approach to delivery through partnerships
- a new carbon reduction strategy

RELATIONSHIPS WITH STAKEHOLDERS

- a focus on openness and inclusiveness with industry collaboration, stakeholder engagement, innovation through our internal platform and through cooperation with third parties.

RESPONSIBLE BUSINESS COMMITMENTS

We have adopted 10 responsible business commitments which will be delivered under the oversight of our responsible business committee as part of our wider renewed approach to environment, social, governance (ESG) issues. Our commitments were designed following engagement for our business plan and were finally selected by our employees and board. We also measure our ESG performance through the GRESB benchmark.

HOW STAKEHOLDERS WERE CONSIDERED

We have drawn on the learning from our customer engagement programme and research to define responsible business commitments that related to what mattered to customers. We then consulted with our employees and board who made the final selection of our responsible business commitment which was included in our business plan.

OUTCOMES:

Our responsible business commitments relate to the matters in section 172(1) and are supported by metrics and action plans to improve our impact in respect of them. This provides us with a framework to consider these matters and measure our progress in taking them on board. We also hope to benefit for the learning opportunities that will come out of engaging with third parties when delivering our commitments.

EMPLOYEES

- ensure fair pay, reward and recognition for all our employees
- improving health, safety and wellbeing of our people and communities

COMMUNITY AND ENVIRONMENT

- develop a future generation schools programme on water
- play an active role regionally in relation to the impact of housing growth on water
- create more partnership community projects on water use and vulnerability
- support the tap water Refill campaign to reduce plastic bottled water
- natural capital accounting
- renewable energy measures

HIGH STANDARDS OF BUSINESS CONDUCT

- trusted corporate governance
- transparency of reporting

Our business plan, corporate plan and our responsible business commitments include initiatives and metrics which relate to all the matters in section 172(1) CA06.

We have also adopted the water industry's Public Interest Commitment.

PENSION STRATEGY TO 2025 AND BEYOND

We need to take account of the decision by Ofwat to stop allowing for contributions into pension scheme in price determinations from 2025 in managing our pension strategy for the next five years and beyond.

HOW STAKEHOLDERS WERE CONSIDERED

The continued reduction of the deficit of our defined benefit pension schemes is a main concern to protect the interests of our employees and pensioners. We have consulted with our Pension Trustee on the next phases of our pension strategy that aims at insuring or securing a buy-out of the schemes.

OUTCOMES:

We have approved the medium and post 2025 pension strategy relating to the two defined benefit pension schemes operated by the company with the agreement of the Pension Trustee. This puts us in a better position to start implementing the next phase of our long-term pension strategy which we are developing in consultation with the Pension Trustee to move towards insuring / securing a buy-out of the schemes.

HOW WE ENGAGE WITH EMPLOYEES

PROVIDING INFORMATION AND RAISING AWARENESS

We believe that open dialogue and keeping our employees informed about our company performance is important. We use a range of channels to make sure everyone has access to information and that they can have dialogue with the organisation to help improve performance.

Our employee intranet, called Gurgle, promotes all news articles and key events. Managers and employees regularly blog via this platform about important issues and anyone can comment freely on all articles. Our Managing Director runs regular briefing sessions which are open to all employees and these update on performance during the preceding period and future activities.

Managers are provided with a monthly Manager's toolkit, health and safety briefings and our Core Brief slides which give a summary of our performance and encourage dialogue via team briefs.

For key information we also circulate email notifications, and recently launched a WhatsApp broadcast channel in order that all our employees, especially those out and about, can keep in touch.

CONSULTING WITH OUR EMPLOYEES

The channels described above are used to consult with employees on many day-to-day activities that can affect them. We also have a Staff Council and specific employee engagement and health and safety committee members who are regularly consulted on key decisions.

SECTION 172 STATEMENT continued

We utilise employee engagement and pulse surveys to seek views of the wider business, for example recently during the Covid-19 pandemic the surveys have enabled us to understand the appetite for flexible working to be available in the future and to check on employee wellbeing.

Atlas is our innovation tool, which we use to ask for ideas and feedback related to future approaches the company may take. This creates a two way tool for real engagement and gives the opportunity for employees to influence the company's direction on issues that matter to them such as the way we might work post-pandemic.

ENCOURAGING INVOLVEMENT IN THE COMPANY'S PERFORMANCE

We have a reward and recognition programme in the business, designed with specific roles in mind. This includes bonuses for some areas where performance particularly impacts on business targets. Our STARS recognition programme encourages everyone to nominate colleagues for rewards and the categories follow our key areas of company performance – the celebration event has been postponed due to Covid-19.

All colleagues can provide thanks to others via our "High Five" feature on Gurgle. All those nominated are reviewed monthly and a committee selects the "Highest Five" of the month for a reward. There is also regular recognition through departments with managers being provided advice on ways they can recognise excellent performance.

DIRECTORS' ENGAGEMENT WITH EMPLOYEES

This year the board considered the company approach to engagement with the workforce and agreed that:

- an independent non-executive director would be the designated point of contact with our workforce
- that independent non-executive directors would also meet directly with our Staff Council for direct two-way engagement with our staff
- to develop a board engagement programme to increase the interaction between directors and different levels of management

Some of our independent non-executive directors had update meetings with members of management to provide support on specific topics.

HOW WE ENGAGE WITH OTHER STAKEHOLDERS

In addition to the information provided above, the annual board programme includes meeting with representatives of the company's regulators and other stakeholders.

This year the board met with:

- Zoe McLeod, Chair of the Customer Challenge Group (CCG) to discuss the work of the CCG at PR19, the lessons learnt from the price review process and the continuation of the company's engagement with customers throughout AMP7 with the CCG/customer engagement panel, the customer steering group and the customer insight team
- the board also met with Rachel Fletcher, CEO, Ofwat, to discuss Ofwat's strategy and priorities for the sector and the company
- the Board met with Sir Tony Redmond, Regional Chair of the Consumer Council for Water to discuss our customer service performance, PR19 and the priorities of CCW
- the board met with Marcus Rink, DWI Chief Inspector, and Milo Purcell, DWI Deputy Chief Inspector, to discuss our water quality performance and the priorities and expectations of the DWI and considered the recommendations and observations received from the DWI

OUR MENTAL HEALTH STRATEGY

The mental health and wellbeing of our employees has been given particular focus this year.

Our Mental Health Strategy was launched at an event for managers across the organisation and supply chain to ensure we know how we will support them and that we are taking this seriously. Working in partnership with MIND we now have 30 mental health first aiders who are there for employees in times of crisis and can help support them to find the appropriate professional help they need.

NON-FINANCIAL INFORMATION STATEMENT

NON-FINANCIAL INFORMATION STATEMENT		
This statement provides an overview of the information in the annual report on non-financial matters that helps understand our development, performance, position and the impact of our activity		
Our business model is focused on value creation through responsible business, a long-term focus, engagement with stakeholders and collaboration.	Our business model on page 95. Our 2020 to 2025 business plan on page 28.	Our vision and strategy on page 26.
Our principal non-financial KPIs	Our business performance on page 48.	Our responsible business commitments on page 209. [in section 172 statement]
Our principal risks	Our risk management on page 59.	Our principle risks on page 61.
OUR KEY POLICIES, STRATEGIES AND OUTCOMES ON:		
The environment	• Corporate Environmental Resilience policy. • We will deliver an extensive WINEP programme and biodiversity improvements on our SSSIs. • We are part of the water industry's commitment to achieve net zero carbon emissions by 2030. • We have adopted a carbon reduction strategy for 2020 to 2025 and our long-term objective for 2030. • We manage long-term water resources through our water resources management plan.	Our approach to environmental matters on page 40. Our water resources management plan on page 30.
Our employees	• Speaking Up (Whistleblowing) policy. • Health, safety and quality policy. • Thrive 365! leadership Charter. • We are a Living Wage employer. • We achieved IIP silver certification and our ambition is to achieve gold certification. • We have a comprehensive Thrive 365! – Health, safety and wellbeing strategy including mental health. • We developed a comprehensive people plan in our corporate plan for 2020 to 2025. • Our responsible business commitments include a commitment to ensure fair pay, reward and recognition for all our employees and to reduced our gender pay gap.	Our people on page 10.

NON-FINANCIAL INFORMATION STATEMENT		
Social matters	• BS 18477 certification on inclusive service provision. • Our business plan for 2020 to 2025 includes commitments on priority service and vulnerability. • Our vulnerability strategy is designed to increase our support to all our vulnerable customers and to help them access our support. • We have adopted ten responsible business commitments which will be delivered under the oversight of our responsible business committee. • Water industry public interests commitments social mobility pledge.	Our approach to social matters on page 87. Our responsible business commitments on page 209. [in section 172 statement]
The respect for human rights	• Ethical purchasing policy. • Modern slavery policy and statement. • We monitor our and our supply chain compliance with modern slavery legislation. • Our procurement selection process considers matters related to human rights and modern slavery. • We require our supply chain to apply similar standards as ours.	Audit Committee report on page 117. Our modern slavery statement is available online at southeastwater.co.uk/modern-slavery
Anti-corruption and anti-bribery	• Anti-corruption and anti-bribery policy. • Hospitality Gratuities and Gifts Policy. • Conflict of interests policy. • Speaking Up (Whistleblowing) policy. • We provide regular training to our employees on these matters. • We require our supply chain to apply similar standards as ours.	Audit committee report on page 117.

Every year, we publish a Performance, People and Planet report with information on our non-financial performance and our corporate social responsibility in a clear and accessible format. Our Performance, People and Planet report is at southeastwater.co.uk/performance

Approved by the board and signed on its behalf by:

PAUL BUTLER
MANAGING DIRECTOR
15 JULY 2020

CORPORATE GOVERNANCE REPORT

INTRODUCTION FROM THE CHAIRMAN

Corporate governance and compliance are an integral part of how our board and our business as a whole operate. This year we have carried out an in depth review of our governance setting the foundation for the next five years. We have drawn on the latest thinking on purposeful business, and the main principles and ideas that have been put forward by stakeholders on the role of business in society. We have used these principles and ideas to define our new corporate governance framework and adopt our company purpose.

Our purpose is to "provide today's public water service and create tomorrow's water supply solutions, fairly and responsibly, working with others to help society and the environment to thrive".

It is centred on our core functions as provider of the public water service and also expresses our ambition to contribute to society and the protection of our environment.

We also adopted a revised corporate governance code combining the objectives, principles and provisions of Ofwat's board leadership, transparency and governance principles and of the UK Corporate Governance Code 2018.

We confirm we have complied with the principles of our own corporate governance code throughout the period.

OUR PURPOSE IS TO PROVIDE TODAY'S PUBLIC WATER SERVICE AND CREATE TOMORROW'S WATER SUPPLY SOLUTIONS, FAIRLY AND RESPONSIBLY, WORKING WITH OTHERS TO HELP SOCIETY AND THE ENVIRONMENT TO THRIVE

This work was an integral part of defining our strategy and corporate plan for 2020 to 2025. It will help us demonstrate that South East Water can be trusted as a provider of an essential public service in years to come.

On 1 August 2019, our new obligation to meet the objectives of the board leadership, transparency and governance principles came into effect and this report explains how we have met these objectives.

We have also approved new articles of association to embed our purpose and revised directors' duties into our articles of association for adoption by our shareholders in accordance with the Companies Act 2006.

This marks our commitment to become a purpose-led organisation and promote a culture of public service and inclusiveness. Importantly, this also marks a move towards a stakeholder model of corporate governance that seeks to achieve a fair balance between our interests and those of our customers, other stakeholders and the environment.

We appointed Rachel Drew as a new shareholder nominated director replacing Stephen Jordan and maintained a compact board with a strong representation of independent non-executive directors and a good balance of experience and skills.

As Paul Butler had informed the board of his intention to retire at the end of July 2020, we oversaw the process for the appointment of his successor. Following a formal interview process we unanimously recommended the appointment of David Hinton, currently Asset and Regulation Director, as CEO with effect from 1 August 2020 to succeed to Paul Butler.

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

NICK SALMON
CHAIRMAN
15 JULY 2020

OUR DIRECTORS

ON 15 JULY 2020

INDEPENDENT NON-EXECUTIVE DIRECTORS*

NICK SALMON

INDEPENDENT CHAIRMAN

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

JOHN BARNES

INDEPENDENT NON-EXECUTIVE DIRECTOR

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

CHRIS GIRLING

INDEPENDENT NON-EXECUTIVE DIRECTOR

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

CÉLIA PRONTO

INDEPENDENT NON-EXECUTIVE DIRECTOR

Célia was appointed a Non-Executive Director on 1 June 2018 and has a wealth of experience and expertise of the service sector in a range of industries. Célia is currently Managing Director at Love Home Swap, a subsidiary of RCI worldwide and an independent non-executive director of Moto Hospitality Ltd. She was previously Group Marketing & E-Commerce Director and board member of the Ford Retail Group and Chief Customer and Digital Officer of Casual Dining Group Ltd.

NON-EXECUTIVE DIRECTORS

RACHEL DREW

NON-EXECUTIVE DIRECTOR – SHAREHOLDER NOMINATED

Rachel is an Investment Director at HRL Morrison & Co and was appointed to the South East Water board in December 2019. Rachel is a non-executive director at rail company Porterbrook and the Northern Irish Gas Distribution business Phoenix Natural Gas. As well as experience in the financial investment industry Rachel has been an operational executive at NZ Bus, NZ's largest public transport operator and a consultant at The Boston Consulting Group.

MARISSA SZCZEPANIAK

NON-EXECUTIVE DIRECTOR

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

* AS DEFINED IN THE UK CORPORATE GOVERNANCE CODE 2016

EXECUTIVE DIRECTORS

PAUL BUTLER

MANAGING DIRECTOR

Paul has a wealth of water industry experience, having previously been Managing Director of Mid Kent Water from 2001 to 2006 and Chairman of UKWIR, a water industry research organisation from 2005 to 2012. A Chartered Accountant, he previously worked for Mid Kent Water as Group Financial Controller, Ernst & Young and Marks and Spencer. Paul Butler had informed the board of his intention to retire at the end of July 2020.

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. Andrew qualified as a Chartered Accountant with Price Waterhouse.

DAVID HINTON

ASSET AND REGULATION DIRECTOR

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

RESIGNING DIRECTOR

Our director who was in office during the period from 1 April 2019 to 31 March 2020 and has resigned before 15 July 2020 is as follows.

Please see page 11 for details of the changes on our board.

STEPHEN JORDAN

NON-EXECUTIVE DIRECTOR (RESIGNED – 6 DECEMBER 2019)

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

This report describes our corporate governance and how the board has operated within our corporate governance framework to promote a culture of public service and the long-term success of the business. It explains the concrete steps we have taken to meet the objectives, principles and provisions of our corporate governance code in the financial year.

This report presents our governance in practice following the main themes in our corporate governance code.

Corporate governance themes	Read more
Board leadership and company purpose	On page 93
Division of responsibilities and board composition	On page 110
Appointment, succession and evaluation	On page 114
Transparency, audit, risk and internal control	On page 117
Remuneration	On page 120

BOARD LEADERSHIP AND COMPANY PURPOSE

OUR CORPORATE GOVERNANCE FRAMEWORK

Our corporate governance framework recognises that "society is best served by corporations that have aligned their goals to the long-term goals of society" and the importance for a regulated water company to have an ethical and inclusive culture of public service guided by a strong sense of purpose.

As a board we promote transparency, accountability, ethical conduct, inclusive engagement with customers and stakeholders, a fair balance between the various interests that we and our staff must consider every day and a commitment to high standards of performance in delivering services to customers and protecting the environment.

We have the support of our investors to improve our governance as they recognise that strong environmental, social and governance performance protects the long-term value and sustainable success of the company and strengthens our licence to operate.

We are already engaged in a number of initiatives to deliver our purpose with our focus on satisfaction and our Insight Strategy, our actions and commitments on vulnerability (being the first water company to achieve the BS 18477 certification on inclusive service provision), our responsible business commitments overseen by a dedicated board committee, and our initiatives for the delivery of our environmental programme with stakeholders. We measure our ESG practices and achievements annually against the GRESB benchmark and work to improve our score year on year.

Building stronger relationships with stakeholders as partners will help us deliver value and shared benefits that go beyond the delivery of the public water service.

This year we have also reviewed our overall approach to transparency and governance. We have considered the latest thinking on purposeful business, and the main principles and ideas that have been put forward by stakeholders on the role of business in society. We have used these principles and ideas in defining our new corporate governance framework and in expressing our company purpose.

We are grateful for the contributions and insight we have found in reports of the British Academy, the Purposeful Company Taskforce and Sustainability First, in Ofwat strategy, in the fundamental concepts underpinning the King Code of South Africa, in the B Corporations initiative and the key international initiatives on ESG reporting.

Our new corporate governance framework sets out our general philosophy and approach to governance. Importantly, it marks a move towards a stakeholder model of corporate governance and incorporates the following key aspects:

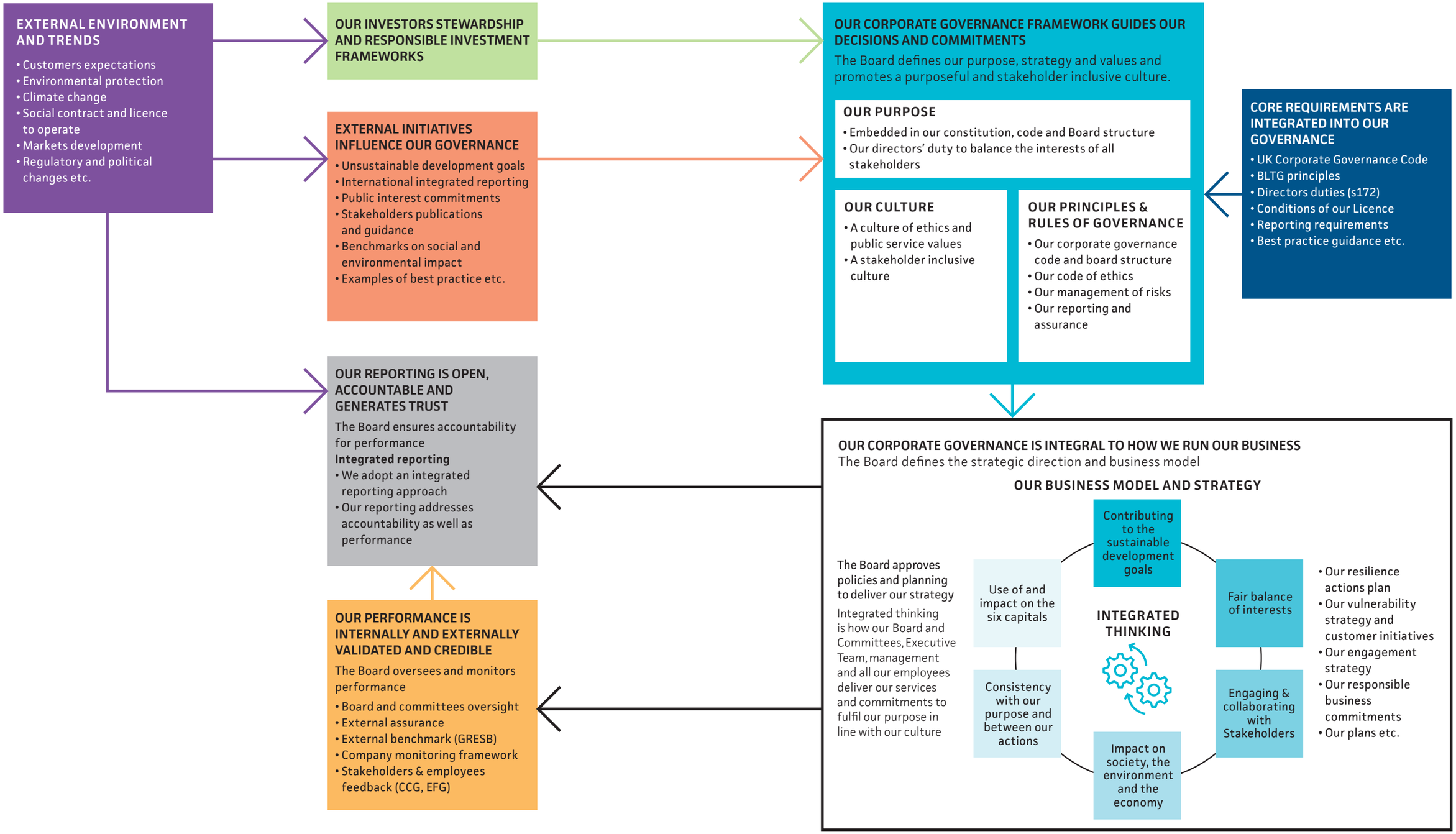
- it is centred on our purpose, which itself is centred on our public service duties, as the keystone of our governance framework
- it focuses on culture and ethical conduct reflecting public purpose values
- it is designed to be an integral part of how we run the business
- it reflects a stakeholder inclusive approach through engagement and cooperation with stakeholders and in balancing their interests
- it reflects the need for the company to consider its impact on society and the environment
- it promotes a holistic approach to decision making and "integrated thinking"
- it promotes accountability and transparency of reporting and an integrated approach to reporting on performance and impact

Our new corporate governance framework will guide our efforts to become a purpose-led organisation and to continuously improve our track record on transparency, responsibility, accountability and governance in the next regulatory period.

We agreed a range of steps for the implementation of our corporate governance framework in the coming years and we explain our actions for next year in our statement of direction and performance on page 208.

Our corporate governance framework is included at page 93.

A GOVERNANCE FRAMEWORK TO FULFIL OUR PURPOSE AND PROMOTE LONG-TERM SUCCESS



OUR PRINCIPLES OF GOVERNANCE AND CORPORATE GOVERNANCE CODE

Under our licence, we are required to conduct our regulated business as if it was substantially our sole business and the regulated business was a public limited company separate from any other business we carry out.

We also have an obligation to meet the objectives of Ofwat's board leadership, transparency and governance principles and to explain in a manner that is effective, accessible and clear how we are meeting these objectives.

We have adopted our own corporate governance code which combines the objectives and provisions of Ofwat's board leadership, transparency and governance principles and also principles and provisions of the UK Corporate Governance Code 2018 which are applicable to a private limited company and consistent with Ofwat's principles. Our previous corporate governance code already incorporated applicable provisions of the UK Corporate Governance Code 2016 and to ensure consistency in our corporate governance we chose to continue to use the provisions of the UK Code rather than those of the Wates principles.

Our code helps us maintain South East Water's reputation for high standards of conduct as a dependable provider of an essential public service and to demonstrate transparently to customers, shareholders, investors, regulators and other stakeholders how this is achieved.

We explain in the tables below the concrete steps we are taking to meet each of the four objectives of the board leadership transparency and governance principles. The tables below, are intended to help readers find easily the explanations in this report about each objective and other relevant information on how we meet these objectives.

Read more

Our corporate governance code is available on our website at **southeastwater.co.uk/ourgovernance**

OBJECTIVE 1	HOW WE MEET THE OBJECTIVES	READ MORE
The board of the Appointee establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.	• We reviewed our corporate governance and values, and formulated the company's purpose which has been a central part of the development of our strategy and corporate plan for 2020 to 2025. • We have considered the principles we should follow in formulating our company's purpose, the key elements that should be present in the purpose of a water company and considered initial formulations of the company's purpose during our strategic session and at subsequent meetings. • We have drawn on learning and experience acquired from engagement with customers at PR19, the work on our responsible business commitments which were selected by our customers and employees, the review of recent publications on the role of business and the work carried out for our new corporate governance framework and company corporate governance code.	On our governance on page 94.
	• We have developed our strategy for 2020 to 2025 to be aligned with our purpose and values. • We review progress on cultural change in the monthly performance report to the board as well as progress against targets including on customer satisfaction, vulnerability, engagement and responsible business • We have met with representatives of Ofwat, DWI and CCW to discuss their priorities and receive feedback on the company's performance. Following the meeting with the DWI this year, we discussed the feedback received on possible improvements in the communication with the DWI and reviewed the proposal from management. In this instance we concluded that the steps proposed at working level would address the feedback we had received.	On how our strategy is aligned to our purpose and values on page 101 of our strategic report.

OBJECTIVE 2	HOW WE MEET THE OBJECTIVES	READ MORE
The Appointee has an effective board with full responsibility for all aspects of the Appointee's business for the long-term.	• The board has full responsibility for all aspects of the company's business and sets the company's strategic aims, purpose, values and the overall culture and standards of behaviours. It balances the long-term and short-term interests of the company. • Decisions for the overall management of the company are made by the board. There are no matters reserved for shareholders or parent companies. There is ongoing dialogue with shareholders representatives which allows the board to take account of investors' interests as well as all other relevant interests.	On the role of the board and its committees on page 104.
	• We maintain a compact board that facilitates discussion and independent non-executive directors are the largest group on our board.	On our board and committees composition on page 104.
	• The board has procedures in place to identify and avoid conflicts of interest.	On how we avoid conflicts of interest on page 106.
	• Our core responsibilities include planning for future water resources and to plan for events such as droughts while investing efficiently and protecting the environment. We also prepare a business plan for our price review and a detailed corporate plan every five years which defines our strategy for the delivery of the public water service in our area of supply. The board as a whole is responsible for developing this strategy and approving the business plan and the corporate plan.	On our strategy and plan in our strategic report on page 27.
	• The board relies on accurate and up to date information from management to make its decisions and receives regular information on the company's performance and the implementation of its strategy and plans. • There is more information on how we make sure that our information is accurate and reliable below in our explanations about how we meet objective 4.	On the information and support the board received on page 100.

OUR PRINCIPLES OF GOVERNANCE AND CORPORATE GOVERNANCE CODE continued

OBJECTIVE 3	HOW WE MEET THE OBJECTIVES	READ MORE
The board of the Appointee's leadership and approach to transparency and governance engenders trust in the Appointee and ensures accountability for their actions.	OUR GENERAL APPROACH TO TRUST, TRANSPARENCY AND GOVERNANCE	
	• We want to engender trust and show that we are accountable for our performance through high standards of corporate governance and the transparency and clarity of our reporting. This report explains our purpose and strategy, how we operate to meet the targets we set ourselves to deliver the public water service to our customers, and how we have performed against these. Our overall approach to trust and transparency is centred on fairness and responsibility in balancing our interests and those of customers, society and the environment and in making sure we minimise our impact on the environment and find opportunities to improve our positive impact on society and the environment while delivering our public water service. Our approach to leadership and transparency is an integral part of our governance.	On our corporate governance framework, our purpose and values and the actions we have taken about this in the year on page 93 and on page 72 of our strategic report.
	TRANSPARENCY ON OUR PERFORMANCE	
	• Every year, we publish a Performance, People and Planet report with information on our performance and our corporate social responsibility in a clear and accessible format.	Our Performance, People and Planet report is at southeastwater.co.uk/performance
	• With the help of our staff, we have chosen 10 responsible business commitments to deliver benefits to customers, society and the environment that go beyond our core public water services.	On our responsible business commitments on page 209.
	• Our annual reporting on performance against the performance commitments is prepared following rigorous internal control processes and external assurance with oversight from the audit and risk committee and the board to ensure it is accurate, transparent and reliable. We also publish our company monitoring framework which sets out what we do to ensure that the data and information we publish is reliable, transparent, timely and appropriate to the audience. We publish our strengths, risks and weaknesses statement and the subsequent draft assurance plan we have developed in order to address any risks that have been identified.	On how we ensure the accuracy and reliability of our data and reporting in our data assurance summary on page 226. Our company monitoring framework is at southeastwater.co.uk/cmf
	• We explain our aspirations and main priorities for next year and how we have done against the objectives we had set ourselves in our statement of company direction and performance.	Our statement of company direction and performance is on page 48.

OBJECTIVE 3	HOW WE MEET THE OBJECTIVES	READ MORE
The board of the Appointee's leadership and approach to transparency and governance engenders trust in the Appointee and ensures accountability for their actions.	TRANSPARENCY ON OWNERSHIP, EXECUTIVE PAY AND DIVIDENDS	
	• Ownership structure: We explain our group and ownership structure and provide information about our investors.	On our structure and investors on page 37.
	• Executive pay: The pay of our executive directors includes a variable element which is based on actual performance against our performance commitments. For the last year of the 2015 to 2020 period, we operated an annual bonus and a long-term incentive plan which is based on our performance during the whole period. Both schemes are focused on operational performance, the rest of the incentive relating to financial performance and personal objectives. The annual bonus scheme includes six operational targets: customer satisfaction, health and safety, leakage, interruptions, burst mains, and discolouration contact. The long-term incentive plan includes eight operational targets: customer satisfaction, leakage, low pressure, interruptions, mean zonal compliance, discolouration, burst mains, SIM penalty/reward.	On the remuneration of our directors and how it is calculated in the directors' remuneration report on page 120.
	• Dividend: We must pay dividends to our shareholder only in accordance with our dividend policy and the principles that the dividends do not impair our ability to finance our business and that dividends are expected to reward efficiency and the management of economic risk. When paying dividends we consider the overall performance and financial resilience of the company which also depends on its performance against its commitments and the level of reward or penalty under the outcome delivery incentive. • We have adopted a revised dividend policy for 2020 to 2025 which is available on our website at southeastwater.co.uk/ourgovernance	On our dividend and how we have applied our dividend policy on page 57.

OUR PRINCIPLES OF GOVERNANCE AND CORPORATE GOVERNANCE CODE continued

OBJECTIVE 4	HOW WE MEET THE OBJECTIVES	READ MORE
The board of the Appointee and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high quality decisions that address diverse customer and stakeholder needs.	BOARD AND COMMITTEES EFFECTIVENESS	
	• One of the main ways we ensure the effectiveness of our board and committees is to maintain a strong proportion of independent non-executive directors. This ensures that considerations relevant specifically to investors or the group as a whole do not dominate decision making at the board of South East Water and that independent challenge at the board of the company is effective. We also keep a compact board which facilitates discussions at board meetings. Our board has four independent non-executive directors which is the largest group, two shareholder nominated directors and three executive directors. From 1 August 2020 the number of executive directors will be reduced to two.	On the composition of our board and its committee on page 104.
	• We also ensure that our board and committees have the appropriate mix of skills and experience including specific customer and service sector experience.	On the experience of our directors on page 90.
	BOARD EVALUATION	
	• We carry an annual board evaluation to review how effectively the board operates and discuss suggestions for improvement. The board evaluation is usually conducted via a non-attributable questionnaire with the results collated by the Company Secretary and discussed by the board.	On our 2020 board evaluation on page 115.

OUR PURPOSE, VALUES AND CULTURE

Our purpose is to "provide today's public water service and create tomorrow's water supply solutions, fairly and responsibly, working with others to help society and the environment to thrive".

Our purpose is centred on our core functions as provider of the public water service and also expresses our ambition to contribute to society and the protection of our environment.

We have developed our company purpose drawing from the work we did for our corporate governance framework, our learning from our engagement with customers at PR19 and our work on customer segmentation, priorities and expectations, the development of our responsible business commitments which were selected by our workforce and stakeholder voices on the purpose of business.

We have considered our purpose and values as an integral part of the development of our strategy and Corporate Plan for 2020 to 2025 during our strategic session in October 2019 and at subsequent board meetings.

We concluded that our purpose should:

- be centred around our core purpose as provider of the public water service (both for now and the future) reflecting our historical role in society and the elements of the human right to a water supply recognised by the UN General Assembly and the Human Rights Council as part of binding international law in 2010
- reflect our wider societal and environmental goals delivered through performing our core service and the "do no harm principle" of not profiting from causing problems for people or the planet
- reflect a commitment to an inclusive approach to stakeholder engagement as a means of achieving the company's purpose and achieve a fair balance between our interests and those of customers, the environment and other stakeholders

We know that our success will be measured by the changes we achieve in the culture of the business in order to become a genuine purpose-led organisation. We are confident in the commitment of our workforce which has shown again and again dedication in delivering our core services and that we will be able to rely on the enthusiasm they have already demonstrated for our responsible business commitments.

Achieving a durable change in culture to become a purpose-led organisation driven by public service values, is a continuous efforts, this year we have:

- approved a new corporate governance framework that is centred on purpose, culture and integrated thinking to balance the interests of the company and of all its stakeholders and partners
- approved new articles of association to embed our purpose and revised directors' duties into our articles of association for adoption by our shareholders who are ultimately responsible for adopting new articles of association
- approved our responsible business commitments and how we will deliver them in the coming years through our corporate plan under the oversight of our responsible business committee
- included responsible business commitments measures in our executives' performance related pay
- agreed that an independent non-executive director would be a designated point of contact with our workforce and that independent non-executive directors would also meet directly with our Staff Council for direct two-way engagement with our staff and also agreed to develop a board engagement programme to increase our interaction at different levels of the business
- continue to measure our ESG practices and achievements against the GRESB benchmark

We have also agreed further actions for the next years which will promote a public service and stakeholder inclusive culture and will also seek feedback from our employees and stakeholders as we make progress.

Read more on our actions for next year in our statement of direction and performance on page 28.

Read more on our purpose, values, vision and strategy on page 26 of our strategic report.

THE ROLE OF THE BOARD AND OF ITS COMMITTEES

LONG-TERM SUSTAINABLE SUCCESS

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

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

In doing so the board, has regard to the duties of directors under section 172 of the Companies Act 2006 and seek to give due consideration to and find the appropriate balance between the various interests relevant to its decisions. Board decisions are also guided by the approach to governance set out in the corporate governance framework and the company's purpose which also seek to promote an integrated approach to decision making that takes into account the various interests of stakeholders as well as those of the company and how each decision contributes to fulfil the company's purpose.

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

Short-term decisions are taken in the context of the overall strategy as defined in the corporate plan, the supporting delivery plans and the actual performance against targets or other strategic outcomes at any given time. They are evaluated by reference to their impact on the delivery of the commitments and long-term objectives of the company and any trade-offs that may arise between the delivery of certain commitments.

Significant decisions such as those relating to investment and the delivery of the capital programme are taken within internal governance processes which also consider commitments, legal obligations and the delivery of efficiencies. The board receives regular updates on performance against targets in respect of all the company's commitments and short-term decisions are assessed in the context of that performance taking corrective actions where necessary.

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

LEADERSHIP OF THE STANDALONE REGULATED COMPANY

Another guiding principles followed by directors in decision making are the requirement in the licence to (i) conduct the regulated business as if it was substantially the sole business of the company and the regulated business was a public limited company separate from any other business and (ii) to meet the objective of the board leadership, transparency and governance principles that "the Appointee has an effective Board with full responsibility for all aspects of the Appointee's business for the long-term".

Consistent with these requirements, all matters pertaining to the business of the company are considered and decided by the board of South East Water and there are no matters reserved to shareholders or parent companies other than those requiring a resolution of members under the Companies Act 2006.

Shareholders typically discuss their respective positions in respect of matters that are a specific concern to them at board meetings of HDF (UK) Holdings, the ultimate UK holding company of South East Water and will also discuss any relevant matters with the Chair of the board and management. The arrangements between shareholders relating to their decision making in relation to South East Water recognise the specific requirements applicable to South East Water as a regulated water company and the need to operate in compliance with them.

The board includes two shareholder representatives who are able to communicate the views of shareholders for consideration by the whole board when making decisions that may be of particular concern for shareholders. Where shareholder representatives have reached different conclusions in respect of a decision being considered by the board, they present their reasons and the board as a whole (with independent non-executive directors being the largest group) decides with each director having one vote.

Our shareholders recognise that strong environmental, social and governance performance protects the long-term value and sustainable success of the company and strengthens its licence to operate. There is a strong alignment between our shareholders' governance and ours as both are focused on long-term value creation.

HOW OUR BOARD, COMMITTEES AND EXECUTIVE TEAM OPERATE

The diagram below shows the roles of our board and its committees and of the executive team and the main management steering group.

OUR GOVERNANCE STRUCTURE

BOARD

CHAIR: NICK SALMON

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

MANAGING DIRECTOR
PAUL BUTLER

EXECUTIVE TEAM

CHAIR: PAUL BUTLER

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

CUSTOMER INSIGHT COMMITTEE

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

COMPETITION AND REGULATORY STRATEGY

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

CORPORATE SECURITY

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

AUDIT AND RISK COMMITTEE

CHAIR: CHRIS GIRLING

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

REMUNERATION COMMITTEE

CHAIR: JOHN BARNES

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

NOMINATION COMMITTEE

CHAIR: NICK SALMON

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

RESPONSIBLE BUSINESS COMMITTEE

CHAIR: MARISSA SZCZEPANIAK

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

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 government of capital investment and the Programme Management Office controls the delivery of capital expenditure. The Information Systems Steering Group approves and monitors key procurement activities.

OUTCOMES DELIVERY

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

WATER QUALITY

The Water Quality Strategy Group monitors water quality performance and the delivery of the water quality strategy and improvement initiatives. It also oversees the development of future investments in water quality.

ALIGNING OUR STRATEGY WITH OUR PURPOSE AND VALUES

Our overall strategy as set out in our business plan and corporate plan was based on engagement with customers and addresses the key elements of our purpose (i) our core purpose as a provider of the public water service, (ii) our wider societal and environmental goals, (ii) a stakeholder inclusive approach.

Our corporate plan is centred on delivery for customers and is intended to cover all the different aspects of our business and as particularly relevant to fulfilling our purpose includes:

- a comprehensive customer engagement and vulnerability strategy with a significant increase in customers supported through our social tariff and priority services register
- stretching core services performance targets requiring significant improvement compared with AMP 6
- ten new responsible business commitments, governed by a dedicated board committee part of our wider renewed approach to ESG
- a comprehensive people plan to ensure our people and culture are focused on delivering our public service and that we have a positive culture promoting diversity where our people are motivated and feel supported by the company
- a continued focus on health, safety and wellbeing with an increased focus on mental health
- a focus on environmental excellence relying on an inclusive approach to delivery through partnerships
- a new carbon reduction strategy
- a focus on openness and inclusiveness with industry collaboration, stakeholder engagement, innovation through our internal platform and through cooperation with third parties

Read more about our business on page 26 of our strategic report.

INFORMATION AND SUPPORT

The board receives as a minimum monthly performance reports to ensure that directors are regularly informed of performance. 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 specific metrics 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 and is able to ask questions directly and provide challenge or ask for additional information.

Directors raise questions directly with the Executive Directors when there is no scheduled board meeting or raise questions at the following board meeting. These are routinely addressed through written explanations and/or meetings with members of the executive team or senior managers to discuss specific topics.

The board has also decided to have an engagement programme with a wider range of people in the business beyond executive directors and senior managers to have a better understanding of how the company operates at all levels, get direct feedback and better understand the culture of the business.

There are processes in place to ensure the accuracy of the information relied on to measure performance and report on it. The board also relies of external assurance on the company's reporting and underlying data to assess the reliability of the information provided to it. It also relies on the company monitoring framework which describes the internal processes to ensure the accuracy and reliability of the information published by the company.

THE ROLE OF THE BOARD AND OF ITS COMMITTEES continued

CONFLICT OF INTERESTS

The avoidance of conflict of interests requires constant consideration for all decisions by the board, the approach followed by the company combines standard and regular checks and communication by the relevant directors who will have direct knowledge of changes in circumstances that could create a potential situation of conflict.

The Directors' induction pack includes information on directors' duties including to avoid conflicts of interests.

There is a standard item at each board meeting to consider any potential conflicts of interest in relation to the matters to be discussed at the meeting.

Each director is also required to notify any potential conflict of interest and to inform the Company Secretary and other directors of any new appointment or directorship.

Directors other commitments and directorships are reviewed annually to ensure records are kept up to date and that potential situations of conflict can be more easily kept under review and identified.

The articles of association of the company include provisions permitting directors to authorise certain potential conflict situations.

BOARD ACTIVITIES IN 2019/20

During the period from 1 April 2019 to 31 March 2020 there were eight scheduled board meetings, including one specific strategy session. In addition there were three additional meetings convened in relation to PR19, making eleven meetings in total. The board also receives a full performance report every month. There was an additional board briefing on 19 December to provide an update on the final determination that was attended by all directors.

A strategy session focusing on the preparation and delivery of our corporate plan, business plan and company purpose was held in October 2019. We considered Ofwat's recently published strategy and had the opportunity to meet with Rachel Fletcher, Ofwat CEO, to discuss their strategy, priorities and objectives as well as the company's performance.

We considered how best to define our purpose as a statement of the company's reasons for existing, the key elements that should be present in our purpose contrasting them with those of other companies. We also discussed and commented on an initial company purpose formulation. We confirmed our values as still reflecting our desired culture and behaviours. We considered an update on the development of our corporate governance framework.

We reviewed our performance commitments and their respective delivery plans which were prepared to ensure we have a coherent approach for the delivery of our commitments across the entire business and for collaboration with our suppliers and stakeholders.

We reviewed our responsible business commitments and the programme of activities to deliver them, the framework to manage these activities and to communicate our approach and promote the desired cultural change. We reviewed our initiatives to continue to improve our performance against the GRESB benchmark.

We reviewed our non-appointed business strategy and opportunities for developing these activities in the next five years and the main investment and financial aspects of our corporate plan.

During the Covid-19 outbreak at the beginning of 2020 and during the lockdown we received weekly updates and had bi-weekly board updates by video conference to follow up our response to the crisis and ensure that we maintain our crucial service to critical facilities and all our customers. A series of board papers were produced and considered. These board papers included our ongoing assessment of the operational, legal and financial consequences of the impact of the Covid-19 outbreak.

ATTENDANCE AT BOARD AND COMMITTEE MEETINGS IN 2019/20

DIRECTOR	BOARD	AUDIT & RISK	NOMINATION	REMUNERATION	RESPONSIBLE BUSINESS
N Salmon	11/11		3/3	5/5	
J Barnes	10/11	3/3	3/3	5/5	1/2
C Girling	11/11	3/3			
C Pronto	11/11	3/3	3/3	5/5	
M Szczepaniak	11/11	3/3	3/3	5/5	2/2
S Jordan – R: 06/12/19	7/7	2/2	3/3	4/4	
R Drew – A: 06/12/19	4/4	1/1		1/1	1/2
P Butler	11/11				
A Farmer	10/11				
D Hinton	11/11				2/2

R – Resigned
A – Appointed

SUMMARY OF OUR ACTIVITIES IN 2019/20

SERVICE DELIVERY AND OPERATIONAL PERFORMANCE

- considered regular updates at board meetings, additional video conferences and email updates of the management of the impact of the Covid-19 pandemic to ensure continuous supply to critical facilities and all our customers whilst maintaining the safety of our workforce and the public
- regularly reviewed performance against our operational commitments and outcome delivery incentives and the initiatives taken to ensure we meet our targeted performance
- considered the annual review of the Company's water quality performance for 2018, recommendations from the DWI and the introduction of the new Compliance Risk Index and Event Risk Index water quality measures. Considered the actions taken in relation to the notice issued by the DWI about the operational practice at the Barcombe Water Treatment Works for resolution of the issues raised
- reviewed the annual report on the delivery of our capital programme and capital expenditure in 2018/19, our capital programme for 2019/20 as well as updates on its delivery and progress of the main schemes in the programme. Reviewed the progress of the transfer of abstraction licences and purchase of land from the administrators of Aylesford Newsprint for the construction of new water treatment works
- reviewed the retendering of our network maintenance contract and our contract for engineering and consultancy services and the alignment of the contract requirements with our operational needs and performance targets. Approved the award of the network maintenance contract

THE ROLE OF THE BOARD AND OF ITS COMMITTEES continued

- considered the review and rationalisation of the location of operational sites based on bursts and incidents modelling with a view to improve response time to interruptions and operational performance and approved the investment in a new operational site
- reviewed updates on our customer services performance, our BS 18477 certification on inclusive service provision, preparation for and initial performance against the C-MeX measure as well as vulnerability and other initiatives to deliver further improvements in AMP 7
- considered the annual review of operational performance, risks and initiatives including performance against operational outcome delivery incentives
- considered the environmental performance update for 2019, the delivery plan of the environment strategy for 2020 to 2025 and environmental risks

FINANCIAL, REPORTING AND TRANSACTIONAL

- approved the five year Corporate Plan for AMP7
- reviewed and approved the annual report and financial statements for 2018/19 and the half-year financial reporting for 2019/20 following recommendations of the audit and risk committee. Considered the viability statement in line with specific requirements set out by Ofwat
- reviewed and approved our annual performance report and other regulatory reporting for 2018/19
- reviewed the company's non-appointed business commercial performance and development of new business opportunities
- considered the report from the audit and risk committee on the audit plan, on the independence of the auditors, on the audit fees and on new reporting requirements for the 2019/20 annual report. Approved the audit and non-audit fees
- approved the financial budget for 2020/21
- considered and approved dividends for the 2019/20 financial year
- we have reviewed the potential financial impact of Covid-19 and discussed a range of potential scenarios with our stakeholders

ESG, RISK MANAGEMENT AND STAKEHOLDER ENGAGEMENT

- reviewed the composition of the board and its committees. Approved the renewal of the appointment of John Barnes and the appointment of Rachel Drew on the recommendations of the nomination committee
- considered and approved the appointment of David Hinton to succeed to Paul Butler as a new CEO upon the retirement of Paul Butler
- considered the appointments of new Customer Services, Regulation and Strategy, and Operations directors through internal succession planning
- carried out the annual evaluation of the board's effectiveness through an anonymous online questionnaire, discussed the points arising and agreed follow up actions
- met with Zoe McLeod, Chair of the Customer Challenge Group (CCG), to discuss the work of the CCG at PR19, the lessons learnt from the price review process and the continuation of the Company's engagement with customers throughout AMP 7 with the Customer Engagement Panel, the Customer Insight Group and the customer insight team
- approved the creation of the Customer Engagement Panel succeeding to the Customer Challenge Group and the appointment of Zoe McLeod as Chair as well her proposal for the renewal of the membership of the Customer Engagement Panel
- considered the result of the staff survey and the initiatives planned to address the survey results with particular emphasis on development learning, reward and recognition as well as initiatives that had been delivered since the previous survey. Reviewed the revised IReview process and the talent management and innovation programme. Considered the board's and wider company approach to engagement with the workforce
- agreed that an independent non-executive director would be the designated point of contact with our workforce and that independent non-executive directors would also meet directly with our Staff Council for direct two-way engagement with our staff and also agreed to develop a board engagement programme to increase our interaction at different levels of the business
- carried out the annual health, safety and wellbeing performance review and considered the effectiveness of our Thrive 365! strategy and related initiatives. Reviewed the initiatives implemented in 2018/19, the programme of actions for 2019/20 including the new mental health strategy
- adopted our modern slavery statement and reviewed the related procedures implemented to ensure compliance with legislation on modern slavery
- met with Rachel Fletcher, CEO, Ofwat, to discuss Ofwat's strategy and priorities for the sector and the company
- met with Sir Tony Redmond, Regional Chair of the Consumer Council for Water to discuss our customer service performance, PR19 and the priorities of CCW
- considered an update on corporate reporting from our auditor
- met with Marcus Rink, DWI Chief Inspector, and Milo Purcell, DWI Deputy Chief Inspector, to discuss our water quality performance and the priorities and expectations of the DWI. Considered the recommendations and observations received from the DWI
- reviewed our carbon reduction strategy and potential initiatives on solar energy generation and use in the business
- considered developments in corporate governance and on the wider purpose of business and the related requirement of Ofwat's board leadership transparency and governance principles as well as those of the 2018 UK corporate governance code and adopted a new corporate governance framework, our company purpose and the approach for embedding our company purpose into our articles of association
- reviewed and approved our pay gap reporting and the actions to take to address gender pay gap
- reviewed the water industry and the company's preparation for a no-deal Brexit and the coordination with Defra. Reviewed the implementation of the industry's and company's risk management plans relating in particular to the supply of chemicals, additional stocks of chemicals and equipment, and the coordination with suppliers and emergency services
- considered the annual review of our information technology systems and infrastructure and of our information technology strategy. Reviewed Cyber Security processes and compliance with the Network and Information Systems Regulations (NIS)
- reviewed our insurance programme and the renewal of the policies and benchmarking. Approved the subscription of a new cyber liability policy
- carried out the annual review of risks and of the effectiveness of our risk management process

STRATEGY AND REGULATION

- reviewed and approved our business plan submissions for PR19 and the company's initial assessment of plan responses. Considered Ofwat's draft determination and reviewed and approved the company's draft determination responses and related board assurance statement. Considered the requirements relating to putting the sector in balance on gearing, executive pay and dividend. Considered the implications of Ofwat's final determination for the company, its customers and other stakeholders and whether to require its referral to the CMA. Considered the presentation of our submissions to the CMA in relation to the referral of the final determinations of other companies
- approved the medium and post 2025 pension strategy relating to the two defined benefit pension schemes operated by the company and using CPI indexation for both schemes as a first step of its implementation as agreed with the Pension Trustee. Approved the valuation date of 31 March 2020 following consultation with the Pension Trustee

THE ROLE OF THE BOARD AND OF ITS COMMITTEES continued

- considered our non-appointed business commercial strategy
- approved the approach for setting and assuring our wholesale and household end-user charges taking account of customers' preference for bill stability and seeking to control increases in bills and the impact on customers. Approved our indicative and final wholesale charges, our household end-user charges and our new connection charges and infrastructure charges for 2020/21 and the related board assurance statements. Set detailed conditions for the delegation of authority of the final calculation of the charges following publication of the relevant RPI and finalisation of the charges documents
- reviewed the development of and approved our Corporate Plan for 2020 to 2025. Dedicated our strategy session to our corporate plan and strategy for AMP 7 in the context of PR19
- reviewed and approved the update of the company Monitoring Framework 2019/20 and assurance plan
- considered our response to pre-consultation on changes to the ring-fencing provisions of the company's instrument of appointment to be included in a revised condition P which would incorporate remaining changes proposed in published decision documents following consultations in 2018/19. Authorised the notification of the consent in principle to the proposes changes to Ofwat

DIVISION OF RESPONSIBILITIES AND BOARD COMPOSITION

CHAIR

The Chair ensures the effectiveness of the decision making process of the board and promotes discussion on key issues based on quality information. The Chair 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 Chair and the Managing Director meet regularly throughout the year to maintain a good communication between the board and the executive directors and to review the board forward programme and the agendas of board meetings.

There is also a formal schedule setting out the division of responsibilities between the Chair and the Managing Director.

BOARD BALANCE AND EFFECTIVENESS

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

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

There are two shareholder nominated directors which ensures that there is constant communication between independent non-executive directors and shareholders and between executive directors and shareholders.

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

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

From 1 August 2020 following the retirement of Paul Butler, the number of executive directors will be reduced to two with David Hinton, CEO and Andrew Farmer, Finance Director sitting on the board.

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

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

Our directors' biographies can be found on page 90.

BOARD BALANCE AND COMPOSITION

INDEPENDENT NON-EXECUTIVE DIRECTORS	APPOINTMENT	RESIGNATION	TERM*	AUDIT & RISK	REMUNERATION	NOMINATION	RESPONSIBLE BUSINESS
Nick Salmon (Chair)	01/04/15	na	5 yrs		■	Chair	
John Barnes	28/01/16	na	4 yrs 2 m	■	Chair	■	■
Chris Girling	30/10/14	na	5 yrs 5 m	Chair			
Célia Pronto	01/06/18	na	1 yr 10 m	■	■	■	
NON-EXECUTIVE DIRECTORS (SHAREHOLDER NOMINATED)	**APPOINTMENT**	**RESIGNATION**	**TERM***	**AUDIT & RISK**	**REMUNERATION**	**NOMINATION**	**RESPONSIBLE BUSINESS**
Rachel Drew (HRL Morrison & Co)	06/12/19	na	4 m	■	■	■	■
Marissa Szczepaniak** (Vantage Infrastructure)	08/12/16	na	3 yrs 3 m	■	■	■	Chair
EXECUTIVE DIRECTORS	**APPOINTMENT**	**RESIGNATION**	**TERM***	**AUDIT & RISK**	**REMUNERATION**	**NOMINATION**	**RESPONSIBLE BUSINESS**
Paul Butler (Managing Director)	02/10/06	na	13 yrs 6 m				
Andrew Farmer (Finance Director)	01/08/15	na	4 yrs 8 m				
David Hinton (Asset and Regulation Director)	01/06/13	na	6 yrs 10 m				■
RESIGNING DIRECTORS	**APPOINTMENT**	**RESIGNATION**	**TERM***	**AUDIT & RISK**	**REMUNERATION**	**NOMINATION**	**RESPONSIBLE BUSINESS**
Stephen Jordan (HRL Morrison & Co)	17/08/18	06/12/19	1 yr 4 m	■	■	■	

* As at 31 March 2020.

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

THE ROLE OF THE BOARD AND OF ITS COMMITTEES continued

DIVISION OF RESPONSIBILITIES

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

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

BOARD COMMITTEES

NOMINATION, REMUNERATION AND AUDIT AND RISK COMMITTEES

The audit and risk committee, nomination committee and remuneration committee are chaired by and have a majority of independent non-executive directors as required by our corporate governance code.

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

RESPONSIBLE BUSINESS COMMITTEE

Our responsible business committee was formally constituted on 7 March 2019 and its terms of reference approved by the board.

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

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

The responsible business committee is chaired by Marissa Szczepaniak and has three other director members: John Barnes, Rachel Drew and David Hinton. Non-director members of the committee ensure that a wide range of skills and knowledge is represented on the committee and provide a clear line of sight into the business. The appointment of Marissa Szczepaniak (Vantage Infrastructure) and Rachel Drew (HRL Morrison & Co), both representatives of shareholders, reflects the emphasis placed by shareholders on strong ESG performance.

RELATIONSHIP WITH SHAREHOLDERS AND INVESTORS

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 long-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 Chair ensures that the Managing Director and Finance Director provide feedback to the board following presentations to investors and meetings with shareholders.

NOMINATION COMMITTEE

CURRENT MEMBERS

Director		Appointment
Nick Salmon (Chair)	INED	01/05/15
John Barnes	INED	06/07/17
Célia Pronto	INED	01/06/18
Rachel Drew	NED	06/12/19
Marissa Szczepaniak*	NED	30/01/19

MEMBERSHIP CHANGES IN 2019/20

Director	Appointment	Resignation
Stephen Jordan	17/08/18	06/12/19
Rachel Drew	06/12/19	–

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

REMUNERATION COMMITTEE

CURRENT MEMBERS

Director		Appointment
John Barnes (Chair)*	INED	10/03/16
Célia Pronto	INED	01/06/18
Nick Salmon	INED	25/09/18
Rachel Drew	NED	06/12/19
Marissa Szczepaniak**	NED	30/01/19

MEMBERSHIP CHANGES IN 2019/20

Director	Appointment	Resignation
Stephen Jordan	17/08/18	06/12/19
Rachel Drew	06/12/19	–

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

AUDIT & RISK COMMITTEE

CURRENT MEMBERS

Director		Appointment
Chris Girling (Chair)	INED	20/05/15
John Barnes	INED	06/07/17
Célia Pronto	INED	01/06/18
Rachel Drew	NED	06/12/19
Marissa Szczepaniak*	NED	30/01/19

MEMBERSHIP CHANGES IN 2019/20

Director	Appointment	Resignation
Stephen Jordan	17/08/18	06/12/19
Rachel Drew	06/12/19	–

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

RESPONSIBLE BUSINESS COMMITTEE

CURRENT MEMBERS

Director		Appointment
Marissa Szczepaniak (Chair)	NED	30/01/19
John Barnes	INED	30/01/19
David Hinton	EXEC	30/01/19
Rachel Drew*	NED	30/01/19
Emma Goddard	NON-D	26/09/19
Chris Lunn	NON-D	26/09/19
Jo Osborn	NON-D	27/09/19
Nicolas Truillet	NON-D	28/09/19

* Rachel Drew was a non-director member from 30/01/19 to 05/12/19 and became a director member on 06/12/2019

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

Read more
You will find our business plan and the responsible business appendix on our website at **southeastwater.co.uk/businessplan2020**

APPOINTMENT, SUCCESSION AND EVALUATION

REPORT FROM THE NOMINATION COMMITTEE

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

- We recommended the renewal of the appointment of John Barnes as an independent non-executive director being satisfied that he continued to meet the requirements of independence set out in our corporate governance code.
- We recommended the appointment of Rachel Drew from HRL Morrison & Co to the board following her interview with Ofwat to succeed Stephen Jordan who resigned in December 2019.
- As Paul Butler had informed the board of his intention to retire at the end of July 2020, we oversaw the process for the appointment of his successor. The search process included a mapping exercise carried out in September 2019 with the help of the external search consultancy firm Redgrave Partners who did not have any other connection with South East Water. The committee reviewed a list of potential external candidates identified in the mapping process and considered David Hinton to succeed Paul as CEO. Following a formal interview process conducted by a panel comprising the Chair of the nomination committee and the shareholder representatives, the panel was of the unanimous view to recommend to the nomination committee the appointment of David Hinton as CEO with effect from 1 August 2020 to succeed Paul Butler. This committee and the remuneration committee formally recommended to the board the appointment of David Hinton as CEO with effect from 1 August 2020 upon the retirement of Paul Butler and the board approved this appointment in December 2019.
- We, and the board as a whole, decided that from 1 August 2020 two executive directors being the CEO and the Finance Director would sit on the board maintaining a compact board with independent directors as the largest group.
- We considered the proposals from management for the appointment of new members of the executive teams which resulted in the appointment of a new Customer Service Director, Operations Director and Regulation and Strategy Director through internal succession planning.
- The whole board reviewed the company's initiatives on diversity and gender pay gap and we provide more information on page 22 [report from MD] and page 25 [people in strategic report].
- The committee reviewed its effectiveness as part of the overall board evaluation process and the members of the committee and directors were satisfied that it is operating effectively in accordance with its terms of reference.

NICK SALMON

CHAIRMAN
15 JULY 2020

CHANGES TO THE COMPOSITION OF THE BOARD AND COMMITTEES IN 2019/20

The appointment of John Barnes as a director of the company, Chair of the remuneration committee, and member of the audit and risk committee, nomination committee and responsible business committee was extended for a period of three years until 27 January 2022 on the recommendation of the nomination committee which concluded that he continued to satisfy the criteria of independence set out in our corporate governance code.

Stephen Jordan resigned as a director on 6 December 2019 to take on other responsibilities. Rachel Drew, from HRL Morrison & Co was appointed as a new shareholder nominated directors on the same date on the recommendation of the nomination committee and following her pre-appointment interview with Ofwat. She was also appointed as a member of the audit and risk committee, remuneration committee, nomination committee and responsible business committee.

BOARD EVALUATION

Our board evaluation was carried out by means of a confidential online questionnaire. The results were collated and summarised by the Company Secretary on a non-attributable basis and the Chair led a discussion on the conclusions to draw from the survey results and recommendations for change or improvement. The discussions related more particularly to questions which had received a relatively lower score and comments made by directors highlighting specific issues or suggestions.

The questionnaire covered the key aspects of the performance of the board and its committees reflecting key aspects of our corporate governance code including compliance with the board leadership, transparency and governance principles. The questionnaire also incorporated questions from the Sustainability First "Check-list for energy and water board effectiveness" in line with our responsible business commitments and questions from the City Values Forum "Governing culture: an agenda for boards" on the alignment of decision making with the company's purpose and values, and on culture and the promotion of behaviours the board wishes to encourage.

The questionnaire also included open questions on the working and effectiveness of the board and committees in fulfilling their roles. Each committee also considered its own practices against its terms of reference and the chairs' reports on their findings in their respective sections of this corporate governance report.

The Chair met with each non-executive and executive director to provide feedback on their performance and to receive suggestions from them. The evaluation of the Chair was carried out by the non-executive directors and the shareholders nominated directors receiving feedback from the executive directors.

In 2019 the board evaluation had emphasised the desire of the directors to see the agenda of the responsible business committee which had only recently been created to develop in conjunction with the preparation of our strategy and corporate plan in 2019/20. During the year the responsible business committee considered the delivery of the responsible business commitment as well as the appropriate metrics and reporting. The committee also reviewed key areas of performance on environmental delivery and health and safety and the wider ESG matters including climate change related actions and reporting.

The 2019 board evaluation also reinforced the need for continued action to improve diversity, succession planning and retention.

During the year several internal senior management positions were filled through the internal succession planning pipeline demonstrating its effectiveness.

The board also considered the initiatives the company had taken following the board evaluation survey on recognition and reward.

The board decided to have more involvement with and visibility of innovations in the company especially for delivering the challenges of the next regulatory period. An update on the innovation strategy and platform was provided to the directors during the year as well as updates on the implementation of the smart network strategy.

APPOINTMENT, SUCCESSION AND EVALUATION continued

At the 2020 board evaluation the board discussed diversity and acknowledged that the gender balance on the board had improved. However, there was more to do to in considering diversity of the whole organisation and to consider whether the company reflected the ethnic diversity of the communities it served.

The board wished to have more visibility and direct engagement with different levels of the business and it was agreed that a board engagement programme would be developed allowing more interaction by the board and individual directors.

The board also wished to have a better understanding of succession planning and especially of the succession pipeline from managers to senior managers.

The 2020 board evaluation concluded that the board and its committees were operating effectively.

COMMITMENT

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

The Chairman's and directors' other commitments were disclosed and considered prior to appointment and have not materially changed since their appointment. Details on the Chairman's and directors' other commitments can be found on page 106.

INDUCTION

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 are maintained at the appropriate level. The induction programme includes meetings with senior managers and visits to production sites and other facilities away from the head office. Such visits give directors the opportunity to speak to a wider group of employees and contractors. The feedback provided by Ofwat following their pre-appointment interview is also incorporated into the induction programme.

TRANSPARENCY, AUDIT, RISK AND INTERNAL CONTROL

TRANSPARENCY AND REPORTING

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

Our annual reporting on performance against the performance commitments in our final determination is prepared following rigorous internal control processes and external assurance with oversight from the audit and risk committee and the board.

Our processes to ensure the accuracy and reliability of our data and reporting are described in our data assurance summary on page 226.

We also maintain and publish our company monitoring framework which sets out what we do to ensure that the data and information we publish is reliable, transparent, timely and appropriate to the audience. We publish our strengths, risks and weaknesses statement and the subsequent draft assurance plan we have developed in order to address any risks that have been identified.

Read more
Our company monitoring framework is available here
southeastwater.co.uk/cmf

RISK MANAGEMENT AND INTERNAL CONTROLS

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.

Read more on our risk management process on page 59 of the strategic report and on how we ensure the information we publish is accurate and reliable in our data assurance summary on page 226.

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.

REPORT FROM THE AUDIT AND RISK COMMITTEE

I am pleased to report on the work of the audit and risk committee since 1 April 2019 and in relation to this annual report for 2019/20.

- We reviewed the half-year group financial reporting and recommended to the board the approval of the half-year group financial statements, and of this annual report for 2019/20.
- We considered the prospects of South East Water for the purpose of both the going concern statement by the directors and the longer-term viability described in the viability statement. We had regard in particular to the impact of both the Covid-19 outbreak and the PR19 final determination on the prospect of the business to 2025 and beyond and throughout the whole lookout period. Our Covid-19 impact assessment considered how our downside sensitivities would change if our trading activities and cash collections were impaired in the current and future financial years. We have recommended that the board maintain a lookout period of 10 years for its viability statement. We have also considered and made recommendations to the board on the appropriate nature and extent of stress testing to be used to assess the future prospects of South East Water. The description of our principal risks and our viability statement are included on pages 62 to 77 of the strategic report.
- We have considered the content and format of this annual report in line with the requirements of our corporate governance code and our company monitoring framework. Our aim is that this annual report and our regulatory reporting is informative, specific, clear and simple to understand. We have applied the same approach and scrutiny to our corporate social responsibility reporting.
- We have paid particular attention to ensure that our reporting on our outcome delivery incentives accurately reflects South East Water's performance in the year and on the quality and quality assurance of the data used for our reporting.
- We considered the impact of the adoption of IFRS 16 as of 1 April 2019 on the capitalisation of leases.
- We considered the report of the auditors on their review of internal controls and management override.
- We considered the impact of Covid-19 on our key judgements and estimates in the financial statements, in particular the impact on our debtor book and expected credit loss adjustment.

TRANSPARENCY AND ACCOUNTABILITY continued

FINANCIAL STATEMENTS AND ANNUAL PERFORMANCE REPORT

- AUDIT PLAN

  The committee reviewed the audit plan with the auditors and was satisfied that it covered the key issues and was consistent with prior years. We reviewed the significant audit risks typical of a water company, including bad debt provisioning, revenue recognition, the classification of costs between operating and capital expenditure and management override of internal controls. We also reviewed the areas of audit focus including the validity of assumptions of the pension funds valuation, the going concern and viability statement in light of our refinancing and the adoption of new accounting standards and in particular IFRS 16.

- FAIR, BALANCED AND UNDERSTANDABLE

  The committee has reviewed this annual report and financial statements and the regulatory reporting in order to assess whether they present a fair, balanced and understandable assessment of South East Water's and the group's position and prospects. We reviewed the relevant specific notes and explanations to the financial statements to ensure they provided clear explanation of accounting policies and technical matters. Following this review, we recommended to the board that, taken as a whole, the group annual report 2019/20 is fair, balanced and understandable.

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

- SIGNIFICANT JUDGEMENTS AND SOURCES OF ESTIMATION UNCERTAINTY CONSIDERED

  A significant proportion of water supplied to our domestic and our smaller commercial customers remains unbilled at the end of the financial year. As such judgements and estimates are made in respect of the value of unbilled water revenue. These estimates are based on previous consumption levels and are validated to ensure that the assessments are reasonable. We have assessed the impact of Covid-19 and the lockdown in the latter part of March and determined that there has been no effect on water consumption levels during this period.

  Our trade receivables balance includes a provision for bad debt, which is our assessment of debts that will be unpaid by our customers. The provision is based on the application of expected recovery rates to our aged debt balances using specific data for household and for non-household debt. We have identified a further expected credit loss to reflect the likely impact on our debt book arising from the Covid-19 outbreak. The full impact is has yet to be determined and may have a greater impact on future billed revenue in the next financial year.

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

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

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

- OTHER AREAS OF AUDIT AND RISK COMMITTEE FOCUS

  Areas of focus reviewed by the committee included the appropriateness of actuarial assumptions for the valuation of the assets and liabilities of the two defined benefit pension schemes to ensure they were within an acceptable range considering the economic environment.

  We considered the relevant disclosure relating to the impact of the adoption of IFRS 16 as of 1 April 2019.

EXTERNAL AUDITORS

- AUDIT FEE

  We reviewed the audit fee proposal from the auditors and the justifications presented for the increase applied for the 2019/20 audit for recommendation to our board for approval.

- EFFECTIVENESS OF THE EXTERNAL AUDIT PROCESS

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

- OBJECTIVITY AND INDEPENDENCE OF AUDITORS

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

  We applied our policy on non-audit services that requires approval of non-audit work by the Chair of the audit committee or, for any work in excess of £50,000, the full committee.

AUDIT TENDER

- We oversaw the preparation of the tender for audit services, which was due to be performed during 2020 but has been deferred until 2021, taking account of the developments of rules relating to the provision of audit services.
- An extension of the appointment of Deloitte LLP for the financial period ending 31 March 2021 was requested due to the impact of the Covid-19 pandemic and granted by the FRC in May 2020 and the tendering process was extended accordingly.

RISK MANAGEMENT AND INTERNAL CONTROLS

- We considered whether or not an internal audit function was required. We considered the established processes in place for regulatory and performance reporting which include both internal and external assurance, the size and structure of the company and the nature of the core activities. We concluded that an internal audit function was not required at this stage and that the current combination of internal reviews of controls and systems carried out by the finance team and of specific reviews by external consultants was appropriate and allowed access to specialist skills and knowledge that it would not be cost effective to maintain internally.
- We 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.
- Compared to the previous year, the focus of the board as a whole has been on the development of our Business Plan and our Corporate Plan and the management of the risks related to PR19 which took priority over the review of other areas of risk management and internal control in 2019/20.

CHRIS GIRLING

CHAIR
15 JULY 2020

DIRECTORS' REMUNERATION REPORT

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 2020. The report summarises our key objectives, our remuneration policy, the key linkages between directors' pay and the performance of the company in addition to the level of each director's emoluments for the year.

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

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

I would highlight the following:

2019/20 ANNUAL BONUS SCHEME

- We decided that the construct of the 2019/20 annual bonus scheme should follow that applied in 2018/19, replacing the SIM measure which would no longer apply with the number of burst mains.
- In defining 2019/20 objectives for the executive directors, we have ensured they further build on the objectives set in the previous year on improving diversity and inclusion, succession planning, the development of our customer engagement strategy beyond PR19, of our environmental strategy and our corporate plan.
- We reviewed the incentives to executive directors for the final year of AMP 6 and transitional year to AMP 7 across the annual bonus scheme and the long-term incentive plan (LTIP) to ensure that the focus on performance for 2019/20 would be maintained, acknowledging that there would be limited opportunity for an award under the LTIP in the final year for reasons due to the original design of the incentives that did not anticipate some of the change that took place during the period.
- We decided to increase the pay-out under the annual bonus scheme by 20 per cent with no other change to the rules and measures in the annual bonus scheme. We also set a deferral condition for any payment relating to the 20 per cent enhanced award until January 2021.
- We reviewed the full year performance of the company in 2019/20 and that of individual executive directors, taking account of their contribution in delivering the targets set and approved the awards for the last year of AMP 6 with a partial deferral of that award until January 2021.
- We approved a two year commercial bonus scheme for 2018 to 2020 for the Commercial Director only and the award under that scheme.

EXECUTIVES' BASE REMUNERATION

- We reviewed the salaries of new members of the executive team ensuring that their remuneration would be consistent with the company's remuneration policy and with the findings of the benchmarking carried out by Mercer | Keppler.
- We reviewed and approved the remuneration of David Hinton who will become the company's CEO on 1 August 2020 upon the retirement of Paul Butler including a pension contribution in line with the workforce.
- We decided that the salaries of the executive directors and the other members of the executive team from April 2020 would be reviewed following the company wide pay award. The same principle was applied to the remuneration of independent non-executive directors.

LONG-TERM INCENTIVE PLAN (LTIP) FOR 2015 TO 2020

- South East Water operates a Long-term Incentive Plan (LTIP) covering the five year period from April 2015 to March 2020. Similar to the annual bonus plan, the LTIP is designed to give priority to delivering operational objectives linked to customer outcomes.
- The related bonus payments were phased 20 per cent in 2018, 30 per cent in 2019 and 50 per cent in 2020. We reviewed progress against the LTIP targets considering actual performance in the AMP and the performance in 2019/20.
- We considered the overall performance of the executive directors in AMP 6 to 31 March 2020. The committee also considered the performance against the LTIP operational targets and, recognising the generally good overall performance through AMP 6, decided to exercise discretion that the 20 per cent award made in 2018 equivalent to 22.5 per cent of the Base Award and this would not be subject to claw back. The committee maintained its decision not to make the second potential payment in 2019.

REPORT FROM THE REMUNERATION COMMITTEE continued

- The committee decided to review the outcome delivery incentive multiplier used in the LTIP formula for the last year of AMP 6, this multiplier ranging from 0.75 at zero penalty to zero at £1.5 million net penalty, and then deducting the 20 per cent payment already made in 2018 provided that there was no major adverse development in the company's performance through to the end of the AMP.
- Following review of the final performance for 2019/20 and the full AMP, the committee approved the final pro-rata award for the last year of the AMP under the LTIP to the three current participants in the scheme.

INCENTIVE SCHEME FOR 2020 TO 2025

- The committee considered the response to the questions raised by Ofwat in its initial assessment of plan relating to performance related pay of the executive directors and the draft determination response on executive pay outlining principles for an AMP 7 incentive scheme. The committee also reviewed a benchmarking of the executive directors and executive team members salaries and incentives carried out by Mercer | Keppler. These responses, Ofwat's expectations set out at PR19 and the benchmarking informed the development of the new incentive scheme for AMP 7.
- The committee agreed that the incentive scheme for AMP 7 would be a single annual bonus scheme with deferral of a third of the annual pay-out for two years providing a mechanism for malus and claw back to reflect possible changes in performance.
- The committee decided that the measures and targets (including the performance levels for threshold, target and stretch) under the AMP 7 scheme would be set to represent an appropriate level of stretch and defined on the basis of the Final Determination and the Corporate Plan to ensure a focus on operational performance and delivery for customers.
- Customer outcomes (including operational outcomes delivery incentives, customer satisfaction, environmental and ESG outcomes) would represent 60 per cent of the total award, the rest being allocated between financial performance (30 per cent) and personal objectives (10 per cent).
- The committee retains discretion to adjust or cancel awards where performance is significantly below expectations or in case of significant operational or reputational issues.
- The committee engaged external legal advisers to draft the rules of the scheme for AMP 7 which were approved in May 2020.
- The committee considered specific proposals on the targets for the new AMP 7 incentive scheme including threshold and stretch, financial metrics, personal objectives and approved the final measures and targets for the year 2021/21. However, due to the uncertainty caused by the Covid-19 outbreak, in respect of the measures for the remaining part of 2020/21, the committee decided to keep the situation under close review taking account of the social and political environment and retained its discretion to decide that there might not be a bonus payment in respect of the year 2020/21.

GOVERNANCE

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

JOHN BARNES
CHAIR
15 JULY 2020

DIRECTORS' REMUNERATION REPORT continued

REMUNERATION POLICY

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

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

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

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

2019/20 ANNUAL BONUS PERFORMANCE CRITERIA

At the end of the 2018/19 financial year the remuneration committee opted to retain the structure of the executive bonus scheme, replacing the SIM measure which no longer applies with the number of burst mains. The committee also took the decision to increase the pay-out under the final year of the annual bonus scheme by 20 per cent, thereby increasing the annual bonus, for 2019/20 only, for the Finance Director and Asset and Regulation Director/CEO Designate and from 50 per cent to 70 per cent for the Managing Director. With the 20 per cent increment being deferred to January 2021 and being subject to continued service till this time, other than if leaving ahead of January 2021 as a "good leaver".

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

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

During the year the operational targets, with exception of the customer satisfaction target, we set were met and the payments to Executive Directors under the scheme have been calculated reflecting this in line with the structure of the executive bonus scheme. The result of which is an overall operational performance multiplier of 90 per cent.

OPERATIONAL OBJECTIVES	· Customer satisfaction · Health and Safety · Leakage (Ml/d) · Interruptions · Burst mains · Discolouration Contacts	Multiplier range 0% to 118% Actual performance 90%
FINANCIAL OBJECTIVES	· Cash collection as a percentage of actual billing · Whole business totex	Multiplier range 0% to 140% Actual performance 140%
PERSONAL OBJECTIVES	· Set individually for each Executive Director	Multiplier range of 0% to 100% Actual performance 95%

2019/20 BONUS AS A PERCENTAGE OF BASIC SALARY

DIRECTORS	PERCENTAGE OF SALARY PAID IF 100% OF TARGET ACHIEVED	AWARDED
Paul Butler	70.0%	70%
Andrew Farmer	50.0%	50%
David Hinton	50.0%	50%

The payments under the performance incentive scheme to Paul Butler relating to 2019/20 were made in July 2020 for the total award upon his retirement. Payments to Andrew Farmer and David Hinton of £70,788 and £55,058 respectively were made in July 2020, the remaining payments of £47,192 to Andrew Farmer and £36,705 to David Hinton being deferred until January 2021.

LONG-TERM INCENTIVE PLAN

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

The LTIP has been constructed to give priority on delivering operational objectives.

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

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

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

DIRECTORS' REMUNERATION REPORT continued

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 0.75 x (depending on outcome achieved)	1.35 x to 0.25 x (depending on position achieved)

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

As detailed within the report from the remuneration committee, the committee approved an amendment to the outcome delivery incentive multiplier used in the calculation of the LTIP award for 2019/20. This change saw the multiplier amend from 1.25 at zero penalty and zero at £1.5 million net penalty to 0.75 at zero penalty and zero at £1.5 million net penalty.

The awards are as follows:

	BASE AWARD £000	CORPORATE PLAN TARGET £000	MAXIMUM AWARD £000	2017/18*	2018/19*	2019/20*
Paul Butler	240	360	607.5	20%	30%	50%
Andrew Farmer	180	270	455.6	20%	30%	50%
David Hinton	140	210	354.5	20%	30%	50%

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

Following a review of the final performance of the current year and the full AMP, the remuneration committee approved the final payments for 2019/20 as set out in the table below. As a result the cash awards vested under the scheme are as follows:

	2017/18 £000	2018/19 £000	2019/20 £000
Paul Butler	54	–	100
Andrew Farmer	41	–	75
David Hinton	32	–	58

Payments of the bonuses awarded for the 2017/18 and 2019/20 years were made in July 2018 and July 2020 respectively.

DIRECTORS' EMOLUMENTS

	SALARY AND FEES £000	OTHER £000	LTIP £000	BONUS £000	2019/20 TOTAL £000	2018/19 TOTAL £000
DIRECTORS						
Nick Salmon (Non-Executive Chairman)	105	–	–	–	105	102
Paul Butler (Managing Director)	259	71	100	217	647	395
Andrew Farmer (Finance Director)	197	53	75	118	443	246
David Hinton (Asset & Regulation Director)	153	44	58	92	347	201
Marissa Szczepaniak (Non-Executive Director) (R – 17 August 2018) (A – 30 January 2019)	–	–	–	–	–	–
Rachel Drew (Non-Executive Director) (A – 06 December 2019)						
Oliver Schubert (Non-Executive Director) (R – 30 January 2019)	–	–	–	–	–	–
Stephen Jordan (Non-Executive Director) (A – 17 August 2018) (R – 06 December 2019)	–	–	–	–	–	–
INDEPENDENT NON-EXECUTIVE DIRECTORS						
John Barnes	41	4	–	–	45	36
Emma Gilthorpe (R – 30 September 2018)	–	–	–	–	–	19
Chris Girling	42	2	–	–	44	42
Célia Pronto (A – 1 June 2018)	35	–	–	–	35	29

A – Appointed R – Resigned

· 2018/19 represents 6 months for E Gilthorpe and 10 months for C Pronto

With effect from 1 April 2020 the salaries of the Executive Directors were increased in line with the company's pay award of 2.0 per cent. The executive bonus scheme for AMP 7 is detailed within the report from the remuneration committee.

In the year, Paul Butler was a member and David Hinton was a deferred member of a defined benefit pension scheme. For Paul Butler, the above table includes a cash supplement in lieu of the pension cap of £51,841 (2019: £50,331). Likewise, for Andrew Farmer the above table includes a cash supplement in lieu of the pension cap of £39,425 (2019: £6,107). David Hinton is a member of a stakeholder pension scheme and was in receipt of a cash supplement in the lieu of the pension cap in the year of £20,664 (2019: £2,481).

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

The bonus values for 2019/20 detailed above include the 20 per cent increment to the annual bonus scheme detailed within the report from the remuneration committee. The payment of which has been made in July 2020 for Paul Butler and deferred till January 2021 for both Andrew Farmer and David Hinton.

DIRECTORS' REMUNERATION REPORT continued

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

	DATE OF CONTRACT	UNEXPIRED TERM (MONTHS)	NOTICE PERIOD (MONTHS)
EXECUTIVE DIRECTORS			
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	12	3
Chris Girling	30 October 2014	7	3
John Barnes	28 January 2016	21	3
Célia Pronto	1 June 2018	14	3

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

PENSION BENEFITS EARNED

APPROVED CONTRIBUTORY FINAL SALARY PENSION SCHEME

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

Accrued benefits	David Hinton
AT MARCH 2020	
Annual pension	29,625
Lump sum	88,767
AT MARCH 2019	
Annual pension	29,127
Lump sum	87,283
INCREASE IN ACCRUED BENEFITS EXCLUDING INFLATION	
Annual pension	-
Lump sum	-
INCREASE IN ACCRUED BENEFITS AFTER ALLOWING FOR INFLATION	
Annual pension	498
Lump sum	1,484

Paul Butler has exercised his right to draw a pension and as such there are no benefits accruing in the pension scheme as at 31 March 2020.

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

APPROVED DEFINED CONTRIBUTION SCHEME

In the year to 31 March 2020 two Executive Directors were members of the defined contribution scheme.

The table below summarises the contributions that were made in the scheme as at 31 March 2020:

	CONTRIBUTIONS IN 2015/16	CONTRIBUTIONS IN 2016/17	CONTRIBUTIONS IN 2017/18	CONTRIBUTIONS IN 2018/19	CONTRIBUTIONS IN 2019/20
Andrew Farmer	27,274	37,453	22,170	10,000	-
David Hinton	28,000	28,392	29,934	29,043	9,966

CEO PAY RATIOS

The company has elected to calculate the CEO pay ratios based upon option B for the 2019/20 financial period. The company adopted the approach to use the Gender Pay Gap analysis published in April 2019 as the basis on which the 25th, 50th and 75th percentage quartiles are identified, due to constrictions on time available and the level of detail required in order to calculate the FTE remuneration figures for each of South East Water's employees effectively. It is the company's belief that the use of the Gender Pay Gap analysis offers a time efficient alternative while also offering up to date comparatives.

The table below details the ratio to which the CEO's total remuneration compares to that of the 25th, 50th and 75th percentile remuneration of all SEWL employees:

	25%	50%	75%
	0:0	0:0	0:0
2019/20	31:1	21:1	17:1

It is the company's belief that the CEO Pay Ratios above are reflective of the overall pay, reward and progression policies of the company, and that they convey the differing levels of remuneration received across the company to attract, motivate and retain staff based upon their level of experience, expertise and responsibility held.

Approved by the board and signed on its behalf by:

JOHN BARNES
CHAIR
15 JULY 2020

DIRECTORS' REPORT

The Directors have pleasure in presenting the group directors' report relating to South East Water Limited ("South East Water" or the "company") and its subsidiary South East Water (Finance) Limited (together referred to as the "group") for the year ended 31 March 2020, together with the audited financial statements.

PRINCIPAL ACTIVITIES AND FUTURE DEVELOPMENTS

The principal activities of the group comprise the supply of water to a population of 2.2 million in an area of 5,700 kms and the provision of certain ancillary services for customers, developers and other bodies within the constraints of the relevant legislation. The directors consider the performance of the business to be satisfactory and that this is expected to continue in the future. An indication of the likely future developments in the business of the company including its strategy for the period 2020 to 2025 are set out in the strategic report as well as information on the prospects of the company in the long term viability statement.

The turnover of the group for the year ended 31 March 2020 was £243.5 million (2019: £238.3 million) and operating profit was £81.3 million for the year (2019: £86.4 million). Profit before taxation for the year was £33.8 million (2019: £36.4 million). The financial position at 31 March 2020 for the group and for the company is shown on pages 146 and 147 respectively. Further analysis of the performance of the business and future developments is included in the strategic report on page 48.

APPOINTMENT AS A WATER UNDERTAKER AND THE RING-FENCE

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

The instrument of appointment deals with ring-fencing and requires South East Water to ensure, so far as is reasonably practicable, that it retains at all times sufficient rights and assets (other than financial resources) for a special administrator, if appointed, to be able to manage the affairs of the business, which must be confirmed annually. Condition I requires South East Water to ensure that it has sufficient financial and managerial resources and adequate systems of planning and internal control to carry out the regulated activities and to certify this annually. Condition I requires South East Water to conduct the appointed business as if it was substantially the company's sole business and it was a separate public limited company. The ultimate controllers of South East Water are bound by a binding undertaking required under Condition P to procure that their subsidiaries, other than South East Water, provide information required by South East Water to comply with its obligations under the Water Industry Act 1991 and the instrument of appointment and to refrain from any action that would cause the appointee to breach any of these obligations.

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

GROUP STRUCTURE

South East Water is the main operating company in the group of companies headed by HDF. Further details of the structure of the HDF group are provided in the strategic report on page 37. There are no branches (as defined in section 1046(3) of the Companies Act 2006 of the company outside of the United Kingdom.

CAPITAL STRUCTURE

Details of the authorised and issued share capital are shown in note 29 of the financial statements. There have been no movements during the year. South East Water has one class of share which carries no right to fixed income. There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the Articles of Association and prevailing legislation.

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

ACCOUNTING FRAMEWORK

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

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

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 £11.0 million (2019: £28.0 million) for the year, paid in equal instalments of £2.75 million per quarter. Further details are given in note 13 of the financial statements. South East Water's immediate parent company, South East Water (Holdings) Limited used £4.5 million of this dividend (2019: £5.2 million) to pay interest on an inter-company loan back to South East Water. No dividends have been proposed and unpaid at the balance sheet date.

The company's dividend policy is discussed on page 57 of the strategic report.

CAPITAL EXPENDITURE

During the year the group's capital expenditure totalled £104.5 million (2019: £104.7 million). Further details are given in notes 15 and 16 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 because of the number of sites and the costs of valuing such sites to precisely quantify this.

TAXATION

While the group makes profits, the extensive investment programme currently being undertaken by South East Water typically means that any taxable profits are exceeded by available capital allowances. As tax losses are available elsewhere in the HDF Group in practice we defer taking some capital allowances and purchase group relief to settle the resulting tax charge. The payment of group relief is made at the statutory rate for corporation tax so does not impact the effective tax rate. The effective rate after making allowance for the future rate change and prior year adjustments is 14.9 per cent. Additional information on taxation is provided in note 12.

DIRECTORS AND THEIR INTERESTS

The directors who at any time during the financial year and at the date of this report were directors of South East Water are set out on pages 90 to 91 and further details regarding their appointments are set out on page 115.

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

DIRECTORS' INDEMNITIES

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

PRINCIPAL RISKS AND UNCERTAINTIES

A description of the principal risks and uncertainties and an explanation of the steps the board takes to mitigate these risks are provided in the strategic report on pages 60 to 70.

DIRECTORS' REPORT continued

CORPORATE GOVERNANCE ARRANGEMENTS

Information on South East Water's corporate governance arrangements are set out in the corporate governance report at page 88.

DISCLOSURES ON GREENHOUSE GAS EMISSIONS

Information on greenhouse gas emissions, energy consumption and energy efficiency action (including as required under Part 7, Schedule 7 of the Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008 are set out on page 49 of the strategic report.

We also report on our greenhouse gas emissions in our Performance, People and Planet report, which is published on the company's website. Further details on our responsible business committee are set out in the corporate governance report at page 88.

ENVIRONMENTAL AND CORPORATE SOCIAL RESPONSIBILITY

South East Water's approach to sustainable development of our business includes a strong commitment to the environment and corporate social responsibility. Details of our actions in this respect are given throughout the strategic report and corporate governance report.

EMPLOYMENT POLICIES ON DISABILITY AND ENGAGEMENT WITH EMPLOYEES, SUPPLIERS, CUSTOMERS AND OTHERS

South East Water offers equal opportunities to all employees and applicants for employment. Our managers and officers are trained to ensure there is no unlawful discrimination on grounds of race, gender, age, religion, union membership, disability or sexual orientation. Employment policies are intended to confirm South East Water as an employer of choice through provision of a safe work environment, satisfying work, personal development and fair rewards. Further details are given in the strategic report on page 46.

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.

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

South East Water has developed a comprehensive engagement program to ensure that we capture the differing views of our customers, suppliers and other stakeholders in the wider community. This program has helped us shape our plans for the 2020 to 2025 AMP. There are a number of examples of how South East Water has interacted with stakeholders in forming its policies and decisions.

The strategic report also discusses how the directors have had due regard to the engagement with employees, customers, suppliers and other business relationships on page 43.

FINANCIAL INSTRUMENTS

Information about the use of financial instruments by South East Water and our subsidiary is given in note 26 of the financial statements.

In September 2019, the group repaid listed bonds totalling £200 million plus associated indexation from an attached interest swap arrangement of £111.5 million. The repayment was financed by issuing of two new series of loan notes via a US private Placement (USPP) totalling £175 million and the drawdown of £120 million from the company's seven year facility entered into in December 2018.

Additionally in September 2019, the company's parent company, South East Water (Holdings) Limited, paid £54 million to the company as part-repayment of the £190 million variable rate loan from the South East Water.

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. In coming to this decision they have considered the implications of the on-going Covid-19 pandemic and the impact this may have on the business. Further details of the group's response to the Covid-19 pandemic are provided on page 14. Our longer-term viability statement is set out on page 71.

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

POST BALANCE SHEET EVENTS

In July 2020 the Trustees of the Mid Kent Group Pension Scheme ("MKGPS") approved a change to scheme's rules to replace the use of the Retail Price Index ("RPI") with Consumer Price Index ("CPI") for the calculation of future obligations of the scheme. The reason for this change is the understanding that CPI more accurately reflects the rate of inflation for the MKGPS and this is in line with changes to public sector and statutory minimum pension increases. This also brings the MKGPS into line with the South East Water Pension Scheme which adopted CPI for increases in future obligations in 2011. The members of the MKGPS have been notified of this change to the rules of their scheme.

The estimated effect of this change on the group's financial statements is to provide a reduction in the costs of the scheme of approximately £7 million which will be recognised in the group's income statement in 2020/21 financial year. The savings in costs would be reflected in a reduction in a defined benefit liability recorded on the balance sheet at the end of that financial year.

DIRECTORS' STATEMENT ON AUDIT INFORMATION

The directors who were members of the board at the time of approving the directors' report are listed on page 5, further information regarding our directors is set out on pages 90 to 91. Having made enquiries of fellow directors, each of these directors confirms that:

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

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

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

This is the tenth year since Deloitte LLP were appointed as statutory auditor for the group. A tender process for the year commencing 1 April 2020 has commenced, as required by UK law. However this process has been postponed due to the current situation caused by the Covid-19 pandemic. The group has sought and obtained permission from the Financial Reporting Council to extend the appointment of Deloitte LLP as statutory auditor for a further year to allow time for the tender process to be conducted after the lockdown period has ceased. Deloitte LLP have agreed to act in the capacity of auditor for the group for a further year.

POLITICAL DONATIONS

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

Approved by the board on 15 July 2020 and signed on its behalf by:

NICOLAS TRUILLET
COMPANY SECRETARY
15 JULY 2020

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

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

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

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

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

RESPONSIBILITY STATEMENT

We confirm that to the best of our knowledge:

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

PAUL BUTLER
MANAGING DIRECTOR
15 JULY 2020

ANDREW FARMER
FINANCE DIRECTOR
15 JULY 2020

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTH EAST WATER LIMITED

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

1. OPINION

In our opinion:

- the financial statements of South East Water Limited (the 'Company') and its subsidiary (together, the 'Group') give a true and fair view of the state of the Group's and of the Company's affairs as at 31 March 2020 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements which comprise:

- the Group and Company income statement;
- the Group and Company statement of comprehensive income;
- the Group and Company statement of financial position;
- the Group and Company statement of changes in equity;
- the Group and Company statement of cash flows;
- the Group and Company cash flow from operating activities; and
- the related notes 1 to 35.

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

2. BASIS FOR OPINION

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

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

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

3. SUMMARY OF OUR AUDIT APPROACH

KEY AUDIT MATTERS	The key audit matters that we identified in the current year were: • Bad debt provisioning; • Revenue recognition – estimating unbilled household customer income; and • Classification of costs between operating and capital expenditure.
MATERIALITY	Group materiality was set at £3.5m (2019: £3.4m), which was determined on the basis of 3% of EBITDA, in line with prior year.
SCOPING	The Group comprises South East Water Limited (the regulated water business) and its only subsidiary company South East Water (Finance) Limited (which issues part of the Group's debt). Both of these companies were subject to a full scope audit by the group audit engagement team.
SIGNIFICANT CHANGES IN OUR APPROACH	Our approach in the current year is substantially consistent with prior year. The timing of the Group's year end, in relation to the Covid-19 pandemic related UK lockdown, means the impact of the pandemic on the Group was not significant for the current financial year. However, we have carried out a thorough reassessment of audit risks in light of Covid-19, in conjunction with additional procedures around the control environment and we have placed additional focus throughout our audit work on the potential future impacts of Covid-19 on key audit matters.

4. CONCLUSIONS RELATING TO GOING CONCERN, PRINCIPAL RISKS AND VIABILITY STATEMENT

GOING CONCERN

We have reviewed the Directors' statement in note 2 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and Company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We considered as part of our risk assessment the nature of the Group, its business model and related risks including, where relevant, the impact of the Covid-19 pandemic and Brexit, the requirements of the applicable financial reporting framework and the system of internal control. We evaluated the Directors' assessment of the Group's ability to continue as a going concern, including challenging the underlying data and key assumptions used to make the assessment, and evaluated the Directors' plans for future actions in relation to their going concern assessment.

We are required to state whether we have anything material to add or draw attention to in relation to that statement that would be required by Listing Rule 9.8.6R(3) if the Company had a premium listing, and report if the statement is materially inconsistent with our knowledge obtained in the audit.

Going concern is the basis of preparation of the financial statements that assumes an entity will remain in operation for a period of at least 12 months from the date of approval of the financial statements.

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

PRINCIPAL RISKS AND VIABILITY STATEMENT

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

- the disclosures on pages 62 to 70 that describe the principal risks, procedures to identify emerging risks, and an explanation of how these are being managed or mitigated;
- the Directors' confirmation on page 63 that they have carried out a robust assessment of the principal and emerging risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity; or
- the Directors' explanation on pages 129 to 131 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Viability means the ability of the Group to continue over the time horizon considered appropriate by the Directors.

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS
OF SOUTH EAST WATER LIMITED continued

4. CONCLUSIONS RELATING TO GOING CONCERN, PRINCIPAL RISKS AND VIABILITY STATEMENT continued

We are also required to report whether the Directors' statement relating to the prospects of the Group required by Listing Rule 9.8.6R(3) if the Company had a premium listing is materially inconsistent with our knowledge obtained in the audit.

5. KEY AUDIT MATTERS

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

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

5.1. BAD DEBT PROVISIONING

Key audit matter description

At 31 March 2020, the bad debt provision was £28.1m (2019: £25.9m). The bad debt charge of £4.2m represented 1.7% of turnover (2019: £1.6m and 0.7% of turnover).

A proportion of the Group's customers do not or cannot pay their water bills, which results in the need for provision to be made for non-payment of the customer balance. The bad debt provision is material, a key area of estimation within the Group and an area of scrutiny by Ofwat.

Provisions are made against the Group's trade receivables based on historical cash collection rates for debt over the past four years, which is considered by management to be representative of collection risk on the whole population of household debtors. A top-up to the provision has been recorded to reflect anticipated changes to cash collection as a result of Covid-19.

The key audit matter, which is also a potential fraud risk, is focused on the estimation of the bad debt provision, including whether the experience of cash collection in historical periods provides an appropriate expectation of future credit losses under IFRS 9 Financial Instruments.

In response to an expected deterioration in future cash collection due to the economic disruption caused by Covid-19, management have provided an additional amount of £0.7m. Management determined this additional provision considering a range of external data points as at year end and actual cash collection rates throughout April and May 2020, in order to assess overall expected credit losses on trade receivables, per IFRS 9. As a result of this, the bad debt provision at 31 March 2020 includes a greater level of estimation than the prior year.

The Board of Directors' also considered this an area of significant judgement as discussed in the Corporate Governance Report on page 88. This is also reflected as a key source of estimation uncertainty in note 3 to the financial statements, where management have included further disclosures in the current year to address the impact of Covid-19, and the relevant accounting policy adopted is disclosed in note 4. The bad debt provision is outlined further in note 20.

5.1. BAD DEBT PROVISIONING continued

How the scope of our audit responded to the key audit matter

In response to this matter we have performed the following procedures on the base provision:

- obtained an understanding of the relevant key management review controls and those relating to the data integrity in the bad debt model;
- verified the accuracy and completeness of information within the aged debt model;
- verified that the final provision has been calculated in line with the policy of the Group through testing the mechanical accuracy of the provision;
- verified that the final provision, including Covid-19 overlay adjustment, has been calculated in line with IFRS 9 methodology;
- reviewed management's bad debt policy, and challenged whether they reflect the lifetime expected credit outcomes for receivables, specifically assessing whether the recoverability assumptions are reflective of current cash collection rates; and
- assessed whether any discrepancies exist between the provision recognised and that supported by current cash collection ratios over the last 12 months and other macroeconomic indicators that may impact the ability of customers to make payments.

We have also performed the following procedures on the Covid-19 overlay adjustment:

- verified the assumptions underpinning the Covid-19 overlay adjustment and challenged the reasonableness through comparison to a wider range of external market forecasts and consistency with other water companies; and
- performed sensitivity analysis on the Covid-19 overlay adjustment to assess if changes to assumptions used by management would materially alter the provision.

Key observations

We are satisfied that the assumptions and estimates applied in assessing the impairment of trade receivables, including the impact of Covid-19, are appropriate and that the bad debt provision has been properly calculated using appropriate relevant data and in accordance with IFRS 9. The estimation uncertainty that exists in relation to bad debt provisioning has been appropriately disclosed in note 3 to the financial statements.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS
OF SOUTH EAST WATER LIMITED continued

5.2. REVENUE RECOGNITION - ESTIMATING UNBILLED HOUSEHOLD CUSTOMER INCOME

Key audit matter description	For customers with meters, which represent 90% of the customer base, the revenue recognised depends upon the volume used, including an estimate of the sales value of units supplied between the date of the last meter reading and the balance sheet date. The unbilled accrual at 31 March 2020 was £34.2m (2019: £32.4m). The risk is focused on the usage estimate, which is based on historical data and assumptions around consumption patterns upon which management then recognise unbilled revenue. Due to the level of management judgement, the estimation of unbilled household revenue has been identified as a key audit matter. We have identified a risk of fraud in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance. The Board of Directors' also considered this an area of significant judgement as discussed in the Corporate Governance Report on page 88. This is also reflected as a key source of estimation uncertainty in note 3 to the financial statements, where management have outlined sensitivity analysis, and the relevant accounting policy adopted is disclosed in note 4. Revenue is disclosed in note 6.
How the scope of our audit responded to the key audit matter	For the estimation of unbilled household revenue customer income, we have performed the following procedures: · obtained an undertsanding of, and tested, the relevant controls around the estimation techniques used with regard to consumption and other key data inputs into the model; · challenged the appropriateness of management's consumption assumptions for a sample of individual customers; · audited the analysis of the prior year accrued revenue through a trend analysis to assess whether we are satisfied with any adjustments included in the FY20 accrual; · performed retrospective analysis of the bills raised during 2019/20 relating to the FY19 accrual to determine the accuracy of management's forecasting; and · involved our IT audit specialists to test the accuracy and completeness of the report utilised by management in determining the accrual required.
Key observations	We are satisfied that management's estimates in relation to the recognition of unbilled household revenue are appropriate.

5.3. CLASSIFICATION OF COSTS BETWEEN OPERATING AND CAPITAL EXPENDITURE

Key audit matter description	The Group continues to invest significantly in infrastructure renewal and replacement, with property, plant and equipment and intangible asset additions of £104m (2019: £101m) in the period. Expenditure in relation to increasing the capacity or enhancing the network is treated as capital expenditure ("capex"). Expenditure incurred in maintaining the operating capability of the network is expensed in the year in which it is incurred ("opex"). Capital projects can contain a combination of enhancement and maintenance activity which are not distinct and hence the allocation of costs between capital and operating expenditure is inherently judgemental. This risk also includes the inappropriate capitalisation of labour overheads as this involves significant management judgement is assessing which costs are to be capitalised. We have identified a risk of fraud in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance. The Board of Directors also considered capital expenditure as an area of significant judgement as discussed in the Corporate Governance Report on page 88. This is reflected as a key judgement in note 3 to the financial statement and the relevant accounting policy adopted is disclosed in note 4. Capital expenditure is disclosed in note 16.
How the scope of our audit responded to the key audit matter	We have: · obtained an understanding and tested relevant controls within the capex and opex process; · assessed the Group's capitalisation policy to determine compliance with relevant accounting standards and tested the operating effectiveness of controls over the application of the policy to expenditure incurred on projects within the capital programme; · reviewed and challenged the additions and transfers to fixed assets for a sample of capital projects. We assessed the application of the capitalisation policy to the costs incurred by agreement to third party invoices and obtained explanations and further support for any significant changes in capital expenditure from budget; · challenged the assumptions and judgements made in allocating overheads to capital projects, through understanding the nature of activities performed; · for a sample of capital projects tested the actual overheads capitalised in the year, assessing the application of the capitalisation policy to the costs incurred by reviewing the business cases as progress and invoices of costs incurred; and. · confirmed the consistency of management's policy with previous years.
Key observations	Based on our audit of a sample of capital projects and our review of the project budgets, we consider that the classification of costs between operating and capital expenditure is appropriate.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS
OF SOUTH EAST WATER LIMITED continued

6. OUR APPLICATION OF MATERIALITY

6.1. MATERIALITY

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

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

	GROUP FINANCIAL STATEMENTS	COMPANY FINANCIAL STATEMENTS
Materiality	£3.46m (2019: £3.40m)	£3.43m (2019: £3.37m)
Basis for determining materiality	Materiality has been determined at 3% (2019 : 3%) of EBITDA.	
Rationale for the benchmark applied	We have used EBITDA as the benchmark for materiality as this is deemed a key driver of business value, is a critical component of the financial statements and is a focus for users of those financial statements. The substantial majority of the Group's operations are carried out by the Company.	

6.2. PERFORMANCE MATERIALITY

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Group performance materiality was set at 70% of Group materiality for the 2020 audit (2019: 70%). In determining performance materiality, we considered the following factors:

a. our consideration of the quality of the Group's control environment, including our ability to apply a control reliance approach on several business cycles;

b. no significant deficiencies noted in the functioning of the key business operations due to Covid-19 and the related changes in working patterns;

c. the limited number of changes to the business and the limited turnover of management and key accounting personnel during the year; and

d. the history of a low number of corrected and uncorrected misstatements identified in previous periods.

6.3. ERROR REPORTING THRESHOLD

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.2m (2019: £0.2m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. AN OVERVIEW OF THE SCOPE OF OUR AUDIT

7.1. IDENTIFICATION AND SCOPING OF COMPONENTS

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level.

South East Water Limited and South East Water (Finance) Limited were subject to full-scope audits and together account for 100% (2019: 100%) of the Group's turnover, total assets, profit before tax and EBITDA.

All procedures were carried out directly by the Group audit team.

7.2. OUR CONSIDERATION OF THE CONTROL ENVIRONMENT

Our work in relation to the Group's internal control environment involved testing of the Group's key reporting system. We, with the involvement of our IT specialists, obtained an understanding of, and tested, relevant General Information Technology Controls (GITCs) within the Group's key reporting system, including the access controls, change management controls and controls around segregation of duties.

We also tested the relevant controls within the household revenue, capital expenditure and operating expenses business processes, which are supported by the Group's key reporting system. We performed a walkthrough and inquiry of management to obtain an understanding of the relevant controls within each of these business processes. We tested, on a sample basis, the operating effectiveness of these controls by verifying that the controls have been performed as designed.

In response to the outbreak of Covid-19 and the changes in working practices which came into effect at the end of March 2020, we performed additional procedures on a number of controls within the business processes over which we take controls reliance to determine whether individual controls had been affected by working practice changes.

We were able to adopt a controls reliance strategy for each of these business processes, including automated controls in these business processes and no significant control deficiencies were identified as a result of our work.

8. OTHER INFORMATION

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

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

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

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

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS
OF SOUTH EAST WATER LIMITED continued

8. OTHER INFORMATION continued

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

- **Fair, balanced and understandable** – the statement given by the Directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit committee reporting** – the section describing the work of the audit committee does not appropriately address matters communicated by us to the audit committee; or
- **Directors' statement of compliance with the South East Water Corporate Governance Code 2020 (the "SEW Code")** – the parts of the directors' statement that would be required if the Company had a premium listing relating to the company's compliance with the equivalent provisions to those in the UK Corporate Governance Code specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the SEW Code.

We have nothing to report in respect of these matters.

9. RESPONSIBILITIES OF DIRECTORS

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

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

10. AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

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

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud and non-compliance with laws and regulations are set out below.

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

11. EXTENT TO WHICH THE AUDIT WAS CONSIDERED CAPABLE OF DETECTING IRREGULARITIES, INCLUDING FRAUD

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

11.1. IDENTIFYING AND ASSESSING POTENTIAL RISKS RELATED TO IRREGULARITIES

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the group's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- results of our enquiries of management and the audit committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the group's documentation of their policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations;
- the matters discussed among the audit engagement team and involving relevant internal specialists, including tax, pensions and IT regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the following areas: bad debt provisioning, estimating unbilled household customer income and classification of costs between operating and capital expenditure. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory frameworks that the Group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements or that had a fundamental effect on the operations of the Group. The key laws and regulations we considered in this context included the UK Companies Act, tax legislation and pension legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the group's ability to operate or to avoid a material penalty. These included compliance with terms of the Group's operating licence and the regulatory solvency requirements which are fundamental to the Group's ability to continue as a going concern.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS
OF SOUTH EAST WATER LIMITED continued

11.2. AUDIT RESPONSE TO RISKS IDENTIFIED

As a result of performing the above, we identified bad debt provisioning, estimating unbilled household customer income and classification of costs between operating and capital expenditure as key audit matters related to the potential risk of fraud. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

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

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

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

12. OPINIONS ON OTHER MATTERS PRESCRIBED BY THE COMPANIES ACT 2006

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

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

In the light of the knowledge and understanding of the Group and the Company and their environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report or the Directors' Report.

13. MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

13.1. ADEQUACY OF EXPLANATIONS RECEIVED AND ACCOUNTING RECORDS

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

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

We have nothing to report in respect of these matters.

13.2 DIRECTORS' REMUNERATION

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

We have nothing to report in respect of these matters.

14. OTHER MATTERS

14.1. AUDITOR TENURE

Following the recommendation of the Audit Committee, we were appointed by the Company on 1 September 2011 to audit the financial statements for the year ended 31 March 2011 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is ten years, covering the years ending 31 March 2011 to 31 March 2020.

14.2. CONSISTENCY OF THE AUDIT REPORT WITH THE ADDITIONAL REPORT TO THE AUDIT COMMITTEE

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

15. USE OF OUR REPORT

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

HELEN BURRIDGE (SENIOR STATUTORY AUDITOR)

FOR AND ON BEHALF OF DELOITTE LLP
STATUTORY AUDITOR
LONDON, UNITED KINGDOM
15 JULY 2020

GROUP INCOME STATEMENT

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Notes	2020 £000	2019 £000
Continuing operations			
Revenue	6	**243,481**	238,281
Bad debt	20	**(4,198)**	(1,584)
Group net operating costs	8	**(170,151)**	(163,257)
Other income	6	**12,199**	12,997
Group operating profit		**81,331**	86,437
Finance costs	10	**(52,862)**	(56,110)
Finance income	11	**5,333**	6,076
Profit before taxation		**33,802**	36,403
Taxation	12	**(16,918)**	(6,992)
Profit for the year from continuing operations		**16,884**	29,411
Discontinued operations			
Profit on discontinued operations		**-**	9,253
Profit for the year		**16,884**	38,664
Earnings per share			
Basic and diluted	14	**34.24p**	78.41p

GROUP STATEMENT OF COMPREHENSIVE INCOME

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Notes	2020 £000	2019 £000
Profit for the year		**16,884**	38,664
Items that will not be reclassified subsequently to profit or loss:			
Remeasurement of defined benefit (deficit)/surplus	27	**4,879**	(3,525)
Deferred tax on defined benefit pension schemes	12	**(927)**	600
Impact of deferred tax rate change in respect of pension schemes	12	**(124)**	-
		3,828	(2,925)
Total comprehensive income for the year attributable to owners of the company		**20,712**	35,739

COMPANY INCOME STATEMENT

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Notes	2020 £000	2019 £000
Continuing operations			
Revenue	6	**243,481**	238,281
Bad debt	20	**(4,198)**	(1,584)
Group net operating costs	8	**(170,129)**	(163,253)
Other income	6	**12,199**	12,997
Group operating profit		**81,353**	86,441
Finance costs	10	**(52,895)**	(56,153)
Finance income	11	**5,308**	6,058
Profit before taxation		**33,766**	36,346
Taxation	12	**(16,911)**	(6,981)
Profit for the year from continuing operations		**16,855**	29,365
Discontinued operations			
Profit on discontinued operations		**-**	9,253
Profit for the year		**16,855**	38,618
Earnings per share			
Basic and diluted	14	**34.18p**	78.31p

COMPANY STATEMENT OF COMPREHENSIVE INCOME

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Notes	2020 £000	2019 £000
Profit for the year		**16,855**	38,618
Items that will not be reclassified subsequently to profit or loss:			
Remeasurement of defined benefit (deficit)/surplus	27	**4,879**	(3,525)
Deferred tax on defined benefit pension schemes	12	**(927)**	600
Impact of deferred tax rate change in respect of pension schemes	12	**(124)**	-
		3,828	(2,925)
Total comprehensive income for the year attributable to owners of the company		**20,683**	35,693

GROUP STATEMENT OF FINANCIAL POSITION

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Notes	31 March 2020 £000	31 March 2019 £000
Non-current assets			
Intangible assets	15	**9,568**	10,501
Property, plant and equipment	16	**1,608,845**	1,555,123
Amount due from parent undertaking	18	**135,941**	189,911
Defined benefit pension surplus	27	**35,912**	25,564
		1,790,266	1,781,099
Current assets			
Inventories	19	**689**	592
Trade and other receivables	20	**84,441**	86,190
Cash and cash equivalents	21	**12,981**	12,804
		98,111	99,586
Total assets		**1,888,377**	1,880,685
Current liabilities			
Loans and borrowings	23	**(30,000)**	(254,890)
Derivative financial instruments	26	**-**	(108,836)
Trade and other payables	25	**(97,627)**	(92,263)
Deferred income	28	**(5,418)**	(7,183)
Provisions	24	**(4,457)**	(3,972)
		(137,502)	(467,144)
Non-current liabilities			
Loans and borrowings	22,30	**(1,029,326)**	(717,604)
Trade and other payables	22	**(4,997)**	(5,379)
Net deferred tax liabilities	12	**(166,352)**	(145,395)
Defined benefit pension liability	27	**(3,115)**	(3,154)
Deferred income	28	**(3,438)**	(3,185)
		(1,207,228)	(874,717)
Total liabilities		**(1,344,730)**	(1,341,861)
Net assets		**543,647**	538,824
Equity			
Ordinary share capital	29	**49,312**	49,312
Revaluation reserve		**241,386**	251,259
Retained earnings		**252,949**	238,253
Total equity		**543,647**	538,824

The notes on page 154 to 207 are an integral part of these financial statements. The consolidated financial statements of South East Water Limited (company number 02679874) on pages 146 to 207 were approved by the board of directors and authorised for issue on 15 July 2020 and were signed on its behalf by:

PAUL BUTLER
MANAGING DIRECTOR

.....
15 JULY 2020

ANDREW FARMER
FINANCE DIRECTOR

.....
15 JULY 2020

COMPANY STATEMENT OF FINANCIAL POSITION

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Notes	31 March 2020 £000	31 March 2019 £000
Non-current assets			
Intangible assets	15	**9,568**	10,501
Property, plant and equipment	16	**1,608,845**	1,555,123
Amount due from parent undertaking	18	**135,941**	189,911
Defined benefit pension surplus	27	**35,912**	25,564
		1,790,266	1,781,099
Current assets			
Inventories	19	**689**	592
Trade and other receivables	20	**84,063**	85,634
Cash and cash equivalents	21	**12,981**	12,607
		97,733	98,833
Total assets		**1,887,999**	1,879,932
Current liabilities			
Loans and borrowings	23	**(30,000)**	(254,890)
Derivative financial instruments	26	**-**	(108,836)
Trade and other payables	25	**(98,729)**	(92,961)
Deferred income	28	**(5,418)**	(7,183)
Provisions	24	**(4,457)**	(3,972)
		(138,604)	(467,842)
Non-current liabilities			
Loans and borrowings	22,30	**(1,029,326)**	(717,604)
Trade and other payables	22	**(4,997)**	(5,379)
Net deferred tax liabilities	12	**(166,352)**	(145,395)
Defined benefit pension liability	27	**(3,115)**	(3,154)
Deferred income	28	**(3,438)**	(3,185)
		(1,207,228)	(874,717)
Total liabilities		**(1,345,832)**	(1,342,559)
Net assets		**542,167**	537,373
Equity			
Ordinary share capital	29	**49,312**	49,312
Revaluation reserve		**241,386**	251,259
Retained earnings		**251,469**	236,802
Total equity		**542,167**	537,373

The notes on page 154 to 207 are an integral part of these financial statements. The consolidated financial statements of South East Water Limited (company number 02679874) on pages 146 to 207 were approved by the board of directors and authorised for issue on 15 July 2020 and were signed on its behalf by:

PAUL BUTLER
MANAGING DIRECTOR

.....
15 JULY 2020

ANDREW FARMER
FINANCE DIRECTOR

.....
15 JULY 2020

GROUP STATEMENT OF CHANGES IN EQUITY

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Notes	Issued share capital £000	Revaluation reserve £000	Retained earnings £000	Total equity £000
Balance at 1 April 2018		49,312	256,396	225,377	531,085
Profit for the year		-	-	38,664	38,664
Other comprehensive income:					
Remeasurement of defined benefit (deficit)		-	-	(3,525)	(3,525)
Deferred tax on defined benefit pension schemes		-	-	600	600
Total other comprehensive income		-	-	(2,925)	(2,925)
Total comprehensive income		-	-	35,739	35,739
Dividends	13	-	-	(28,000)	(28,000)
Amortisation of revaluation reserve		-	(6,127)	6,127	-
Release revaluation on disposals		-	(51)	51	-
Deferred tax on revaluation and retained earnings transfer		-	1,041	(1,041)	-
Balance at 31 March 2019		**49,312**	**251,259**	**238,253**	**538,824**
Profit for the year		-	-	16,884	16,884
Other comprehensive income:					
Remeasurement of defined benefit surplus:		-	-	4,879	4,879
Deferred tax on defined benefit pension schemes		-	-	(927)	(927)
Impact of deferred tax rate change in respect of pension schemes		-	-	(124)	(124)
Total other comprehensive income		-	-	3,828	3,828
Total comprehensive income		-	-	**20,712**	**20,712**
Dividends	13	-	-	(11,000)	(11,000)
Amortisation of revaluation reserve		-	(6,129)	6,129	-
Release of revaluation reserve on disposals		-	(19)	19	-
Deferred tax on revaluation and retained earnings transfer		-	1,164	(1,164)	-
Impact of deferred tax rate change		-	(4,889)	-	(4,889)
Balance at 31 March 2020		**49,312**	**241,386**	**252.949**	**543,647**

All transactions relate to the equity holders of the group.

COMPANY STATEMENT OF CHANGES IN EQUITY

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Notes	Issued share capital £000	Revaluation reserve £000	Retained earnings £000	Total equity £000
Balance at 1 April 2018		49,312	256,396	223,972	529,680
Profit for the year		-	-	38,618	38,618
Other comprehensive income:					
Remeasurement of defined benefit (deficit)		-	-	(3,525)	(3,525)
Deferred tax on defined benefit pension schemes		-	-	600	600
Total other comprehensive income		-	-	(2,925)	(2,925)
Total comprehensive income		-	-	35,693	35,693
Dividends	13	-	-	(28,000)	(28,000)
Amortisation of revaluation reserve		-	(6,127)	6,127	-
Release revaluation on disposals		-	(51)	51	-
Deferred tax on revaluation and retained earnings transfer		-	1,041	(1,041)	-
Balance at 31 March 2019		**49,312**	**251,259**	**236,802**	**537,373**
Profit for the year		-	-	16,855	16,855
Other comprehensive income:					
Remeasurement of defined benefit surplus		-	-	4,879	4,879
Deferred tax on defined benefit pension schemes		-	-	(927)	(927)
Impact of deferred tax rate change in respect of pension schemes		-	-	(124)	(124)
Total other comprehensive income		-	-	3,828	3,828
Total comprehensive income		-	-	**20,683**	**20,683**
Dividends	13	-	-	(11,000)	(11,000)
Amortisation of revaluation reserve		-	(6,129)	6,129	-
Release of revaluation reserve on disposals		-	(19)	19	-
Deferred tax on revaluation and retained earnings transfer		-	1,164	(1,164)	-
Impact of deferred tax rate change		-	(4,889)	-	(4,889)
Balance at 31 March 2020		**49,312**	**241,386**	**251,469**	**542,167**

All transactions relate to the equity holders of the group.

GROUP STATEMENT OF CASH FLOWS

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Notes	2020 £000	2019 £000
Operating activities			
Net cash flow from operating activities		**134,443**	125,023
Interest received		**4,705**	5,437
Interest element of lease payments		**(110)**	-
Other interest paid		**(41,828)**	(36,940)
Corporation tax received/(group tax relief paid)		**44**	(1,314)
Net cash flow before investing and financing activities		**97,254**	92,206
Investing activities			
Proceeds from the sale of property, plant and equipment		**94**	736
Purchase of property, plant and equipment		**(96,153)**	(97,132)
Proceeds from the sale of non-household customer base		**-**	9,156
Purchase of intangible assets		**(2,116)**	(2,997)
Net cash flow used in investing activities		**(98,175)**	(90,237)
Financing activities			
Loan to Parent undertaking repaid		**54,000**	-
New loans and borrowing received		**295,000**	35,000
Issue cost of new debt		**(130)**	(2,693)
Repayment of capital element of lease liability		**(222)**	-
Repayment of other loans and borrowing		**(336,550)**	-
Dividends paid to shareholder	13	**(11,000)**	(28,000)
Net cash flow from financing activities		**1,098**	4,307
Increase in cash and cash equivalents		**177**	6,276
Cash and cash equivalents at the beginning of the year		**12,804**	6,528
Cash and cash equivalents at the year end	21	**12,981**	12,804

GROUP CASH FLOW FROM OPERATING ACTIVITIES

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	2020 £000	2019 £000
Profit for the year	**16,884**	38,664
Adjustments for:		
Tax charge	**16,918**	6,992
Finance income	**(5,333)**	(6,076)
Finance costs	**52,862**	56,110
Depreciation and impairment of property, plant and equipment	**51,615**	48,046
Amortisation and impairment of intangibles	**3,049**	3,254
Profit on disposal of fixed assets	**(50)**	(377)
Proceeds from the sale of non-household customer base	**-**	(9,253)
Difference between pension contributions paid and amounts recognised in the income statement	**(4,896)**	(4,086)
Changes in working capital		
(Increase) in trade and other receivables	**(1,165)**	(5,451)
(Increase) in inventory	**(97)**	(356)
Increase/(Decrease) in trade and other payables	**4,656**	(2,444)
Net cash flow from operating activities	**134,443**	125,023

COMPANY STATEMENT OF CASH FLOWS

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Notes	2020 £000	2019 £000
Operating activities			
Net cash flow from operating activities		**134,465**	125,027
Interest received		**4,680**	5,414
Interest element of lease payments		**(110)**	-
Other interest paid		**(41,639)**	(36,910)
Corporation tax received/(group tax relief paid)		**55**	(1,304)
Net cash flow before investing and financing activities		**97,451**	92,227
Investing activities			
Proceeds from the sale of property, plant and equipment		**94**	736
Purchase of property, plant and equipment		**(96,153)**	(97,132)
Proceeds from the sale of non-household customer base		**-**	9,156
Purchase of intangible assets		**(2,116)**	(2,997)
Net cash flow used in investing activities		**(98,175)**	(90,237)
Financing activities			
Loan to Parent undertaking repaid		**54,000**	-
New loans and borrowing received		**295,000**	35,000
Issue cost of listed debt		**(130)**	(2,693)
Repayment of capital element of lease liability		**(222)**	-
Repayment of other loans and borrowing		**(336,550)**	-
Dividends paid to shareholder	13	**(11,000)**	(28,000)
Net cash flow from financing activities		**1,098**	4,307
Increase in cash and cash equivalents		**374**	6,297
Cash and cash equivalents at the beginning of the year		**12,607**	6,310
Cash and cash equivalents at the year end	21	**12,981**	12,607

COMPANY CASH FLOW FROM OPERATING ACTIVITIES

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	2020 £000	2019 £000
Profit for the year	**16,855**	38,618
Adjustments for:		
Tax charge	**16,911**	6,981
Finance income	**(5,308)**	(6,058)
Finance costs	**52,895**	56,153
Depreciation and impairment of property, plant and equipment	**51,615**	48,046
Amortisation and impairment of intangibles	**3,049**	3,254
Profit on disposal of fixed assets	**(50)**	(377)
Proceeds from the sale of non-household customer base	**-**	(9,253)
Difference between pension contributions paid and amounts recognised in the income statement	**(4,896)**	(4,086)
Changes in working capital:		
(Increase) in trade and other receivables	**(1,165)**	(5,451)
(Increase) in inventory	**(97)**	(356)
Increase/(decrease) in trade and other payables	**4,656**	(2,444)
Net cash flow from operating activities	**134,465**	125,027

NOTES TO THE FINANCIAL STATEMENTS

FOR THE 12 MONTHS ENDED 31 MARCH 2020

1. AUTHORISATION OF FINANCIAL STATEMENTS AND STATEMENT OF COMPLIANCE WITH IFRS

The financial statements of South East Water and its subsidiary (the "group") for the year ended 31 March 2020 were authorised for issue by the board of Directors on 15 July 2020 and the Statement of Financial Position was signed on the board's behalf by Paul Butler and Andrew Farmer. South East Water is a private company that has limited liability by shares and is incorporated in the United Kingdom and domiciled in England and Wales.

2. BASIS OF PREPARATION

BASIS OF PREPARATION

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

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

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

GOING CONCERN

The directors have, at the time of approving the financial statements, a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. In coming to this decision they have considered the implications of the on-going Covid-19 pandemic and the impact this may have on the business. The directors have concluded that it is correct to continue to adopt the going concern basis of accounting in preparing the financial statements. Further details are provided in the Strategic Report on page 53.

BASIS OF CONSOLIDATION

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

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

3. KEY JUDGEMENTS AND SOURCES OF ESTIMATION UNCERTAINTY

Our key judgements and estimations have been considered with close focus on the impact of Covid-19. The impact is included in each of the key judgements and source of estimation uncertainty.

KEY JUDGEMENTS

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE 12 MONTHS ENDED 31 MARCH 2020

3. KEY JUDGEMENTS AND SOURCES OF ESTIMATION UNCERTAINTY continued

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

- *The useful lives of infrastructure and non-infrastructure assets:* the group's asset lives, as detailed on page 161, represent a key judgement which impacts the value of depreciation charged to the income statement. The useful lives of the asset categories which determine the value of depreciation charged to the income statement are reviewed annually and are based on management's judgement and experience. An impairment review of assets is also undertaken annually to write down the value of assets where it is considered appropriate to do so. The Covid-19 outbreak and prevailing economic factors are not considered to have an impact on this key judgement
- *The capitalisation of employee and other directly attributable costs:* the group determines employee costs directly attributable to capital projects based on the time spent on the projects. Other directly attributable costs are then assessed. The costs relating to capital projects are then capitalised into individual projects. During the year £11.8 million of employee and other directly attributable costs have been capitalised (2019: £11.7 million). The Covid-19 outbreak and prevailing economic factors are not considered to have an impact on this key judgement

KEY SOURCES OF ESTIMATION UNCERTAINTY

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

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

- *Unbilled water income at the year-end (Household customers):* metered customers are billed on a six monthly cycle. This means that at the year-end there is a large volume of water which has been supplied but not billed to customers. The value of unbilled water income at 31 March 2020 is estimated to be £34.2 million (2019: £32.4 million)

  The methodology for arriving at the value of unbilled consumption incorporates estimates of water used based on historical consumption data and the relevant tariffs for customers. Previously billed consumption history provides a reliable basis for the estimate that is included in the financial statements. Our historical analysis of consumption indicates that billed revenue has been within 2 per cent of our previous estimates of the value of unbilled consumption

  The sensitivity of the estimate of unbilled consumption is illustrated in the table below where the impact of fluctuations in estimated water consumption in one year of one per cent and three per cent have been set out. These variants have been selected because, in previous years, our annual assessment of unbilled revenue has been between 1 per cent and 2 per cent of actual billed revenue

	31 March 2020	Sensitivity			
		+1%	+3%	-1%	-3%
Unbilled water income	£34.2m	+£0.3m	+£1.0m	-£0.3m	-£1.0m

Cash and cash equivalents at the year end *(Wholesale customers):* Water revenue chargeable to wholesale customers is governed by the Market Settlement Process and information provided by the Central Market Operating System. System data is used to estimate the amount of unbilled revenue in respect of wholesale customers. As at 31 March 2020, the level of unbilled revenue was estimated to be £3.8 million (2019: £4.6 million).

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

3. KEY JUDGEMENTS AND SOURCES OF ESTIMATION UNCERTAINTY continued

	31 March 2020	Sensitivity			
		+1%	+3%	-1%	-3%
Unbilled water income	£3.8m	+£0.04m	+£0.11m	-£0.04m	-£0.11m

Our calculations are prepared at the year end and whilst the Government Lockdown instructions were beginning to be implemented during March, the impact on consumption in the final weeks of the year is not considered to be material. As such the Covid-19 outbreak and prevailing economic factors are not considered to be a factor on this key judgement.

- *Provision for doubtful trade receivables*

  Household Debt

  Our Household customer base includes customers who cannot or will not pay their bills and therefore, we need to make a provision for the level of doubtful debt. The value of the provision for doubtful debts as at 31 March 2020 was £24.6 million (2019: £25.9 million)

  Our methodology establishes the expected credit loss of our household debt at the year-end by identifying customer debt categories and projecting historic cash collections across these customer groups to determine an estimate of irrecoverable debt. The estimated cash collection percentages take into account historical performance. Our cash collection history over the past four years has been used to determine future collection rates

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

	31 March 2020	Sensitivity			
		+1%	+3%	-1%	-3%
Bad debt provision estimate	£24.6m	+£0.2m	+£0.7m	-£0.2m	-£0.7m

  Management has reviewed the impact of Covid-19 on household customer debt. Our assessment has included a review of a number of potential scenarios to predict the likely impact on our cash collections profile as we move towards a recession. We have used these scenarios to determine likely impact on our customer debt and have included an additional household provision of £0.7m to reflect the impact of Covid-19. We will closely monitor our level of cash collections throughout the next financial year and if we deem it appropriate, may increase our bad debt provision as the year progresses or at the end of the next financial year.

  Retailer Debt

  South East Water provides wholesale supply to Retailers through the Non-household market/(MOSL). Trading terms are governed under the Wholesale Code and as such we secure collateral from Business Retailers in the form of bank guarantee, deposit or other form of security. At the year end, our assessment is that the security provided by Business Retailers obviates the need to make a provision against retailer debt.

  Management has reviewed the estimates included in the wholesale provisions and we do not consider there to be any need for further adjustment to reflect the impact of Covid-19 due to the security and guarantees held by the group as is noted above.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

3. KEY JUDGEMENTS AND SOURCES OF ESTIMATION UNCERTAINTY continued

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

  The costs of defined benefit pension schemes are determined using actuarial valuations. The actuarial valuations are determined by using certain assumptions for discount rates, mortality rates, expected return on assets and corporate bond performance projections as set out in note 27. Pension increases are based on expected future inflation rates. The net defined benefit pension scheme asset at 31 March 2020 is £32.8 million (2019: asset of £22.4 million). The Trust Deed provides South East Water with an unconditional right to a refund of surplus assets, assuming the full settlement of plan liabilities in the event of a plan winding-up. Furthermore, in the ordinary course of business the Trustee has no rights to unilaterally wind-up or otherwise augment the benefits due to members of the scheme. Based on these rights, any net surplus in the UK schemes is recognised in full.

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

Sensitivities	Decrease in schemes' surplus	
0.1% decrease to the discount rate	£4.0m	1.5%
0.1% increase to inflation	£3.5m	1.3%
One year increase in life expectancy	£10.0m	3.9%

Our assumptions have been set with a long-term view of the key factors and therefore the impact of the Covid-19 outbreak and prevailing economic factors in the short to medium term are not considered to have an impact on this key estimate.

4. ACCOUNTING POLICIES

Our accounting policies have been considered against the background of the Covid-19 outbreak and, where appropriate, relevant factors have been taken into account in preparing our financial statements.

The principal accounting policies adopted by the group are set out below. These policies have been consistently applied in both the current and prior years, except for those changes required due to the mandatory adoption of new reporting standards.

NEW STANDARDS AND INTERPRETATIONS ADOPTED

The group has adopted all new accounting standards and interpretations with mandatory adoption date on or before 1 April 2019. It is the view of the group that the adoption of these standards will have no material effect of the group with the exception of IFRS 16 which is explored below.

IFRS 16 LEASES

IFRS 16 is effective for periods commencing on or after 1 January 2019 and therefore this has been adopted by the group for the year ending 31 March 2020. For lessees, IFRS 16 removed the distinction between operating and finance leases and required the recognition of a right-of-use asset and corresponding liability.

The annual rents for operating leases was previously charged to the income statement as operating costs under IAS 17 Leases ("IAS 17"). From 1 April 2019, right-of-use assets are recognised under property, plant and equipment and the corresponding lease liabilities has been recognised as financial liabilities.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

4. ACCOUNTING POLICIES continued

The values of right-of-use assets are calculated as the present value of future lease payments plus expenses incurred in arranging the leases and any costs in upgrading or remediating the assets. The values of the liabilities under the leases are the present value of future lease payments.

Right-of-use assets are depreciated in line with the depreciation policies detailed below. Payments under leases are accounted for both as interest and capital repayment based on the applicable interest rate applied to the lease financing.

The calculation of the initial cost of the right-of-use asset and the liability is the present value of future payments under the lease discounted by the interest rates at which the group would currently be able to borrow in order to finance similar assets to those under the lease over a similar period.

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

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

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

Further details of the transition to IFRS 16 are provided in note 5.

NEW STANDARDS AND INTERPRETATIONS NOT APPLIED

As the group prepares their financial statements in accordance with IFRS as adopted by the European Union ("EU"), 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 3 (amended)	Business Combinations
IFRS 7 (amended)	Financial Instruments: Disclosures
IFRS 8 (amended)	Operating Segments
IFRS 9 (amended)	Financial Instruments
IFRS 16 (amended)	Leases
IFRS 17	Insurance contracts (replaces IFRS 4)
IAS 1 (amended)	Presentation of Financial Statements
IAS 8 (amended)	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 16 (amended)	Property, Plant and Equipment
IAS 37 (amended)	Provisions, Contingent Liabilities and Contingent Assets
IAS 39 (amended)	Financial Instruments: Recognition and Measurement

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

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

4. ACCOUNTING POLICIES continued

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, that is the company will not bill an address without first knowing the name of the person living at the address. Specific recognition criteria must also be met before revenue is recognised as detailed below.

Metered and unmetered income

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

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

Unmetered water income was invoiced in full for the financial year 2019/20 on 1 April 2019 and is recognised over the year as water is supplied to the named customer and the performance obligation is satisfied.

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

Infrastructure charges

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

Grants and contributions

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

Other income

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

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

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

Finance income

Finance income is recognised using the effective interest rate method.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

4. ACCOUNTING POLICIES continued

TAXATION

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

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

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

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

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

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

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

DIVIDENDS

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

INVESTMENTS IN SUBSIDIARIES

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

INTANGIBLE ASSETS

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.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

4. ACCOUNTING POLICIES continued

PROPERTY, PLANT AND EQUIPMENT

Infrastructure assets

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

Non-infrastructure assets

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

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

Derecognition

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

Residual values and useful lives

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

Capitalisation of employee and other directly attributable costs

Employee and other costs, including borrowing costs, directly attributable to capital projects are capitalised in the financial statements as part of the cost of the property, plant and equipment to which they relate. Training costs, administration and other general overhead costs are not capitalised.

Leased assets

Property, plant and equipment held under 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.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

4. ACCOUNTING POLICIES continued

BORROWING COSTS

Borrowing costs are incurred on the group's general borrowings. Where appropriate borrowing costs are attributed to qualifying assets in line with IAS 23 Borrowing Costs. Otherwise borrowing costs are expensed as incurred. See note 10 for further details.

INVENTORY

Inventory is valued at the lower of average cost or net realisable value. The stocks of treated water held by the group are valued at £nil. Consumable chemical purchases are recognised as an expense in the income statement at the point they are received on site for use, either from central stores or from suppliers direct.

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

SHORT-TERM TRADE AND OTHER RECEIVABLES

Short-term trade receivables are initially measured at their transaction price in line with the provisions of IFRS 9. The carrying value for trade receivables includes an allowance for the lifetime expected credit loss (doubtful debts) of the outstanding debts. An estimate for the expected credit loss is calculated by the group's management in accordance with the defined methodology detailed under key sources of estimation uncertainty above.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents in the statement of financial position comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

Included within cash and cash equivalents are amounts that are held in designated bank accounts as short-term deposits in order to meet the interest falling due in respect of listed debt and other long-term borrowings.

TRADE PAYABLES

Trade payables are measured at fair value and subsequently measured at amortised cost.

FINANCIAL INSTRUMENTS

The group's financial instruments comprise fixed and variable rate borrowings, index linked loans, fixed rate debentures, lease liabilities, 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.

Impairment of financial assets

A provision for twelve month expected credit loss on new financial assets is recognised in the income statement to establish a loss allowance on initial recognition in line with the impairment requirements of IFRS 9.

At each reporting date an assessment is carried out to determine whether there is any indication that the credit risk on financial assets has increased significantly. If this is considered to be the case, full life-time expected credit loss is recognised in the income statement.

Where there is objective evidence that an impairment loss has arisen, the loss is recognised in the income statement in the year in which the respective assessment takes place. Impaired debts are derecognised when they are assessed as irrecoverable.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

4. ACCOUNTING POLICIES continued

Derecognition

Financial liabilities are removed from the statement of financial position when the related obligation is discharged, cancelled or it expires.

Financial assets are removed from the statement of financial position when the rights to the cash flows from the asset expire, or when the risks and rewards of ownership of the asset are transferred or when control of the asset is transferred.

Embedded derivatives

Financial instruments that are not carried at fair value through the income statement are reviewed to determine if they contain embedded derivatives. Embedded derivatives are accounted for separately as derivative financial instruments when the economic characteristics and risks are not closely related to the respective host financial instrument.

Derivative financial instruments

The group uses an interest rate swap to hedge its risks associated with certain interest rate fluctuations. This use does not qualify for hedge accounting. Derivative financial instruments are recognised initially and subsequently in the statement of financial position at fair value through profit or loss with any movements during the year charged or credited to the income statement. The fair value is determined by reference to market values for similar instruments.

Interest bearing loans and borrowings

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

Interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

REVALUATION RESERVE

The revaluation reserve was created on the adoption of IFRS when the company took the option to treat the revalued amounts as deemed cost. This reserve is released over the life of the underlying assets to which it relates in line with the depreciation of the revalued assets and transferred to retained earnings. The revaluation uplift remaining on any assets that are disposed of is also transferred to retained earnings at the time of the disposal.

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.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

4. ACCOUNTING POLICIES continued

RESEARCH AND DEVELOPMENT

Research costs are charged to the income statement in the year in which they are incurred.

Development costs are capitalised based on management's judgement that the technological and economic feasibility of a project is confirmed, usually when a project has reached a defined milestone according to an established project management model. In determining the amounts to be capitalised management makes assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits.

PENSION AND OTHER POST-EMPLOYMENT BENEFITS

The group accounts for pensions and other post-employment benefits under IAS 19(R). The group operates both defined benefit and defined contribution pension schemes. Defined benefits are provided using both funded and unfunded pension plans.

Defined contribution plans

Contributions to defined contribution plans are recognised as an expense in the income statement when the contributions fall due.

Defined benefit plans

The pension scheme asset or liability in the statement of financial position represents the net present value of the defined benefit obligation and the fair value of scheme assets at the balance sheet date. The present value of the defined benefit obligation is analysed between the funded and unfunded pension plans.

The present value of the defined benefit obligation and the cost of providing benefits under defined benefit plans is determined on a triennial basis, and updated to each year end by an independent qualified actuary using the Projected Unit Credit actuarial valuation method, discounted at an interest rate equivalent at measurement date to the rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities.

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.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

5. ADOPTION OF IFRS 16

The group has adopted IFRS 16 at the beginning of the financial year. The group has taken the practical expedient to apply this Standard only to contracts which were previously identified as leases when applying IAS 17 Leases and IFRIC 4 Determining whether an Arrangement Contains a Lease.

IFRS 16 has been adopted using the modified retrospective method which has led to the accumulated historical adjustments being made to opening balances at 1 April 2019.

The initial values of lease liabilities equate to the present value of future lease payments under the relevant lease contracts. The group have applied the practical expedient of using a single discount rate to leases with reasonably similar characteristics. The discount rates used in calculating the liabilities reflect the interest rates at which the group would currently be able to borrow in order to finance similar assets to those under the lease affected by the transition (the incremental borrowing rate).

The company has recently entered into loan facilities at fixed rates and with weighted average repayment maturities comparable with the lengths of the leases affected by the transition. The interest rates attached to the new facilities have, therefore, been deemed appropriate proxies for the incremental borrowing rates, as follows:

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

The right-of-use assets at the date of initial application have been measured as an amount equal to the lease liability under each lease affected by the transition.

At 1 April 2019, the group held the following operating leases previously accounted for under IAS 17 which met the criteria under IFRS 16 for such recognition. There were no long-term leases with outstanding periods of less than 12 months at the adoption date.

Year ended 31 March 2020	Start date	End date	Annual rent £000	Values of assets and liabilities on adoption £000
Laboratory at Farnborough	22 May 2015	21 May 2035	195	2,466
Unit at Brooke House, Larkfield	8 Aug 2018	7 Aug 2021	19	43
Water Tower at Blackhill, Camberley	19 Jan 2004	14 Jun 2022	17	52
Offices at Leithrim House, Larkfield	4 Apr 2018	4 Apr 2028	67	537
			298	3,098

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

5. ADOPTION OF IFRS 16 continued

The impact of the adoption of IFRS 16 on the group's financial statements in the period has been:

	31 March 2020 pre IFRS 16 £000	Adjustment for the adoption of IFRS 16 £000	31 March 2020 post IFRS 16 £000
Revenue	243,481	-	243,481
Group net operating costs	(174,361)	12	(174,349)
Other income	12,199	-	12,199
Group operating profit	**81,319**	**12**	**81,331**
Finance costs	(52,752)	(110)	(52,862)
Finance income	5,333	-	5,333
Profit before taxation	**33,900**	**(98)**	**33,802**
Taxation	(16,918)	-	(16,918)
Profit for the period	**16,982**	**(98)**	**16,884**

Adoption of IFRS 16 has resulted in an adjustment to net operating costs of £12,000. This represents the removal of the rental charges of £319,000 offset by the depreciation change of £307,000 on the right-of-use assets, which have been included in the balance sheet at 1 April 2019.

Further, the interest chargeable on the lease finance has been accrued to 31 March 2020 resulting in a finance charge of £110,000.

The adoption if IFRS 16 has no material impact on EPS in the year.

The value of payments under leases in the year has been £332,000.

The impact of IFRS 16 on earning per share for the year was 0.20p per share for both the group and company.

An analysis of the maturity of lease liabilities is provided below:

Year ended 31 March 2020	Within 1 year £000	1 – 2 years £000	2 – 5 years £000	Over 5 years £000	Total £000
Laboratory at Farnborough	195	195	585	1,979	2,954
Unit at Brooke House, Larkfield	19	7	-	-	26
Water Tower at Blackhill, Camberley	17	17	3	-	37
Offices at Leithrim House, Larkfield	68	68	204	201	541
Lenham Depot	160	160	480	741	1,541
	459	**447**	**1,272**	**2,921**	**5,099**

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

5. ADOPTION OF IFRS 16 continued

The impact of the adoption of IFRS 16 on the Group's opening statement of financial position has been:

	1 April 2019 pre IFRS 16 £000	Adoption of IFRS 16 £000	1 April 2019 post IFRS 16 £000
Intangible assets	10,501	-	10,501
Property, plant and equipment	1,555,123	3,098	1,558,221
Amount due from parent undertaking	189,911	-	189,911
Defined benefit pension surplus	25,564	-	25,564
Non-current assets	1,781,099	3,098	1,784,197
Current assets	99,586	-	99,586
Total assets	1,880,685	3,098	1,883,783
Loans and borrowings	(254,890)	-	(254,890)
Derivative financial instruments	(108,836)	-	(108,836)
Trade and other payables	(92,263)	-	(92,263)
Deferred income	(7,183)	-	(7,183)
Provision	(3,972)	-	(3,972)
Current liabilities	(467,144)		(467,144)
Non-current liabilities			
Loans and borrowings	(717,604)	(3,098)	(720,702)
Trade and other payables	(5,379)	-	(5,379)
Net deferred tax liabilities	(145,395)	-	(145,395)
Defined benefit pension liability	(3,154)	-	(3,154)
Deferred income	(3,185)	-	(3,185)
	(874,717)	(3,098)	(877,815)
Total liabilities	(1,341,861)	(3,098)	(1,344,959)
Net assets	538,824	-	538,824
Equity			
Ordinary share capital	49,312	-	49,312
Revaluation reserve	251,259	-	251,259
Retained earnings	238,253	-	238,253
Total equity	538,824	-	538,824

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

5. ADOPTION OF IFRS 16 continued

The following tables show the movement in the year in the values of right-of-use assets and lease financing liabilities.

	Right-of-use assets £000
Balance at 1 April 2019 on adoption of IFRS 16	3,098
Additions from new lease arrangements	1,585
Depreciation	(307)
Balance at 31 March 2020	4,376

	Lease financing liabilities £000
Balance at 1 April 2019 on adoption of IFRS 16	3,098
Additions from new lease arrangements	1,363
Capital element of lease payments	(222)
Balance at 31 March 2020	4,239

The adoption of IFRS 16 has had no impact on the net cash flow of the group.

6. TOTAL INCOME

GROUP AND COMPANY	2020 £000	2019 £000
Revenue		
Unmetered water income	**20,800**	24,966
Metered water income	**208,405**	199,278
Metered sewerage income	**-**	(15)
Other sales	**14,276**	14,052
Total Revenue	**243,481**	238,281
Other income		
Rental income	**1,284**	1,233
Sundry income	**10,915**	11,764
Total other income	**12,199**	12,997
Total income	**255,680**	251,278

All revenue is from customers within the United Kingdom.

Other sales includes new connections income of £5.8 million (2019: £7.7 million), infrastructure income of £5.8 million (2019: £5.2 million) and capital contributions of £1.4 million (2019: £1.0 million).

Sundry income includes charges for billing and cash collection services amounting to £7.6 million (2019: £8.1 million), and laboratory income of £2.5 million (2019: £2.3 million).

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

7. SEGMENTAL ANALYSIS

The group's revenue mainly arises from the supply of water and related activities. The activities of the group, for management purposes, fall into three operating areas being the supply of potable water on a wholesale and retail basis, both of which are governed by the Water Act 2014, and related non-regulated activities.

YEAR ENDED 31 MARCH 2020	Wholesale activities £000	Retail activities £000	Other activities £000	Total £000
Total income	221,820	21,749	12,111	255,680
Operating profit	72,803	3,568	4,960	81,331
Finance costs				(52,862)
Finance income				5,333
Profit before taxation				33,802
Taxation				(16,918)
Profit for the year				**16,884**

YEAR ENDED 31 MARCH 2019	Wholesale activities £000	Retail activities £000	Other activities £000	Total £000
Total income	217,705	21,379	12,194	251,278
Operating profit	76,996	4,901	4,540	86,437
Finance costs				(56,110)
Finance income				6,076
Profit before taxation				36,403
Taxation				(6,992)
Profit from continued operation				29,411
Profit from discontinued operation				9,253
Profit for the year				38,664

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

NOTES TO THE FINANCIAL STATEMENTS

FOR THE 12 MONTHS ENDED 31 MARCH 2020

8. NET OPERATING COSTS

	Notes	GROUP 2020 £000	GROUP 2019 £000	COMPANY 2020 £000	COMPANY 2019 £000
Employee benefits expense	9	**30,166**	30,078	**30,166**	30,078
Asset expense/(income):					
Depreciation – owned assets		**50,537**	47,456	**50,537**	47,456
Depreciation – right-of-use assets		**885**	579	**885**	579
Impairment of fixed assets		**193**	10	**193**	10
Amortisation of intangible assets		**3,049**	3,129	**3,049**	3,129
Impairment of intangible assets		**-**	126	**-**	126
(Profit)/loss on disposal of non-current assets		**(50)**	(377)	**(50)**	(377)
		54,614	50,923	**54,614**	50,923
Other operating expenses:					
Operating lease rentals:					
Vehicles and office equipment		**242**	211	**242**	211
Land and buildings		**14**	287	**14**	287
Fees payable to the group's auditor (see below)		**300**	279	**300**	279
Other expenses (see below)		**89,974**	87,190	**89,952**	87,186
Other operating expenses charged to capital projects		**(5,159)**	(5,711)	**(5,159)**	(5,711)
		85,371	82,256	**85,349**	82,252
Total operating costs		**170,151**	163,257	**170,129**	163,253
Fees payable to the group's auditor in respect of:					
Audit of the group and company financial statements		**208**	203	**208**	203
Audit of subsidiary		**1**	1	**1**	1
Total audit		**209**	204	**209**	204
Regulatory accounts		**49**	50	**49**	50
Other assurance services		**37**	15	**37**	15
		86	65	**86**	65
Services relating to iXBLaccount coding		**5**	10	**5**	10
Total non-audit services		**91**	75	**91**	75
Total fees payable to the group's auditor		**300**	279	**300**	279
Other expenses comprise:					
Energy costs		**18,346**	16,440	**18,346**	16,440
Rates		**18,186**	17,770	**18,186**	17,770
Contractors		**26,218**	23,768	**26,218**	23,768
Bulk water supplies and abstraction licences		**8,619**	9,195	**8,619**	9,195
Chemicals		**3,524**	3,300	**3,524**	3,300
Insurance and related costs		**2,646**	3,083	**2,646**	3,083
Other		**12,435**	13,634	**12,413**	13,630
Total other expenses		**89,974**	87,190	**89,952**	87,186

NOTES TO THE FINANCIAL STATEMENTS

FOR THE 12 MONTHS ENDED 31 MARCH 2020

9. DIRECTORS AND EMPLOYEES

The average monthly number of employees, including salaried directors, of the group in the year was:

GROUP AND COMPANY	2020 Number	2019 Number
Operations	**434**	440
Management and administration	**525**	510
	959	950

	Notes	2020 £000	2019 £000
The aggregate payroll costs of these persons were:			
Wages and salaries		**31,124**	30,193
Social security costs		**2,550**	3,049
Pension costs for defined benefit schemes	27	**710**	1,067
Pension costs for unfunded pensions		**-**	266
Pension costs for defined contribution schemes	27	**2,385**	2,143
		36,769	36,718
Less: direct salary costs charged to capital projects		**(6,603)**	(6,640)
		30,166	**30,078**

Emoluments of the directors, who are the group's key management, were:

	2020 £000	2019 £000
Aggregate emoluments including bonuses	**1,666**	1,071
Company contributions to defined contribution scheme	**10**	39
	1,676	1,110
Emoluments of the highest paid director were:		
Aggregate emoluments including bonuses	**647**	395

Retirement benefits are accruing to one director (2019: one) under the defined benefit pension schemes and two directors (2019: two) under a defined contribution scheme. Further disclosures in respect of directors' emoluments are set out in the remuneration report on page 120.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

10. FINANCE COSTS

	GROUP		COMPANY	
	2020 £000	2019 £000	**2020 £000**	2019 £000
Debenture interest	**42**	42	**42**	42
Interest payable to subsidiary	**-**	-	**21,321**	25,684
Indexation payable to subsidiary	**-**	-	**7,392**	7,671
Effective interest on listed debt	**18,411**	22,842	**-**	-
Fair value movements on interest rate swap	**2,713**	4,668	**2,713**	4,668
Indexation on variable rate bonds	**4,378**	4,564	**-**	-
Bank interest and other finance charges	**5,068**	975	**5,068**	975
Financing guarantee fees	**1,430**	1,289	**1,430**	1,289
Interest payable on index linked loans	**12,500**	12,174	**9,623**	9,375
Indexation on index linked loans	**10,444**	11,487	**7,430**	8,380
Lease interest	**110**	-	**110**	-
Amortisation of loan issue costs	**594**	546	**594**	546
Interest and related fees payable	**55,690**	58,587	**55,723**	58,630
Interest capitalised	**(2,828)**	(2,477)	**(2,828)**	(2,477)
	52,862	56,110	**52,895**	56,153

Interest capitalised during the year amounted to £2.8 million (2019: £2.5 million) and is calculated using the weighted average interest rate of the group's long-term lending of 4.25 per cent (2019: 4.44 per cent).

11. FINANCE INCOME

		GROUP		COMPANY	
	Notes	**2020 £000**	2019 £000	**2020 £000**	2019 £000
Interest receivable on bank balances and short-term deposits		**201**	135	**176**	117
Interest receivable from group undertakings		**4,499**	5,305	**4,499**	5,305
Pension fund finance income	27	**633**	636	**633**	636
		5,333	6,076	**5,308**	6,058

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

12. TAXATION

Major components of the group's tax expense for the years ended 31 March 2020 and 2019 are:

	GROUP		COMPANY	
	2020 £000	2019 £000	**2020 £000**	2019 £000
Group income statement				
Current tax:				
Current UK tax charge	**2,042**	878	**2,035**	867
Amounts over provided in previous years	**(141)**	-	**(141)**	-
	1,901	878	**1,894**	867
Deferred tax:				
Relating to origination and reversal of temporary differences	**3,052**	6,017	**3,052**	6,017
Relating to impact of change in tax rate	**11,965**	-	**11,965**	-
	15,017	6,017	**15,017**	6,017
Tax charge reported in the group income statement	**16,918**	6,895	**16,911**	6,884
Tax charge/(credits) to equity				
Deferred tax on defined benefit pension schemes	**927**	(600)	**927**	(600)
Impact of rate change on pension scheme	**124**	-	**124**	-
Tax reported in comprehensive income statement	**1,051**	(600)	**1,051**	(600)

FACTORS AFFECTING THE TAX CHARGE FOR THE YEAR

The total tax charge for the year of £16.9 million is higher than the applicable amount of statutory corporate tax in the UK of £6.4 million (at 19 per cent). The differences are explained below:

	GROUP		COMPANY	
	2020 £000	2019 £000	**2020 £000**	2019 £000
Profit for the year on Continued operation	**33,802**	36,403	**33,766**	36,346
Profit multiplied by the rate of corporation tax in the UK of 19% (2019: 19%)	**6,423**	6,917	**6,416**	6,906
Effects of:				
Adjustments to current tax charge in respect of previous years	**(141)**	-	**(141)**	-
Adjustment to deferred tax in respect of rate change	**11,965**	-	**11,965**	-
Adjustments to deferred tax charge in respect of previous years	**(1,846)**	(451)	**(1,846)**	(451)
Expenses not deductible for tax purposes	**534**	594	**534**	594
Tax effect of income not taxable in determining taxable profit	**(10)**	(68)	**(10)**	(68)
Other – RD depreciation allowed	**(7)**	-	**(7)**	-
Total tax charge reported in the group income statement	**16,918**	6,992	**16,911**	6,981

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

12. TAXATION continued

The £12 million charge for the adjustment to deferred tax in respect of rate change relates to the effect of changes in the future tax rate, which was announced by the UK Government in its budget statement in March 2020.

The adjustments to current and deferred tax charge in respect of previous years represents the changes between the prior year financial statements and the prior year tax computations submitted.

The expenses not deductible for tax purposes are primarily driven by the movement on general provisions, non-deductible entertainment expenditure, and depreciation on non-qualifying capital expenditure.

GROUP AND COMPANY	2020 £000	2019 £000
Profit for the year on discontinued operation	-	9,156
Profit multiplied by the rate of corporation tax in the UK of 19% (2019: 19%)	-	1,739
Effects of:		
Tax effect of income not taxable in determining taxable profit	-	(1,836)
Total tax charge reported in the group income statement	-	(97)

DEFERRED TAX

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

GROUP AND COMPANY	2020 £000	2019 £000
At 1 April	**145,395**	140,085
Charge to the income statement	**15,017**	6,017
Charge/(credit) to equity	**927**	(600)
Impact of rate change on pension scheme	**124**	-
Impact of IFRS taken to Reserves	**4,889**	(107)
At 31 March	**166,352**	145,395

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.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

12. TAXATION continued

The movements in deferred tax assets and liabilities during the year are shown below:

GROUP AND COMPANY	Accelerated tax depreciation £000	Pension provision £000	Total £000
Deferred tax liabilities			
At 1 April 2018	138,239	3,607	141,846
Charge to the income statement	4,034	800	4,834
Charge to equity	-	(600)	(600)
At 1 April 2019	142,273	3,807	146,080
Charge to the income statement	13,157	1,373	14,530
Charge to equity	-	927	927
Impact of rate change on deferred taxation	4,889	124	5,013
At 31 March 2020	**160,319**	**6,231**	**166,550**

GROUP AND COMPANY	Fair value swap £000	Other provision £000	Total £000
Deferred tax liabilities			
At 1 April 2018	1,502	259	1,761
(Charge)/credit to the income statement	(1,100)	24	(1,076)
At 1 April 2019	402	283	685
(Charge)/credit to the income statement	(402)	(85)	(487)
At 31 March 2020	**-**	**198**	**198**

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 2020 was £166.4 million (2019: £145.4 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 on temporary differences using a balance sheet approach, using a tax rate of 19 per cent. The reversal of the 17 per cent (back to 19 per cent) tax rate previously substantively enacted by the Finance Act 2016 has resulted in an increase to the net deferred tax liability of £17 million.

For the year ended 31 March 2020 the UK rate of corporation tax of 19 per cent has been used. The deferred tax on temporary differences as at 31 March 2020 have been calculated using 19 per cent, the substantively enacted rate for the periods during which the temporary differences are expected to unwind.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

13. DIVIDENDS

GROUP AND COMPANY	2020 £000	2019 £000
Equity dividends paid during the year:		
First interim dividend of 5.58p per ordinary share (2019: 14.20p per ordinary share)	**2,750**	7,000
Second interim dividend of 5.58p per ordinary share (2019: 14.20p per ordinary share)	**2,750**	7,000
Third interim dividend of 5.58p per ordinary share (2019: 14.20p per ordinary share)	**2,750**	7,000
Final dividend of 5.58p per ordinary share (2019: 14.20p per ordinary share)	**2,750**	7,000
	11,000	28,000

There were no dividends proposed for approval as at 31 March 2020 and 31 March 2019.

14. EARNINGS PER ORDINARY SHARE

Basic earnings per share amounts are calculated by dividing profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year. The following reflects the income and shares data used in the basic and diluted earnings per share computations:

	GROUP		COMPANY	
	2020 £000	2019 £000	2020 £000	2019 £000
Profit for the year from continuing operations	**16,884**	29,411	**16,855**	29,365
Profit/(loss) for the year from discontinued operations	**-**	9,253	**-**	9,253
	2020 Number	2019 Number	2020 Number	2019 Number
Basic and diluted weighted average number of shares	**49,312,354**	49,312,354	**49,312,354**	49,312,354
Basic and diluted earnings per share from continuing operations	**34.24p**	59.64p	**34.18p**	59.55p
Basic and diluted earnings per share from discontinued operations	**-**	18.77p	**-**	18.77p

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

15. INTANGIBLE ASSETS

GROUP AND COMPANY	Computer software £000	Assets in the course of construction £000	Total £000
Cost			
At 1 April 2019	**24,087**	**1,248**	**25,335**
Additions	**-**	**2,985**	**2,985**
Transfers	**1,129**	**(1,129)**	**-**
Reclassifications to/from tangible assets	**2,029**	**(2,898)**	**(869)**
At 31 March 2020	**27,245**	**206**	**27,451**
Accumulated amortisation and impairment			
At 1 April 2019	**(14,834)**	**-**	**(14,834)**
Charge for the year	**(3,049)**	**-**	**(3,049)**
At 31 March 2020	**(17,883)**	**-**	**(17,883)**
Net book amount at 31 March 2020	**9,362**	**206**	**9,568**
Cost			
At 1 April 2018	22,406	296	22,702
Additions	-	4,067	4,067
Transfers	2,619	(2,619)	-
Reclassifications	(573)	(496)	(1,069)
Disposals	(365)	-	(365)
At 31 March 2019	24,087	1,248	25,335
Accumulated amortisation and impairment			
At 1 April 2018	(11,944)	-	(11,944)
Charge for the year	(3,129)	-	(3,129)
Eliminated on disposals	365	-	365
Impairment	(126)	-	(126)
At 31 March 2019	(14,834)	-	(14,834)
Net book amount at 31 March 2019	9,253	1,248	10,501

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

16. PROPERTY, PLANT AND EQUIPMENT

GROUP AND COMPANY	Notes	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 31 March 2019		239,056	1,094,883	394,701	42,693	1,771,333
Adoption of IFRS 16	5	3,098	-	-	-	-
At 1 April 2019		242,154	1,094,883	394,701	42,693	1,774,431
Additions		1,363	-	-	100,122	101,485
Transfers		5,799	49,626	30,619	(86,044)	-
Reclassifications to/from intangible assets		-	-	(2,029)	2,898	869
Disposals		(42)	(172)	(1,441)	-	(1,655)
At 31 March 2020		**249,274**	**1,144,337**	**421,850**	**59,669**	**1,875,130**
Accumulated depreciation and impairment						
At 1 April 2019		(20,428)	(87,734)	(108,048)	-	(216,210)
Charge for the year		(4,753)	(19,264)	(27,405)	-	(51,422)
Eliminated on disposals		2	103	1,435	-	1,540
Impairment		-	-	(193)	-	(193)
At 31 March 2020		**(25,179)**	**(106,895)**	**(134,211)**	**-**	**(266,285)**
Net book amount at 31 March 2020		**224,095**	**1,037,442**	**287,639**	**59,669**	**1,608,845**
Net book amount of right-of-use assets included above		8,311	-	4,618	-	12,929
Assets under construction relate to the following categories		2,822	16,471	40,376	-	59,669
Deemed cost						
At 1 April 2018		231,158	1,048,217	332,818	59,908	1,672,101
Additions		-	-	-	100,621	100,621
Transfers		8,004	48,140	62,188	(118,332)	-
Reclassifications		-	-	573	496	1,069
Disposals		(106)	(1,474)	(878)	-	(2,458)
At 31 March 2019		239,056	1,094,883	394,701	42,693	1,771,333
Accumulated depreciation and impairment						
At 1 April 2018		(16,123)	(69,128)	(85,143)	-	(170,394)
Charge for the year		(4,313)	(19,963)	(23,759)	-	(48,035)
Eliminated on disposals		8	1,357	865	-	2,230
Impairment		-	-	(11)	-	(11)
At 31 March 2019		(20,428)	(87,734)	(108,048)	-	(216,210)
Net book amount at 31 March 2019		218,628	1,007,149	286,653	42,693	1,555,123

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

16. PROPERTY, PLANT AND EQUIPMENT continued

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
Net book amount of right-of-use assets included above	4,095	-	5,038	-	9,133
Assets under construction relate to the following categories	752	18,385	23,920	-	43,057

The group's index linked loans and listed bonds are secured on certain assets of the group (see note 22).

17. INVESTMENTS IN SUBSIDIARIES

Details of the company's subsidiary, the results of which are included in the group financial statements at 31 March 2020 and 31 March 2019 are as follows:

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

South East Water (Finance) Limited's principal purpose is to raise debt on behalf of South East Water and any proceeds from such issues are lent on to South East Water. South East Water (Finance) Limited is a company registered in the Cayman Islands but the company does not gain any tax benefit from this as the company is resident for tax purposes in the UK.

South East Water (Finance) Limited is wholly-owned by South East Water Limited, which owns 100 per cent of the voting rights. Its registered address is P O Box 309GT, Ugland House, South Church Street, Georgetown, Grand Cayman, Cayman Islands.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

18. AMOUNT DUE FROM PARENT UNDERTAKING

GROUP AND COMPANY	2020 £000	2019 £000
Non-current assets		
Measured at amortised cost		
Amount due from parent due in more than one year	**136,013**	190,013
Expected credit loss	**(72)**	(102)
	135,941	189,911

The amount due from parent undertaking falls due for repayment on 27 July 2034 and bears interest at the rate of LIBOR plus two per cent. The carrying value has been adjusted to reflect the £54 million repayment from the parent company in September 2019 and expected credit loss.

19. INVENTORIES

GROUP AND COMPANY	2020 £000	2019 £000
Consumables	**639**	531
Work-in-progress	**50**	61
	689	592

20. TRADE AND OTHER RECEIVABLES

	GROUP		COMPANY	
	2020 £000	2019 £000	2020 £000	2019 £000
Financial asset receivables				
Trade receivables	**39,751**	38,562	**39,751**	38,562
Accrued income	**39,018**	37,835	**39,018**	37,835
Sundry Debtors	**1**	-	**-**	-
Amounts due from parent and fellow subsidiary undertakings due within one year	**-**	4	**-**	4
	78,770	76,401	**78,769**	76,401
Non-financial asset receivables				
Prepayments and accrued income	**3,872**	3,856	**3,495**	3,300
Other receivables	**1,799**	5,933	**1,799**	5,933
	5,671	9,789	**5,294**	9,233
Total trade and other receivables	**84,441**	86,190	**84,063**	85,634

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

20. TRADE AND OTHER RECEIVABLES continued

GROUP AND COMPANY

All trade receivables at 31 March 2020 and 31 March 2019 are denominated in sterling.

Trade receivables are stated after provision for doubtful debts of £28.1 million (2019: £25.9 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:

	2020 £000	2019 £000
Provision brought forward	**25,937**	28,054
Charge for the year from continued operation	**4,198**	1,584
Charge for the year from discontinued operation	**-**	43
Provision for legacy debt	**-**	502
Amounts utilised	**(2,050)**	(4,246)
Provision carried forward	**28,085**	25,937

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
2020	**39,751**	**9,501**	**4,297**	**2,500**	**1,482**	**1,697**	**8,911**	**11,363**
2019	38,562	9,368	3,863	2,702	1,610	1,683	9,930	9,406

21. CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise the following at 31 March:

	GROUP		COMPANY	
	2020 £000	2019 £000	2020 £000	2019 £000
Cash at bank and in hand	**12,981**	12,804	**12,981**	12,607
	12,981	12,804	**12,981**	12,607

Included in the group and company cash at bank and in hand balance at 31 March 2020 was £12 million (2019: £11.6 million) held on an on demand deposit account.

At 31 March 2020, £0.4 million (2019: £0.2 million) of restricted cash was held for the group in designated bank accounts and £0.4 million (2019: £nil) of restricted cash was held for the company in designated bank accounts in order to meet interest and associated swap payments falling due in respect of the listed debt and interest payments on index linked loans (note 10).

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

22. NON-CURRENT FINANCIAL LIABILITIES

GROUP		2020 £000	2019 £000
Loans and borrowings	(i)	**1,029,326**	717,604
Trade and other payables	(ii)	**4,997**	5,379
		1,034,323	722,983
(i) Loans and borrowings			
Irredeemable debenture stock	(a)	**990**	991
Listed bonds	(b)	**338,926**	334,387
Index linked loans	(c)	**392,839**	382,226
Variable rate loan	(d)	**118,493**	-
Fixed rate loan	(e)	**173,839**	-
Lease liability	(f)	**4,239**	-
		1,029,326	717,604
(A) IRREDEEMABLE DEBENTURE STOCK			
3 % perpetual stock		**25**	25
3 ½ % perpetual stock		**384**	384
4 % perpetual stock		**178**	178
5 % perpetual stock		**365**	366
5 ½ % perpetual stock		**1**	1
6 % perpetual stock		**37**	37
		990	991

Interest on irredeemable debenture stock is payable six monthly.

(B) LISTED BONDS

The group holds non-current bonds listed on the London Stock Exchange with an original value of £296 million (2019: £296 million), with effective terms, having taken account of a related interest rate swap, as follows:

- £166 million at a fixed rate of 5.5834 per cent, falling due for repayment on 29 March 2029 (or earlier at the option of the group)
- £130 million at a variable rate linked to inflation, falling due for repayment on 3 June 2041 (or earlier at the option of the group)

Issue costs incurred by the group in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

Indexation accrues on the bond repayable in 2041 under the terms of the bond.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

22. NON-CURRENT FINANCIAL LIABILITIES continued

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 2029 £000	Loan due 2041 £000	Total £000
2020			
Original loan consideration	166,000	130,000	296,000
Indexation on bonds	-	44,986	44,986
Less: unamortised issue costs	(996)	(1,064)	(2,060)
	165,004	**173,922**	**338,926**
2019			
Original loan consideration	166,000	130,000	296,000
Indexation on bonds	-	40,608	40,608
Less: unamortised issue costs	(1,106)	(1,115)	(2,221)
	164,894	169,493	334,387

C) INDEX LINKED LOANS

The group holds index linked loans with an original value of £269 million and with effective terms as follows:

- £135 million at a variable rate linked to inflation, falling due for repayment on 30 September 2032 (or earlier at the option of the group)
- £34 million at a variable rate linked to inflation, falling due for repayment on 30 September 2033 (or earlier at the option of the group)
- £100 million at a variable rate linked to inflation, falling due for repayment on 1 December 2037 (or earlier at the option of the group)

Indexation on the loans accrues under the terms of the loans. Issue costs incurred by the group in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

22. NON-CURRENT FINANCIAL LIABILITIES continued

Index linked loans are stated after the uplift for accrued indexation and the deduction of issue costs to be amortised at the balance sheet date as follows:

	Loan due 2032 £000	Loan due 2033 £000	Loan due 2037 £000	Total £000
2020				
Original loan amounts	135,000	34,000	100,000	269,000
Indexation on bonds	88,530	18,216	19,652	126,398
Less: unamortised issue costs	(1,035)	(196)	(1,328)	(2,559)
	222,495	**52,020**	**118,324**	**392,839**
2019				
Original loan amounts	135,000	34,000	100,000	269,000
Indexation on bonds	82,508	16,809	16,638	115,955
Less: unamortised issue costs	(1,116)	(209)	(1,404)	(2,729)
	216,392	50,600	115,234	382,226

The irredeemable debentures, listed bonds and index linked loans detailed in a, b and c above respectively are secured on the assets of South East Water (Holdings) limited, South East Water Limited and South East Water (Finance) Limited (the South East Water (Holdings) Limited group) as far as allowed by the Water Industry Act 1991 and South East Water's licence. The agreements for the bonds and loans contain a number of covenants that the group is required to meet to safeguard the interests of the lenders.

(D) VARIABLE RATE LOAN

	2020 £000	2019 £000
Original loan amount	**120,000**	-
Less: unamortised issue costs	**(1,507)**	-
	118,493	-

In December 2018 the company entered into a new bank loan arrangement for £120 million at a variable rate of LIBOR plus 1.2 per cent which matures on 20 December 2025. This loan was drawn down in September 2019 as part of the refinancing for the maturing index linked bonds on 30 September 2019.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

22. NON-CURRENT FINANCIAL LIABILITIES continued

(E) FIXED RATE LOAN

	2020 £000	2019 £000
Original loan amount	**175,000**	-
Less: unamortised issue costs	**(1,161)**	-
	173,839	-

On 16 September 2019 the company has issued new fixed rate loan notes totalling £175 million. The notes were issued in two tranches being:

- £75 million falling due for repayment on 16 September 2031
- £100 million falling due for repayment on 16 September 2042

(F) LEASE LIABILITY

	2020 £000	2019 £000
Balance as at 1 April	**3,098**	-
Capital addition	**1,363**	-
Less: capital repayment	**(222)**	-
	4,239	-

(ii) Trade and other payables

Trade and other payables comprise of deposits payable to developers of £5.0 million (2019: £5.8 million).

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

22. NON-CURRENT FINANCIAL LIABILITIES continued

COMPANY		2020 £000	2019 £000
Loans and borrowings	(i)	**1,029,326**	717,604
Trade and other payables	(ii)	**4,997**	5,379
		1,034,323	722,983
(i) Loans and borrowings			
Irredeemable debenture stock	(a)	**990**	991
Listed bonds	(b)	**457,250**	449,621
Index linked loans	(c)	**274,515**	266,992
Variable rate loan	(d)	**118,493**	-
Fixed rate loan	(e)	**173,839**	-
Lease liability	(f)	**4,239**	-
		1,029,326	717,604
(A) IRREDEEMABLE DEBENTURE STOCK			
3 % perpetual stock		**25**	25
3 ½ % perpetual stock		**384**	384
4 % perpetual stock		**178**	178
5 % perpetual stock		**365**	366
5 ½ % perpetual stock		**1**	1
6 % perpetual stock		**37**	37
		990	991

(B) AMOUNTS DUE TO SUBSIDIARY UNDERTAKINGS

The company's subsidiary undertaking, South East Water (Finance) Limited, has debt with an original consideration of £396 million (2019: £396 million), of which £296 million (2019: £296 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 £33,000 (2019: £43,000) was charged by South East Water (Finance) Limited.

The effective terms of the £396 million loans due to South East Water (Finance) Limited are as follows:

- £166 million at a fixed rate of 5.5834 per cent, falling due for repayment on 29 March 2029 (or earlier at the option of the company)
- £130 million at a variable rate linked to inflation, falling due for repayment on 3 June 2041 (or earlier at the option of the company)
- £100 million at a variable rate linked to inflation, falling due for repayment on 1 December 2037 (or earlier at the option of the company)

Issue costs incurred by the company in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate.

Indexation accrues on the loan repayable in 2041 under the terms of the loan.

The amounts due to subsidiary undertakings and the indexed loans are secured on the assets of South East Water (Holdings) Limited Group as far as allowed by the Water Industry Act 1991 and South East Water's licence.

The agreements for the bonds and loan contain a number of covenants that the company is required to meet to safeguard the interests of the lenders.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

22. NON-CURRENT FINANCIAL LIABILITIES continued

The amounts due to group undertakings are stated at the original consideration plus accrued indexation and less issue costs unamortised at the balance sheet date as follows:

	Loan due 2029 £000	Loan due 2033 £000	Loan due 2037 £000	Total £000
2020				
Original loan consideration	166,000	130,000	100,000	396,000
Indexation on bonds	-	44,986	19,652	64,638
Less: unamortised issue costs	(996)	(1,064)	(1,328)	(3,388)
	165,004	**173,922**	**118,324**	**457,250**
2019				
Original loan consideration	166,000	130,000	100,000	396,000
Indexation on bonds	-	40,608	16,638	57,246
Less: unamortised issue costs	(1,106)	(1,115)	(1,404)	(3,625)
	164,894	169,493	115,234	449,621

(C) INDEX LINKED LOANS

The company holds index linked loans with an original consideration of £169 million and effective terms as follows:

- £135 million at a variable rate linked to inflation, falling due for repayment on 30 September 2032 (or earlier at the option of the company)
- £34 million at a variable rate linked to inflation, falling due for repayment on 30 September 2033 (or earlier at the option of the company)

Indexation on the loans accrues under the terms of the loans. Issue costs incurred by the company in securing the long-term borrowings were deducted from the amount of the consideration received. The issue costs have been amortised under the effective interest rate method over the lives of the bonds to which the costs relate. Index linked loans are stated after the uplift for accrued indexation and the deduction of issue costs to be amortised at the balance sheet date. The issue costs for this debt were borne by the company on behalf of its subsidiary company.

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

The agreements for the loans contain a number of covenants that the company is required to meet to safeguard the interests of the lenders.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

22. NON-CURRENT FINANCIAL LIABILITIES continued

	Loan due 2032 £000	Loan due 2033 £000	Total £000
2020			
Original loan amounts	135,000	34,000	169,000
Indexation on bonds	88,530	18,216	106,746
Less: unamortised issue costs	(1,035)	(196)	(1,231)
	222,495	**52,020**	**274,515**
2019			
Original loan amounts	135,000	34,000	169,000
Indexation on bonds	82,508	16,809	99,317
Less: unamortised issue costs	(1,116)	(209)	(1,325)
	216,392	50,600	266,992

(D) VARIABLE RATE LOAN

	2020 £000	2019 £000
Original loan amount	**120,000**	-
Less: unamortised issue costs	**(1,507)**	-
	118,493	-

In December 2018 the company entered into a new bank loan arrangement for £120 million at a variable rate of LIBOR plus 1.2 per cent which matures on 20 December 2025. This loan was drawn down in September 2019 as part of the refinancing for the maturing index linked bonds on 30 September 2019.

(E) FIXED RATE LOAN

	2020 £000	2019 £000
Original loan amount	**175,000**	-
Less: unamortised issue costs	**(1,161)**	-
	173,839	-

On 16 September 2019 the company has issued new fixed rate loan notes totalling £175 million. The notes were issued in two tranches being:

- £75 million falling due for repayment on 16 September 2031
- £100 million falling due for repayment on 16 September 2042

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

22. NON-CURRENT FINANCIAL LIABILITIES continued

(F) LEASE LIABILITY

	2020 £000	2019 £000
Balance as at 1 April	**3,098**	-
Capital addition	**1,363**	-
Less: capital repayment	**(222)**	-
	4,239	-

(ii)Trade and other payables

Trade and other payables comprise of deposits payable to developers of £5.0 million (2019: £5.8 million).

23. CURRENT LOANS AND BORROWINGS

GROUP AND COMPANY	**2020 £000**	2019 £000
Bank loans	**30,000**	55,000
Index linked Bond	**-**	200,000
Less: unamortised issue cost	**-**	(110)
Loan	**30,000**	254,890

During the year, the group repaid its committed borrowing facilities by a total of £25 million of loans. The loan facilities are secured on the assets of the group, as far as allowed by the Water Industry Act 1991 and South East Water Limited's licence, and against the assets of the immediate parent company, South East Water (Holdings) Limited, at a variable interest rate of LIBOR plus 0.45 per cent.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

24. PROVISIONS

GROUP AND COMPANY	Third party damage claims £000	Leak allowance £000	Other provisions £000	Total £000
As at 1 April 2019	**2,144**	**1,828**	**-**	**3,972**
Additional provisions	**824**	**4,632**	**-**	**5,456**
Amounts utilised	**(1,313)**	**(3,658)**	**-**	**(4,971)**
31 March 2020	**1,655**	**2,802**	-	**4,457**
As at 1 April 2018	1,988	527	-	2,515
Additional provisions	1,406	3,825	-	5,231
Amounts utilised	(1,250)	(2,524)	-	(3,774)
31 March 2019	2,144	1,828	-	3,972

It is anticipated that all provisions will be utilised within the next year. The provisions are based on the known details at the signing date of this report. However, the nature of the provisions mean that they are often subject to negotiation and, therefore, the amount and timing of payments resulting from these provisions will be subject to a small degree of uncertainty.

25. TRADE AND OTHER PAYABLES

	GROUP		COMPANY	
	2020 £000	2019 £000	**2020 £000**	2019 £000
Financial liability payables				
Trade payables	**12,877**	13,890	**12,877**	13,890
Amounts due to parent and fellow subsidiary undertakings	**10,727**	8,786	**14,407**	16,670
Other payables	**4,606**	2,303	**4,606**	2,303
Accruals	**33,546**	33,553	**30,968**	26,367
	61,756	58,532	**62,858**	59,230
Non-financial liability payables				
Payments received in advance	**34,856**	32,724	**34,856**	32,724
Other taxes and social security	**1,015**	1,007	**1,015**	1,007
	35,871	33,731	**35,871**	33,731
	97,627	92,263	**98,729**	92,961

As at 31 March 2020 and 2019, amounts due to parent and fellow subsidiary undertakings represent unsecured non-interest bearing balances relating to the surrender of group tax relief in respect of the group and the surrender of group tax relief and interest due on debt with the subsidiary company in respect of the company.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

26. GROUP FINANCIAL INSTRUMENTS

FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The group's financial instruments comprise index linked loans, fixed rate debentures, variable rate bank loans, a variable rate loan to its parent undertaking, cash, short-term and medium-term deposits, trade receivables and trade and other payables. The main purpose of the group's financial instruments, other than the interest rate swap, is to raise finance for the group's operations.

Derivative activity is undertaken as determined by the Board of Directors. The board considers the overall risk profile of the group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. The group does not use derivative financial instruments for speculative purposes.

The group's treasury operations are managed within parameters defined by the board and its parent undertaking. It is the group's policy to minimise liquidity risk within an acceptable range of interest rates. The group does not use foreign currency financial instruments. The main risks arising from the group's financial instruments are interest rate and liquidity risk. There are no regulatory capital requirements placed on the group.

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 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 2020 there was a net outflow of £25.0 million from financing activities within the group (excluding dividend payments) (2019: £35.0 million). It is the view of the group that long-term fluctuations in interest rates will be within the parameters that are considered acceptable by the group.

The following table demonstrates the sensitivity to a reasonable possible change in interest rates, with all other variables held constant, on the group's profit before tax (through the impact on floating rate borrowings). The sensitivity analysis excludes all non-derivative fixed rate financial instruments carried at amortised cost but includes those recognised at fair value as well as all non-derivative floating rate financial instruments.

	Increase/ decrease in basis points	Effect on profit before tax £000	Effect on shareholders' equity £000
2020			
Sterling	+300	(12,390)	(9,912)
Sterling	-100	(4,130)	(3,304)
2019			
Sterling	+300	(13,920)	(11,136)
Sterling	-100	(4,640)	(3,712)

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

26. GROUP FINANCIAL INSTRUMENTS continued

LIQUIDITY RISK

The group aims to maintain a balance between continuity of funding and flexibility. Continuity of funding has been guaranteed throughout the period by the existence of long-term funding facilities. Short-term flexibility is achieved by varying the drawdown amounts under these facilities. Further details are given below. Cash is put on deposit with variable maturity dates so as to mitigate liquidity risk.

INFLATION RISK

The group manages its inflation risk on its financial liabilities through the use of an index linked bonds and loans (note 22). 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 (see note 3). An estimate for the provision for doubtful debts is calculated by management based on the application of expected recovery rates to an aged debt profile. We have no significant concentration of credit risk with exposure spread over a large number of domestic customers and for our retail customers, we have secured adequate collateral under the Market Codes to mitigate any risk.

CAPITAL MANAGEMENT RISK

The objectives and management of the group's capital management risk are discussed in the strategic report.

FAIR VALUES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Fair value is the amount at which a financial instrument could be exchanged in an arm's length transaction between informed and willing parties. In the opinion of the directors, the fair values of the financial assets and liabilities of the group (apart from the specific items shown in the fair value table below) are not materially different from the book values.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

26. 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 2020.

	Notes	**Book Value 2020 £000**	**Fair Value 2020 £000**	Book Value 2019 £000	Fair Value 2019 £000
Financial assets at amortised cost					
Trade and other receivables	20	**84,433**	**84,433**	83,499	83,499
Cash	21	**12,981**	**12,981**	12,804	12,804
Amounts due from parent undertaking	18	**135,941**	**107,771**	189,918	148,811
		233,355	**205,185**	286,221	245,114
Financial liabilities at amortised cost					
Trade and other payables	25	**47,349**	**47,089**	41,862	41,632
Irredeemable debentures	22	**990**	**842**	991	861
Listed bonds	22	**338,926**	**430,369**	534,277	633,509
Index linked loans	22	**392,839**	**504,074**	382,226	499,694
Bank loans	23	**30,000**	**30,000**	55,000	55,000
Bank loan	22	**118,493**	**118,493**	-	-
Loan Note	22	**173,839**	**173,839**	-	-
Lease liability	22	**4,239**	**4,239**	-	-
Amounts due to parent and group undertakings	25	**14,407**	**14,328**	16,670	16,578
		1,121,082	**1,323,273**	1,031,026	1,247,274
Financial liabilities at fair value through profit and loss					
Interest rate swap		**-**	**-**	**108,836**	**108,836**

The net book value is considered to equate to the fair value for trade receivables due to the short maturity of the amounts receivable. The fair value of trade and other payables and amounts due to parent and group undertakings have been adjusted for the appropriate credit risk. The fair values of amounts due from parent and irredeemable debentures have been calculated using the discounted cash flow method. The calculation includes all future capital and interest payments discounted by an amount representing credit risk and a further amount representing future inflation.

Index-linked loans have been calculated by discounted cash flow method, taking into account future capital and interest payments based on estimated interest and inflation rates appropriate to the loans. These amounts have been similarly discounted for credit risk and inflation using appropriate discount rates in effect at the balance sheet dates. The fair values of listed bonds are based on market prices. The book value of the interest rate swap has been adjusted to reflect its fair value.

FAIR VALUE HIERARCHY

The group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities
- Level 2: other techniques for which all inputs with a significant effect on the recorded fair value are observable, either directly or indirectly
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

26. GROUP FINANCIAL INSTRUMENTS continued

The group held the following financial instruments measured at fair value:

31 MARCH 2020	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
Financial liabilities at fair value through profit and loss				
Interest rate swap	-	-	-	-
31 March 2019				
Financial liabilities at fair value through profit and loss				
Interest rate swap	(108,836)	-	(108,836)	-

The group held the following financial instruments which are not measured at fair value but fair value disclosures are required:

31 MARCH 2020	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
Fair value of financial assets at amortised cost				
Amounts due from parent undertaking	107,771	-	107,771	-
Fair value of financial liabilities at amortised cost				
Trade and other payables	(47,089)	-	(47,089)	-
Irredeemable debentures	(842)	-	(842)	-
Listed bonds	(430,369)	(430,369)	-	-
Index linked loans	(504,074)	-	(504,074)	-
Bank loans	(30,000)	-	(30,000)	-
Bank loan	(118,493)	-	(118,493)	-
Loan note	(173,839)	-	(173,839)	-
Lease liability	(4,239)	-	(4,239)	-
Amounts due to parent and group undertakings	(14,328)	-	(14,328)	-
Total fair value of financial liabilities at amortised cost	**(1,323,273)**	**(430,369)**	**(892,904)**	**-**

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

26. GROUP FINANCIAL INSTRUMENTS continued

31 MARCH 2019	Total £000	Level 1 £000	Level 2 £000	Level 3 £000
Fair value of financial assets at amortised cost				
Amounts due from parent undertaking	148,811	-	148,811	-
Fair value of financial liabilities at amortised cost				
Trade and other payables	(41,632)	-	(41,632)	-
Irredeemable debentures	(861)	-	(861)	-
Listed bonds	(633,509)	(633,509)	-	-
Index linked loans	(499,694)	-	(499,694)	-
Bank loans	(55,000)	-	(55,000)	-
Amounts due to parent and group undertakings	(16,578)	-	(16,578)	-
Total fair value of financial liabilities at amortised cost	(1,247,274)	(633,509)	(613,765)	-

During the reporting years ended 31 March 2020 and 2019, 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.

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 2020	Within 1 year £000	1 – 2 years £000	2 – 5 years £000	Over 5 years £000	Total £000
Fixed rate					
Fixed rate financial liabilities:					
Irredeemable debentures	42	42	125	1,045	1,254
Listed bond	9,268	9,268	27,805	230,879	277,220
Total fixed rate financial liabilities	**9,310**	**9,310**	**27,930**	**231,924**	**278,474**
Floating rate					
Floating rate financial assets:					
Short-term financial assets	85,133	-	-	-	85,133
Long-term financial assets	3,721	3,721	11,164	173,227	191,833
Total floating rate financial assets	**88,854**	**3,721**	**11,164**	**173,227**	**276,966**
Floating rate financial liabilities:					
Short-term financial liabilities	102,625	-	-	-	102,625
Listed bond	4,414	4,519	14,189	234,851	257,973
Index-linked loans	12,659	12,926	40,382	659,203	725,170
Total floating rate financial liabilities	**119,698**	**17,445**	**54,571**	**894,054**	**1,085,768**

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

26. GROUP FINANCIAL INSTRUMENTS continued

YEAR ENDED 31 MARCH 2019	Within 1 year £000	1 – 2 years £000	2 – 5 years £000	Over 5 years £000	Total £000
Fixed rate					
Fixed rate financial liabilities:					
Irredeemable debentures	42	42	126	1,087	1,297
Listed bond	9,268	9,268	27,805	240,149	286,490
Total fixed rate financial liabilities	9,310	9,310	27,931	241,236	287,787
Floating rate					
Floating rate financial assets:					
Short-term financial assets	83,499	-	-	-	83,499
Long-term financial assets	5,199	5,199	15,596	247,200	273,194
Total floating rate financial assets	88,698	5,199	15,596	247,200	356,693
Floating rate financial liabilities:					
Short-term financial liabilities	58,532	-	-	-	58,532
Listed bond	13,730	4,414	323,100	235,737	576,981
Index-linked loans	12,322	12,589	39,371	670,378	734,660
Total floating rate financial liabilities	84,584	17,003	362,471	906,115	1,370,173

BORROWING FACILITIES

The group has committed borrowing facilities of £147.0 million (2019: £147.0 million), of which £30.0 million (2019: £55.0 million) was drawn down. Any drawdowns under these facilities are repayable in less than one year.

As part of the group's response to the Covid-19 pandemic, further draw downs have been made on the borrowing facilities in the two months after the balance sheet date totalling £40.0 million, bringing the total draw down from the group's borrowing facilities to £70.0 million.

The capital and working capital facility of £90.0 million (2019: £90.0 million) expires in June 2022. The DSR Liquidity Facility of £38.0 million (2019: £38.0 million) and the O&M Reserve Facility of £19.0 million (2019: £19.0 million) expire in June 2020.

ITEMS OF INCOME, EXPENSE, GAINS AND LOSSES

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

GROUP AND COMPANY	Notes	2020 £000	2019 £000
Financial assets at amortised cost	11	**5,333**	6,076
Financial liabilities at amortised cost	10	**(50,140)**	(51,441)
Financial liabilities at fair value through profit and loss	10	**(2,713)**	(4,470)
Financial assets due to impairment	20	**1,448**	(2,178)

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

27. 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 decided to contract-out via a salary related basis.

The final salary defined benefit section of the scheme was closed to new entrants with effect from July 2002.

The last full actuarial valuation of the scheme took place as at 31 March 2017. The next full actuarial valuation will be performed at 31 March 2021.

The group contribution rate was nil (2019: nil) of pensionable remuneration during the year plus an annual contribution of £3.9 million (2019: £3.8 million). The group's future annual contribution is expected to be £3.9 million.

As a result of the merger of South East Water and Mid Kent Water Limited in October 2006, the group acquired the Mid Kent Group Pension Scheme, which is a defined benefit scheme in the UK.

The last full actuarial valuation of the scheme took place as at 31 March 2017. The next full actuarial valuation will be performed at 31 March 2021.

The group contributed nil (2019: nil) of pensionable remuneration plus £1.4 million (2019: £1.3 million) in respect of the deficit as at 31 March 2019 to the scheme during the year. The group's future annual contribution is expected to be £1.3 million.

On 31 March 2015 both of the group's defined benefit schemes closed to further benefit accrual. This was advised to the schemes' members on 13 December 2012. From 31 March 2015 all active members became deferred members and their accrued benefits will increase in line with statutory deferred revaluation. All members were invited to join the group's defined contribution scheme from 1 April 2015.

The group also has obligations to pay a number of former employees' pensions on a defined benefit basis which are not included in either of the pension schemes. These pensions are paid by the group and charged directly to the income statement each year. The value of future obligations has been valued and the liability is recognised on the statement of financial position.

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

	2020 £000	2019 £000
Defined contribution scheme	**2,385**	2,149

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

27. RETIREMENT BENEFIT SCHEMES continued

The major assumptions used for the actuarial valuations were:

	SEW Pensions 2020 %	SEW Pensions 2019 %	**MKW Pensions 2020 %**	MKW Pensions 2019 %
Main assumptions:				
Rate of increase in pensions in payment				
RPI – Linked	**2.50**	3.25	**2.50**	3.25
CPI – Linked	**1.75**	2.25	**1.75**	2.25
Rate of increase in deferred pensions	**1.75**	2.25	**1.75**	2.25
Discount rate	**2.30**	2.55	**2.30**	2.55
RPI assumption	**2.50**	3.25	**2.50**	3.25
CPI assumption	**1.75**	2.25	**1.75**	2.25
Post-retirement mortality (in years)				
Current pensioners at 65 – male	**21.7**	21.5	**21.7**	21.5
Current pensioners at 65 – female	**23.7**	23.3	**23.7**	23.3
Future pensioners at 65 – male	**22.9**	22.6	**22.9**	22.6
Future pensioners at 65 – female	**25.8**	25.4	**25.8**	25.4

The following table demonstrates the sensitivity to a reasonably possible change in the above key assumptions, with all other variables held constant, on the schemes' liabilities:

	(Decrease)/ increase in liabilities £000	(Decrease)/ increase %
0.1% decrease to the discount rate	4,000	1.5
0.1% increase to inflation	3,500	1.3
One year increase in life expectancy	10,000	3.9

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
2020			
Equities	29,862	14,221	44,083
Corporate bonds	73,983	55,604	129,587
Government bonds	50,221	42,066	92,287
Cash	10,088	6,758	16,846
Insured persons	5,044	4,761	9,805
Total fair value of assets	169,198	123,410	292,608
Present value of funded obligations	(154,121)	(102,575)	(256,696)
Surplus in the schemes	15,077	20,835	35,912
			£000
Unfunded obligation 2020			
Present value of unfunded obligations			**(3,115)**

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

27. RETIREMENT BENEFIT SCHEMES continued

	SEW Pensions £000	MKW Pensions £000	Total £000
2019			
Equities	32,111	15,675	47,786
Corporate bonds	87,219	64,426	151,645
Government bonds	42,630	34,622	77,252
Cash	4,608	5,044	9,652
Insured persons	5,326	4,850	10,176
Total fair value of assets	171,894	124,617	296,511
Present value of funded obligations	(161,451)	(109,496)	(270,947)
Surplus in the schemes	10,443	15,121	25,564
			£000
Unfunded obligation 2019			
Present value of unfunded obligations			(3,154)

Equity investments include Global Tactical Asset Allocation, Private Equity Fund and Absolute Return Investments.

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

	SEW Pensions £000	MKW Pensions £000	Unfunded £000	Total £000
2020				
Net interest on defined asset	(311)	(399)	77	(633)
Administrative expenses	411	299	-	710
Total amount charged to income statement	**100**	**(100)**	**77**	**77**
2019				
Net interest on defined (asset)	(212)	(424)	-	(636)
Past service costs	164	109	-	273
Administrative expenses	423	371	-	794
Total amount charged to income statement	375	56	-	431

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

27. RETIREMENT BENEFIT SCHEMES continued

Analysis of amounts recognised in the statement of comprehensive income:

	SEW Pensions £000	MKW Pensions £000	Unfunded pensions £000	Total £000
2020				
Return on schemes' assets excluding interest income	(2,692)	211	-	(2,481)
Actuarial gains due to changes in financial assumptions	4,834	5,019	62	9,915
Actuarial gains due to changes in demographic assumptions	(1,347)	(981)	(33)	(2,361)
Experience loss on obligation	-	-	(194)	(194)
Actuarial gain/(losses) recognised in the statement of comprehensive income	**795**	**4,249**	**(165)**	**4,879**
Cumulative actuarial losses	**(5,319)**	**(9,186)**	**(3,319)**	**(17,824)**
2019				
Return on schemes' assets excluding interest income	2,343	2,084	-	4,427
Actuarial gains due to changes in financial assumptions	(5,732)	(4,170)	140	(9,762)
Actuarial loses due to changes in demographic assumptions	1,092	731	-	1,823
Experience loss on obligation	-	-	(13)	(13)
Actuarial (losses)/gains recognised in the statement of comprehensive income	(2,297)	(1,355)	127	(3,525)
Cumulative actuarial losses	(6,114)	(13,435)	(3,154)	(22,703)

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

27. RETIREMENT BENEFIT SCHEMES continued

Reconciliation of defined benefit obligations:

	SEW Pensions £000	MKW Pensions £000	Unfunded pensions £000	Total £000
2020				
Opening defined benefit obligations	161,451	109,496	3,154	274,101
Interest cost	4,017	2,721	77	6,815
Actuarial (gains)/losses	(3,487)	(4,038)	165	(7,360)
Past service cost	-	-	-	-
Benefits paid	(7,860)	(5,604)	(281)	(13,745)
Closing defined benefit obligations	**154,121**	**102,575**	**3,115**	**259,811**
2019				
Opening defined benefit obligations	160,169	107,713	3,281	271,163
Interest cost	4,304	2,846	-	7,150
Actuarial losses/(gains)	4,640	3,439	(127)	7,952
Past service cost	164	109	-	273
Benefits paid	(7,826)	(4,611)	-	(12,437)
Closing defined benefit obligations	161,451	109,496	3,154	274,101

Reconciliation of fair value of plans' assets:

	SEW Pensions £000	MKW Pensions £000	Total £000
2020			
Opening fair values of schemes' assets	171,894	124,617	296,511
Interest income on assets	4,328	3,120	7,448
Return on scheme assets excluding interest income	(2,692)	211	(2,481)
Contributions by employer	3,939	1,365	5,304
Administrative expenses	(411)	(299)	(710)
Benefits paid	(7,860)	(5,604)	(13,464)
Closing fair values of schemes' assets	**169,198**	**123,410**	**292,608**
2019			
Opening fair values of schemes' assets	169,469	122,923	292,392
Interest income on assets	4,516	3,270	7,786
Return on scheme assets excluding interest income	2,343	2,084	4,427
Contributions by employer	3,815	1,322	5,137
Administrative expenses	(423)	(371)	(794)
Benefits paid	(7,826)	(4,611)	(12,437)
Closing fair values of schemes' assets	171,894	124,617	296,511

The Trust Deed provides South East Water with an unconditional right to a refund of surplus assets assuming the full settlement of plan liabilities in the event of a plan wind-up. Furthermore, in the ordinary course of business the Trustee has no rights to unilaterally wind up or otherwise augment the benefits due to members of the scheme. Based on these rights, any net surplus in the UK scheme is recognised in full.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

28. DEFERRED INCOME

GROUP AND COMPANY	2020 £000	2019 £000
As at 1 April	**10,368**	10,166
Received in the year	**7,048**	9,099
Released during the year	**(8,560)**	(8,897)
As at 31 March	**8,856**	10,368
Non-current	**3,438**	3,185
Current	**5,418**	7,183
	8,856	10,368

Contributions received towards below ground assets are released to the income statement on completion of the performance obligations within the contracts with customers.

29. ISSUED SHARE CAPITAL

GROUP AND COMPANY	2020 £000	2019 £000
Allotted, issued, called up and fully paid		
49,312,354 ordinary shares of £1 each (2019: 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 2020 (2019: £100 million).

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

30. MOVEMENT IN LIABILITIES ARISING FROM FINANCING ACTIVITIES

GROUP NON-CURRENT LOANS AND BORROWINGS	Irredeemable debenture stock £000	Listed bonds £000	Fixed, Variable, Indexed linked loans and lease liability £000	Non-current loans and borrowing £000
Balance 1 April 2018	991	529,337	370,569	900,897
Changes from other financing activities:				
Indexation on index linked instruments	-	4,564	11,487	16,051
Loan transfer to current liabilities	-	(199,890)	-	(199,890)
Amortisation of issue costs	-	376	170	546
Balance at 31 March 2019	991	334,387	382,226	717,604
Balance 1 April 2019	**991**	**334,387**	**382,226**	**717,604**
Changes from financing cash flows:				
Net proceeds from bank loan	**-**	**-**	**118,437**	**118,437**
Net proceeds from loan notes issued	**-**	**-**	**173,872**	**173,872**
Debentures redeemed	**(1)**	**-**	**-**	**(1)**
Changes from financing cash flows:				
Indexation on index linked instruments	**-**	**4,378**	**10,443**	**14,821**
Lease liability on adoption of IFRS 16	**-**	**-**	**4,239**	**4,239**
Loan transfer to current liabilities	**-**	**-**	**-**	**-**
Amortisation of issue costs	**-**	**161**	**193**	**354**
Balance at 31 March 2020	**990**	**338,926**	**689,410**	**1,029,326**

COMPANY NON-CURRENT LOANS AND BORROWINGS	Irredeemable debenture stock £000	Amounts due to subsidiary undertakings £000	Fixed, Variable & Indexed linked loans £000	Non-current loans and borrowing £000
Balance 1 April 2018	991	641,388	258,518	900,897
Changes from other financing activities:				
Indexation on index linked instruments	-	7,672	8,379	16,051
Loan transfer to current liabilities	-	(199,890)	-	(199,890)
Amortisation of issue costs	-	451	95	546
Balance at 31 March 2019	991	449,621	266,992	717,604
Balance 1 April 2019	**991**	**449,621**	**266,992**	**717,604**
Changes from financing cash flows:				
Net proceeds from bank loan	**-**	**-**	**118,437**	**118,437**
Net proceeds from loan notes issued	**-**	**-**	**173,872**	**173,872**
Debentures redeemed	**(1)**	**-**	**-**	**(1)**
Changes from other financing activities:				
Indexation on index linked instruments	**-**	**7,392**	**7,429**	**14,821**
Lease liability on adoption of IFRS 16	**-**	**-**	**4,239**	**4,239**
Loan transfer to current liabilities	**-**	**-**	**-**	**-**
Amortisation of issue costs	**-**	**237**	**117**	**354**
Balance at 31 March 2020	**990**	**457,250**	**571,086**	**1,029,326**

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

30. MOVEMENT IN LIABILITIES ARISING FROM FINANCING ACTIVITIES continued

GROUP CURRENT LOANS AND BORROWINGS	Listed bonds £000	Bank loans £000	Current loans and borrowings £000
Balance at 1 April 2018	-	20,000	20,000
Changes from financing cash flows:			
Net proceeds from facility drawdown	-	35,000	35,000
Changes from other financing activities:			
Transfer from non-current liabilities	199,890	-	199,890
Balance at 31 March 2019	199,890	55,000	254,890
Balance at 1 April 2019	**199,890**	**55,000**	**254,890**
Changes from financing cash flows:			
Repayment of bonds on maturity	**(200,000)**	**-**	**(200,000)**
Net repayment of facility drawdowns	**-**	**(25,000)**	**(25,000)**
Changes from other financing activities:			
Loan Amortisation fee	**110**	**-**	**110**
Balance at 31 March 2020	**-**	**30,000**	**30,000**

COMPANY CURRENT LOANS AND BORROWINGS	Amounts due to subsidiary undertakings £000	Bank loans £000	Current loans and borrowings £000
Balance at 1 April 2018	-	20,000	20,000
Changes from financing cash flows:			
Net proceeds from facility drawdown	-	35,000	35,000
Changes from other financing activities:			
Transfer from non-current liabilities	199,890	-	199,890
Balance at 31 March 2019	199,890	55,000	254,890
Balance at 1 April 2019	**199,890**	**55,000**	**254,890**
Changes from financing cash flows:			
Repayment of bonds on maturity	**(200,000)**	**-**	**(200,000)**
Net repayment of facility drawdowns	**-**	**(25,000)**	**(25,000)**
Changes from other financing activities:			
Loan Amortisation fee	**110**	**-**	**110**
Balance at 31 March 2020	**-**	**30,000**	**30,000**

NOTES TO THE FINANCIAL STATEMENTS
FOR THE 12 MONTHS ENDED 31 MARCH 2020

30. MOVEMENT IN LIABILITIES ARISING FROM FINANCING ACTIVITIES continued

GROUP AND COMPANY DERIVATIVE FINANCIAL INSTRUMENTS	2020 £000	2019 £000
Balance 1 April	**108,836**	104,169
Changes from financing cash flows:		
Payment of loss on maturity	**(111,549)**	-
Changes from other financing activities:		
Movement in fair value of interest rate swap	**2,713**	4,667
Balance 31 March	**-**	108,836

Amounts owed by the company in respect of derivative financial instruments are owed to its subsidiary undertaking.

31. CAPITAL COMMITMENTS

GROUP AND COMPANY	2020 £000	2019 £000
Contracts placed for future capital expenditure not provided in the financial statements	**35,169**	**33,780**

All of the above capital commitments relate to property, plant and equipment.

Contingent liabilities

Through the ordinary course of operations, the company is party to various contract disputes. The Directors do not expect the ultimate resolution of any of these proceedings to have a material adverse effect on the company's results of operations, cash flows or financial position.

32. OBLIGATIONS UNDER OPERATING LEASES

GROUP AND COMPANY	Notes	2020 £000	2019 £000
Minimum lease payments under operating leases recognised as an expense in the year	8	**256**	**498**

GROUP AND COMPANY	Land and buildings 2020 £000	Land and buildings 2019 £000
Amounts for the following periods:	**-**	195
- within one year	**-**	195
- in the first to second	**-**	585
- in the second to fifth years	**-**	2,145
- after five years		
	-	3,120

The group has adopted IFRS 16 from 1 April 2019. The standard requires operating leases to be considered as finance leases and therefore the liabilities for the company's land and building have now been included as long term financing on the financial statement.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE 12 MONTHS ENDED 31 MARCH 2020

33. EVENT AFTER THE BALANCE SHEET DATE

In July 2020 the Trustees of the Mid Kent Group Pension Scheme ("MKGPS") approved a change to the scheme's rules to replace the use of the Retail Price Index ("RPI") with Consumer Price Index ("CPI") for the calculation of future obligations of the scheme. The reason for this change is the understanding that CPI more accurately reflects the rate of inflation for the MKGPS and this is in line with changes to public sector and statutory minimum pension increases. This also brings the MKGPS into line with the South East Water Pension Scheme which adopted CPI for increases in future obligations in 2011. The members of the MKGPS have been notified of this change to the rules of their scheme.

The estimated effect of this change on the group's financial statements is to provide a reduction in the costs of the scheme of approximately £7 million which will be recognised in the group's income statement in the 2020/21 financial year. The savings in costs would be reflected in a reduction in a defined benefit liability recorded on the balance sheet at the end of that financial year.

The group has drawn down an additional £40 million from its committed loan facilities after the balance sheet date as a contingency plan to overcome any potential short-term liquidity issues that may manifest as a consequence of Covid-19. At the date of signing this Annual Report, the group has not had the need to utilise these funds and the £40 million remains held in reserve to protect against any future unforeseen circumstances.

34. GROUP RELATED PARTY TRANSACTIONS

The group's ultimate holding company is Utilities of Australia Pty Ltd as Trustee for the Utilities Trust of Australia, which is resident in Australia.

The group of companies into which results of the group are consolidated is that headed by HDF, a company registered in England and Wales. The consolidated financial statements of HDF may be obtained from the Company Secretary, Rocfort Road, Snodland, Kent ME6 5AH.

TRANSACTIONS WITH THE GROUP'S PARENT COMPANY

An unsecured loan to the immediate parent company SEWH of £136 million (2019: £190 million) is disclosed in note 18 under non-current assets. Loan interest receivable during the year was £4.5 million (2019: £5.3 million). There was no interest outstanding as at 31 March 2020 (2019: £nil) included under trade and other receivables in note 20.

Also, as at 31 March 2020 the group has a current account debt due to its parent company of £7.2 million (2019: £5.4 million) in respect of group tax relief payable.

TRANSACTIONS WITH OTHER RELATED PARTIES

As at 31 March 2020 the group has net current account balances due to other related parties totalling £3.4 million (2019: £3.2 million) all relating to group tax relief payable.

The company has received loans totalling £460.6 million (2019: £761.9 million) on various terms from its subsidiary company as disclosed in note 22. Interest of £21.3 million (2019: £25.7 million) has been charged on these loans during the year. Interest outstanding on the loans at 31 March 2020 totalled £3.7 million (2019: £7.9 million).

Key management compensation is disclosed in note 9 and discussed further in the remuneration report. Contributions to retirement benefit schemes are disclosed in note 27.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE 12 MONTHS ENDED 31 MARCH 2020

35. ULTIMATE CONTROLLING PARTY

Utilities of Australia Pty Limited as Trustee for the Utilities Trust of Australia ("UTA"), RBS Pensions Trustees Limited as Trustee for The Royal Bank of Scotland Group Pension Fund – Group Fund Section ("RBSPF"), Régime de Rentes du Mouvement Desjardins ("RRMD"), Desjardins Financial Security Life Assurance Company ("DFSL") and Certas Home and Auto Insurance Company ("Certas") are the company's joint ultimate holding companies. UTA is resident in Australia. RBSPF is resident in the United Kingdom, RRMD, DFSL and Certas are resident in Canada. It is the directors' belief that there is no single ultimate controlling party and that the joint ultimate holding companies control the company jointly.

STATEMENT OF DIRECTION AND PERFORMANCE

This statement has been prepared to explain how the board of South East Water has set its aspirations and performed for all those it serves in accordance with board leadership, transparency and governance principles.

We provide a service that is essential for society to thrive now and in the future. As a board, our main goals are to deliver a great service to all our customers today and to plan for future water services by investing efficiently and protecting the environment.

The Covid-19 pandemic highlighted the importance of our public service function. Our priority has been to maintain our services to all our customers and critical facilities and protect our workforce and the public.

As we prepare this statement about our aspirations and objectives for 2020/21, we are acutely aware of the challenges that the Covid-19 pandemic brings and will continue to bring for the rest of the year for our customers, our partners and us.

We have also set out below an overview of our performance in the last five years and in 2019/20 which we want to be accessible and informative.

HOW WE SET OUT ASPIRATIONS FOR SOUTH EAST WATER

As we set out last year, we revisited the culture of South East Water, our company purpose and our values.

Our newly stated purpose is to "provide today's public water service and create tomorrow's water supply solutions, fairly and responsibly, working with others to help society and the environment to thrive".

It is our guiding principle when setting our aspirations for the company and its strategy. This includes finding opportunities to have a positive impact on society and the environment as we provide our public water service.

To transform these aspirations into actions, we have adopted service targets that will require us to keep delivering significant service improvements every year during 2020 to 2025 and 10 responsible business commitments to improve and measure our impact on society and the environment.

Last year we had also decided to rethink our corporate governance and we have:

- approved a new corporate governance framework that is centred on purpose, culture and integrated thinking
- approved articles of association to embed our purpose and revised directors' duties into our articles of association which will be submitted to our shareholders for adoption

A regulated water company must have an ethical and inclusive culture of public service guided by a strong sense of purpose. This means that to deliver the best service possible and to face challenges (our own and global ones), we must have an integrated approach and we must work with and learn from our customers and all other stakeholders. We refer to these as "integrated thinking" and "stakeholder inclusiveness".

There is more information on our purpose, values and governance on page 101.

This philosophy has guided our aspirations for 2020 to 2025 and many of our actions this year relating both to our core services and to governance and transparency.

Our core purpose in our business plan

Our core purpose to provide the public water and plan for future water services is reflected in the way we have set out objectives for 2020/21 and through the next five years in the key areas of our business.

BEING A BUSINESS THAT UNDERSTANDS OUR CUSTOMERS

Our plan for 2020 to 2025 is built around customer satisfaction. We have evolved our approach to measuring customer satisfaction that we introduced in 2015, and have developed an innovative approach to measuring satisfaction based on attitudinal segments. This will help us understand the needs of all our customers and make sure we go beyond delivering what the 'average' customer wants. Our customer insight team has been set up to continuously engage with our customers and other stakeholders and to act on the feedback we receive.

BEING A RESPONSIBLE BUSINESS THAT SUPPORTS OUR VULNERABLE CUSTOMERS

We have stretched our performance and ambitions with six new performance commitments specifically around vulnerability. These have been co-created with our customers, stakeholders, employees and our CCG; so too has the strategy that underpins these performance commitments.

We have published our vulnerability strategy and we are the first water company to achieve the BS 18477 certification demonstrating that we provide an inclusive service for customers with vulnerable circumstances.

We are working with other utilities and charities to promote our Priority Service Register and the other support we provide vulnerable customers to share experience and insight on how we can improve our support and engage with customers we have not been able to reach before.

BEING A BUSINESS THAT ENHANCES THE ENVIRONMENT

Operating in an environmentally diverse yet water stressed area we need to make the right choices for our local communities and the environment. We have developed a suite of six new performance commitments that recognise the influence we can, and should, have on landowners, other water users and abstractors to make water catchments more resilient to drought, while also ensuring we enhance habitats to give wildlife an opportunity to thrive.

We intend to build on the partnership approach we have developed over the last five years to achieve these ambitions as we know our shared experience and knowledge of the environment is key.

BEING A BUSINESS THAT DRIVES INNOVATION

We have developed a focused innovation strategy which targets our customers' and stakeholders' priorities; and where we can make the most difference. We have developed a number of innovation tools to help us deliver our stretching performance commitments for the next five years and beyond.

Our wider social and environmental purposes and responsible business commitments

Together with our renewed approach to corporate governance, our 10 responsible business commitments define our governance road map for 2020 to 2025.

As stated last year we have also reviewed our reporting to improve transparency in key areas highlighted by Ofwat on executive pay and dividends. We also considered their feedback in our reporting against the board leadership, transparency and governance principles.

We developed our new reporting to meet our obligations under the Companies (Miscellaneous Reporting) Regulations 2018. There is more information on how we take into account the interest of customers and other stakeholders in our section 172(1) statement on page 78.

We expanded our reporting on carbon emissions to meet new requirements and also started to implement the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

The business already has a well-developed culture driven by public service values but we can do more. We explain what we have done this year and are planning to do in the next to strengthen our public service culture further.

BEING A RESPONSIBLE BUSINESS

We have developed a responsible business strategy by listening to our customers, stakeholders and employees and board. This has resulted in the creation of 10 new responsible business commitments to reflect the actions and behaviours that our customers and stakeholders expect a responsible business to display; and, in conjunction with great service and high standards of governance, have the potential to create a step change in trust of the water sector.

Employees

- ensure fair pay, reward and recognition for all our employees
- improving health, safety and wellbeing of our people and communities

Community and environment

- develop a future generation schools programme on water

STATEMENT OF DIRECTION AND PERFORMANCE continued

- play an active role regionally in relation to the impact of housing growth on water
- create more partnership community projects on water use and vulnerability
- support the tap water refill campaign to reduce plastic bottled water
- Natural capital accounting
- Renewable energy measures

High standards of business conduct

- trusted corporate governance
- transparency of reporting

This year we defined how we will deliver our responsible business commitments, measure our progress and report on them under the oversight of our responsible business committee. We also included environmental, social and governance metrics in our executives' performance related pay.

BEING A TRANSPARENT BUSINESS

Our remuneration committee has designed and adopted a new bonus scheme that reflects the importance of service delivery to customers and of our commitments to act responsibly and we have adopted a new dividend policy.

Bonus scheme

Our remuneration committee is responsible for designing, monitoring and reporting executive pay in accordance with its terms of reference. It reviews the ongoing appropriateness and relevance of the remuneration policy. The committee set annual bonus and longer term targets and decides the performance bonus payment to each member of the executive team based on an assessment of their performance. This is part of the ongoing monitoring of performance against the company's commitments.

Our remuneration committee has designed and adopted a new bonus scheme for 2020 to 2025 that reflects the importance of service delivery to customers and of our commitments to act responsibly. The new scheme is an annual bonus scheme where the payment of one third of any award is deferred for two years. It includes metrics in relation to outcome delivery incentives (ODIs), environmental, social and governance matters, financial performance (each with three levels of performance: threshold under which no award is made, target and outperformance) and personal objectives. Our ESG metrics put into practice our aspiration set last year to include broader stakeholder considerations in the design of our incentives.

There is more information on our directors' remuneration on page 120.

Dividend policy

Our new dividend policy provides that dividends should be set and paid at a level that enables the company to maintain its long term financial resilience in the interest of shareholders, customers, employees and other stakeholders. Our policy sets out principles and considerations we must have regards to when authorising dividend in relation to our financial obligations and financial resilience, the interests of employees, the ability of the company to finance current and future investment, and performance against our commitments.

Read more
Our dividend policy is available at:
southeastwater.co.uk/ourgovernance

PERFORMANCE

Our experience to date has shown us that having a strong focus on customer satisfaction ensures that we are constantly listening to our customers and stakeholders to improve our service. In our plans for 2020 to 2025 we are taking this approach even further to ensure that the voice of all of our customers' is heard and acted on.

Our performance in the last five years

During the past five years our people have worked hard trying to meet or exceed the challenging objectives set within the 2014 business plan.

Our cumulative performance over 2015 to 2020 resulted in a net penalty of £1.3 million under our regulatory ODIs which provides for rewards or penalties depending on our performance against set targets. This total net penalty relates to some of our operational metrics, SIM and our satisfaction metrics as explained below.

This penalty was mainly due to our performance in relation to interruptions to water supplies which was affected by two exceptional incidents in the 2015 to 2020 period: the burst of a trunk main which affected the supplies to a large number of customers between 10 and 11 May 2015 and the extreme weather event, known as the Beast from the East, between 24 February 2018 and 3 March 2018 which resulted in a large number of supply interruptions driven in the main by leaks within customers pipework.

The lessons learned from these severe events have been put into action over subsequent years, ensuring that taps keep flowing whatever the weather. This experience also influenced the development of our resilience action plan and our resilient customer concept in our business plan for 2020 to 2025.

We have reduced the duration of interruptions for each property served from 32 minutes to 10 minutes.

Between 2015 and 2020 our leakage levels decreased year-on-year and we have halved the number of customers across our supply area at risk of low pressure. We have improved resilience by reducing the number of sites at risk of flooding from 55 to zero.

The performance in the last year of the 2015 to 2020 period concluded with a net ODI reward on operational measures (excluding SIM and our customer satisfaction improvement metrics) showing an improvement of our underlying performance on operational metrics.

We incurred a penalty of £0.5 million under the Service Incentive Mechanism (SIM). Although a penalty on SIM was disappointing, we improved our ranking under SIM in the period and our performance in 2019/20 corresponds to a 9th place in the water industry. Our performance on complaints reduction was good corresponding to a top quartile performance compared with the rest of the water industry.

We had defined an innovative approach to measure customer satisfaction at the previous price review and despite improvements in customer satisfaction we did not achieve the degree of improvement that we had targeted which resulted in a penalty of £0.271 million. Our satisfaction score from customers who had a direct interaction with us is 4.3 out of 5 (and our target was 4.5).

We have been recognised in 2018 when we became the first water company to receive the coveted British Standards Institution (BSI) verification certification BS 18477, a certificate we have now held two years in a row.

During the five year period we have promoted innovation with dedicated Innovation Champions fully established and pushing forward new ideas, as well as using the latest technology to develop our smart network strategy to tackle issues such as leakage.

Our performance in 2019/20

We end the five year period outperforming our targets for leakage, low pressure, discolouration contacts and interruptions.

We have beaten our leakage target for the 18th year in a row. Our target was 88.1 million litres a day (Ml/d) and we achieved 86.4 Ml/d a day during the year.

We also experienced our lowest level of mains bursts with only 2,298 bursts versus a target of 2,429.

We have reached out and helped more of those who need it most working in partnership with vulnerable customer charities and colleagues from other water companies and utilities. We have also seen an increase in customers signing up to our Priority Services Register following our efforts to advertise the benefits and assistance our dedicated Customer Care Team can provide.

Our smart water network trial successfully concluded in the Hartley district of Kent. This brought together data from digital water meters, sensors and loggers into one central area for advanced analysis, exploring artificial intelligence techniques. The project could help us drive down the amount of water lost to leaks, helping us hit our ambitious target to reduce leakage by a further 15 per cent by 2025.

We have maintained high overall water quality with 99.96 per cent of samples passing standards set by the Drinking Water Inspectorate (calendar year January to December 2019).

STATEMENT OF DIRECTION AND PERFORMANCE continued

As a major landowner, and guardian of some of the region's most precious environmental resources, our work has resulted in the successful conclusion of a ground-breaking trial to increase biodiversity at a number of our sites as part of the Water Industry National Environment Programme (WINEP).

We are not complacent and are aware there's still work to do to improve areas such as customer complaints and increase our customer satisfaction scores further.

OUR MAIN OBJECTIVES FOR 2020/21

At the time of writing the country is still social distancing due to the Covid-19 pandemic. We have been engaging with our employees and stakeholders to develop our future plans to decide what our 'new normal' will be once restrictions are fully lifted.

Our main objectives for 2020/21 is to start delivering our performance commitments, our investment programme and strategy for the next five years as we would have done in normal circumstances. However, we acknowledge that we will face many challenges, as will our supply chain and partners and, our customers and that we will have to adapt and be agile to achieve our goals.

We set out below our key aspirations and objectives for 2020/21 under each of our key strategic themes.

OUR FUNDAMENTALS

Our "licence to operate" relies on us getting the basics right by delivering our core services well and constantly improving. Our key aspirations and objectives for 2020/21 are to:

Performance

- improve our relative industry position across key comparative measures
- deliver a high level of compliance, both in meeting our performance commitments and in fulfilling all our other obligations as a business
- reduce our per capita consumption through behavioural change
- manage the customer side element of leakage as part of our leakage strategy
- improve the effectiveness of our operational workforce by developing multi-skilled teams and implementing a new approach to their management
- roll-out of our Smart Network strategy based on the innovative trial we completed this year and of our Calm Networks strategy to improve the integrated management of our networks which will help us meet a number of our performance commitments
- review our governance and monitoring of our performance against our new commitments for 2020 to 2025

Technology and innovation

- to promote the creation and adoption of innovation through our innovation strategy relying on partnerships, our innovation champions and our collaboration platform "Atlas"
- to start to implement our IS cloud based strategy, and roll-out the technology into the key areas of the business to support the delivery of our Smart Networks strategy including new systems and data solutions using artificial intelligence

OUR CUSTOMERS

Our strategy for 2020 to 2025 is built on the engagement with our customers, meeting their different needs and expectation and provide increased support to customers in vulnerable circumstances. Our key aspirations and objectives for 2020/21 are to:

- embed our customer segmentation approach into our day to day business
- implement our action plan to meet our performance commitments under C-MeX and D-MeX
- develop key collaborations with partners to help improve our support to vulnerable customers and extend our reach
- implement our resilient customer concept
- continue to engage with our customer and stakeholders to understand their priorities

THE ENVIRONMENT

The protection of the environment, the promotion of biodiversity and the reduction of our impact, are integral parts of both our core purpose such as planning for water resources and investing for the future and our wider environmental purpose. Our key aspirations and objectives for 2020/21 are to:

- implement our engagement and collaborative approach for the delivery of our WINEP (environmental programme)
- deliver biodiversity improvements under our performance commitments
- embed our environmental resilience strategy within the business

RESPONSIBLE BUSINESS

We have agreed a number of actions for the next years to promote a public service and stakeholder inclusive culture and to implement our corporate governance framework. We will also seek feedback from our employees and stakeholders as we make progress.

The key aspirations and objectives we set ourselves for 2020/21 are to:

- promote our purpose and the ethos of a responsible business to embed it in our day to day activities
- embed our purpose into our articles of association
- prepare for reporting against the TCFD recommendations on our emissions and climate related financial disclosures
- start using external standards such as the sustainable development goals and the six capitals to move towards integrated reporting
- improve our score against the GRESB benchmark
- continue to promote a positive culture on health and safety including on wellbeing and mental health
- further develop the engagement between the board and our employees
- simplify our financial structure by removing the intergroup loan between South East Water and its parent company
- progress our action plan for the delivery of our responsible business commitments
- finalise our people plan which reflects our aspirations for our employees including defining the "new normal" following engagement with our people on new methods of flexible working

Since 2016, we have also been publishing every year our customer friendly people, planet and performance report which is the natural companion to this statement.

Read more
You can find more information on our business and our performance and read the report for 2019/20 at: **southeastwater.co.uk/performance**

Our performance can be compared with other water companies by visiting **discoverwater.co.uk** which has been developed to provide more transparency to the performance in the industry. This is an important tool to enable stakeholders to compare our performance to ensure we are striving for continuous improvement and stretching ourselves to be providing the best possible service.

DISCLOSURES AND STATEMENTS BY DIRECTORS

This annual performance report has been prepared in accordance with Condition F of South East Water Ltd's ("SEW") instrument of appointment ("Licence") and in accordance with the latest regulatory accounting guidelines ("RAGs") issued by Ofwat.

In instances where there are differences between international financial reporting standards ("IFRS") as adopted for use in the European Union and the RAGs, the RAGs take precedence.

These disclosures and statements should be read in conjunction with the information set out in the financial statements of South East Water Ltd for the year ended 31 March 2020.

DIRECTORS' REMUNERATION AND STANDARDS OF PERFORMANCE

The directors' remuneration report in the company's annual report and financial statements sets out the remuneration paid or due for the financial year to the directors under arrangements linking the remuneration of directors to standards of performance in connection with the carrying out by South East Water of its functions as a relevant undertaker. It provides details of these arrangements and of the relevant remuneration. The relevant information provided in the directors' remuneration report is incorporated by reference into this annual performance report as the statement required under section 35A of the Water Industry Act 1991. The report from the Remuneration Committee in the corporate governance report also provides information on the arrangements in place for the remuneration of directors and how they have been reviewed by the Committee.

DISCLOSURE TO AUDITOR

The directors who were members of the board at the time of approving the annual performance report are listed in the company's financial statements. Having made enquiries of fellow directors, and exercising reasonable care, skill and diligence, each of these directors confirms that:

- so far as the director is aware, there is no relevant audit information of which South East Water Ltd's auditor is unaware
- each director has taken all the steps that a director ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that South East Water Ltd's auditor is aware of that information

DIVIDEND POLICY

Dividends are authorised in accordance with the Companies Act 2006 and our dividend policy, having due regard to condition I12 and I26.6 of the Licence which state that dividends paid must be in accordance with the dividend policy, must not impair the ability of South East Water Ltd to finance the appointed business and that, under a system of incentive regulation, the dividend would be expected to reward efficiency and the management of economic risks. Dividends are paid as declared and are recognised as a distribution when approved by the board. No unpaid dividends exist at the year end.

Dividends paid in the year amounted to £11.0 million, of which £4.5 million was used by our parent company, South East Water (Holdings) Ltd, to pay interest on a loan from South East Water Ltd. Additional information on our dividend policy is set out in the Strategic Report.

ACCOUNTING POLICIES

PRICE CONTROL SEGMENTS

Operating costs are directly attributed to price control units, where possible, based on the activities that cause the cost to be incurred. Costs are attributed based on the guidelines set out in RAG 2.07. Where costs cover more than one price control unit, an appropriate basis of allocation consistent with the activities that cause the costs is used in order to allocate the costs to the relevant price control units.

In the majority of cases, assets and their associated depreciation are directly attributed to price control units that solely use the assets. However, where assets are used by more than one price control unit, the assets are initially allocated to the price control unit where the principal use occurs with a recharge being made to other price control units using the assets in proportion to the use of the assets.

There have been no significant changes in the methodology of allocating costs to price segments in the year. For further information on the allocations of costs and assets, see South East Water Ltd's accounting methodology statement which is available on our website.

REVENUE RECOGNITION

The revenue recognition policy is the same in the regulatory accounts as in the statutory accounts. Additional charges added to a customer's account as a result of debt recovery activity, such as court costs or solicitors fees, are recognised as a credit within operating costs in both the statutory and regulatory accounts and as such do not affect turnover.

There have been no changes made to the procedure followed in calculating the measured income accrual in the year. A review was undertaken of the measured income accrual for the year 2018/19 and there were no significant differences between the accrual and the amounts billed in the year.

The following applies in relation to our policy on billing:

- if supply is not required, charges on an unoccupied or void property will normally be waived from the date we are informed. When informed of the vacation of a property, we may choose to turn off or disconnect the water supply at the stopcock. If we are requested not to turn off or disconnect the water supply either by the outgoing or incoming occupier they must undertake to pay all water charges arising until we are otherwise notified
- we do not send a bill to "the occupier" for premises where the name of the customer is not known. At the point that the occupier's details are known we will issue a bill as appropriate
- where we have donated to a charitable trust/ assistance fund in relation to assisting customers with payment of water debt, any associated billing is included within water turnover
- when a new property is connected to our network, billing commences upon meter installation

When a property is identified as unoccupied on the billing system it will then proceed into our void property process to verify with as much certainty as possible whether the property is truly empty or not. As part of this process we will send out letters along with an application form to properties that are recorded as being empty for over 21 days. If there is no response a further letter is then sent. If there is still no response, we will review the account and take a range of additional steps including further written communication, meter reader visits to the property and enquiries to view the land registry to confirm the owner of the property whom we then contact.

CAPITALISATION

We determine employee costs directly attributable to capital projects based on the time spent on each project recorded on timesheets completed by employees. Other directly attributable costs are then assessed and any costs relating to capital projects are capitalised into individual projects. Training costs, administration and other general overhead costs are not capitalised. Over the past year our policies on the capitalisation of costs have not changed.

BAD DEBT

The bad debt policy is the same in the regulatory accounts as in the statutory accounts.

Debt is written off in only a limited number of scenarios when all collection avenues have been fully exhausted. Examples include where a debtor is not a current customer and all procedures to trace their whereabouts have been undertaken or where a customer is insolvent and we have been advised that no payment will be forthcoming.

An estimate for the provision for doubtful debts is calculated by our management based on the application of expected recovery rates to an aged debt profile. We have no significant concentration of credit risk with exposure spread over a large number of domestic customers and for our retail customers, we have secured adequate collateral under the Market Codes to mitigate any risk.

DISCLOSURES AND STATEMENTS BY DIRECTORS continued

SUFFICIENCY OF NON-FINANCIAL RESOURCES – CERTIFICATE UNDER CONDITION K

The directors of South East Water Ltd confirm that, in their opinion, the company was in compliance with sub-paragraph 3.1 of Condition K of its Licence at the 31 March 2020 and would have available sufficient rights and assets, other than financial resources, to enable a special administrator to manage the affairs, business and property of the company.

SUFFICIENCY OF FINANCIAL RESOURCES AND FACILITIES – CERTIFICATE OF ADEQUACY UNDER CONDITION I

Under condition I of the Licence, sub-paragraph I17 – Certificate of Adequacy, the directors of the company are required to provide a "certificate of adequacy" relating to the availability of sufficient financial and other resources to carry out the functions of a water undertaker in relation to the wholesale and household retail business (referred to as the Residual Business in the Condition) and, in respect of the wholesale business only, a statement on any contracts entered into with any associated company. This certificate is set out below in accordance with the requirements of sub-paragraph I17.

In addition, paragraph I24 provides that each certificate of adequacy, must be accompanied by a report prepared by the company's auditors and addressed to Ofwat, stating whether they are aware of any inconsistencies between the certificate and either the regulatory accounting statements or any information which the auditors obtained in the course of their work.

South East Water exited the non-household retail market on 1 May 2018 and transferred its non-household retail business to Invicta Water Ltd as the acquiring licensee pursuant a transfer scheme made under the Water and Sewerage Undertakers (Exit from Non-Household Retail Market) Regulations 2016. In accordance with the provision of Condition I sub-paragraphs I17 and I18, the requirement under that Condition to provide a separate certificate of adequacy in relation to the non-household retail business ceased to apply on 1 May 2018.

Information relevant to this certificate has been compiled and analysed for the purpose of our financial and regulatory reporting in accordance with our internal and external assurance processes. The most relevant information to support this certificate is mentioned in the review of the consideration the board had regard to in respect of this certificate.

The independent auditor's report can be found on page 232 of this annual performance report and is relevant to the understanding of this certificate.

CERTIFICATE OF ADEQUACY IN RELATION TO THE WHOLESALE AND HOUSEHOLD RETAIL BUSINESS (RESIDUAL BUSINESS)

- in the opinion of the directors, the company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least 12 months from the date of signing the accounts, the regulated activities as defined in the Licence (including the investment programme necessary to fulfil its obligations under the Licence)
- in the opinion of the directors, the company will, for at least 12 months from the date of signing of the accounts, have available management resources and systems of planning and internal control which are sufficient to enable it to carry out the regulated activities
- in respect of the wholesale business only, in the opinion of the directors, all contracts entered into with any associated company include all necessary provisions and requirements concerning the standard of service to be supplied to the company, to ensure that it is able to meet all its obligations as a water undertaker

MAIN FACTORS TAKEN INTO ACCOUNT BY THE DIRECTORS

The certificate above has been made having regard to the company's performance, position and prospects as reflected and explained in the entire annual report and APR.

In providing the certificate set out above, the directors have taken into account the following considerations:

FINANCIAL RESOURCES AND FACILITIES	READ MORE
Financial details, e.g. cash position, financial headroom, refinancing undertaken/planned	
• the updates provided at each board meeting confirming that the financial performance of the company is in accordance with budget or forecast and the steps taken to address variances • our audited financial statements, which have been prepared on the going concern basis • the financial budget for 2020/21 approved by the board on 25 March 2020 and our subsequent regular forecasting to take account of the impact of Covid-19 on the financial position of the company and providing comfort on its ability to deliver its investment programme • the refinancing completed in 2019 and the fact that further refinancing will next be required in 2026 and 2029	Our going concern statement on page 77
Performance against Final Determinations (FDs) set at the past price review	
• the performance in the last year of AMP6 which concluded with a net reward on operational measures (excluding SIM and our customer satisfaction improvement metrics) and a 9th equal position on SIM and strong performance on complaints reduction • the updates provided at each board meeting on the operational performance of the company and the preparation for the delivery of the performance commitments in the next AMP • the initial assessment of the impact of Covid-19 on the ability of the company to (i) still deliver its investment programme albeit with a detrimental effect on its ability to achieve targeted efficiencies, and (ii) to deliver its performance commitments subject to any necessary adjustments to the regulatory mechanisms in relation to performance commitments that will be necessarily affected by Covid-19 following discussions with Ofwat	Details on our performance are set out on page 210
Credit related factors e.g. credit facilities, ratings, compliance with covenants etc.	
• that we have complied with our financial covenants and have maintained our investment grade rating of BBB • the gearing reduction achieved through our refinancing in 2019 • available borrowing facilities, and the prudent management of liquidity in the context of the impact of Covid-19 resulting from additional drawdowns on the credit facility to ensure the company will have the required liquidity • the ongoing work on a STID proposal to address the potential consequences of Covid-19 on compliance with our financial covenants to improve our financial resilience and avoid any disruption that could result from severe disruption caused by Covid-19	

DISCLOSURES AND STATEMENTS BY DIRECTORS continued

FINANCIAL RESOURCES AND FACILITIES	READ MORE
• our engagement with credit rating agencies to understand their approach to Covid-19 when assessing water companies credit ratings	
Business plans, long-term viability statements, etc.	
• the outcome of the 2019 price review for the five years from 1 April 2020 to 31 March 2025 and the corporate plan for 2020 to 2025 prepared on the basis of the final determination	Our long term viability statement on page 71
• our long term viability statement using a baseline scenario reflecting our corporate plan for 2020 to 2025 and including further scenarios and stress testing to reflect the impact of Covid-19 and of the final determination on the position, prospects and financial viability of the company over 2020 to 2025 and for the whole duration of the lookout period of 10 years; including the outcome of the scenario analysis and stress testing on compliance with our financial covenants and on the key ratios for our credit ratings which confirmed the prospects and long term viability of South East Water in light of severe but plausible scenarios	
Any relevant reports – internal or third party	
• the report commissioned by Water UK on the "Impact of Coronavirus on the UK water industry" which was developed to assess the potential impact on the regulated business on a sector-wide basis of the Covid-19 pandemic	
• the detailed report presented to the audit and risk committee and the board on the assumptions considered and scenarios used for the purpose of the long term viability statement and their impact on the prospects of the company	
MANAGEMENT RESOURCES	
Management skills, experience and relevant qualifications	
• the recent renewal of our executive team and senior management team including the appointment of a new Customer Service Director, Operations Director and Regulation and Strategy Director through our internal succession planning pipeline and the recruitment of a new Head of Economic Regulation of Strategy and Head of Human Resources all with proven experience in their respective fields.	Our board evaluation on page 115
• the outcome of the latest board evaluation carried out in 2020 which reviewed the balance of skills and experience of the board and concluded that the board operated effectively	

MANAGEMENT RESOURCES	READ MORE
Recruitment process, staff engagement	
• our IIP silver accreditation	Our section 172(1) statement on page 78
• the annual update on human resources presented to the board and regular monthly updates on staff and cultural matters	Our non-financial information statement on page 86
• the people plan within our corporate plan for 2020 to 2025	
• our Responsible Business commitments relating to our employees pay reward and recognition	
• our approach to board engagement with employees through a designated independent non-executive director, directors' attendance at meetings of our Staff Council and a board engagement programme	
Succession planning for key management/staff, Quality of management/ staff induction and other training and development	
• the review of our succession planning process and oversight of the recruitment of new directors and executives which allowed the successful renewal of our executive team as explained above	Our people on page 25 of the strategic report
• our reiterated focus on succession planning at our board evaluations in the previous year and during 2020/21 with a focus on the succession pipeline from management to senior management	
• our training initiatives managed by our organisational development team and our people plan referred to above	
Process for ensuring diversity of perspectives, independence of the board	
Board or management activities, reports or statements	
• the stakeholder inclusive approach of our corporate governance framework	Our corporate governance framework on page 93
• our board evaluation which considers the balance of skills, experience and diversity of our board, and how the board operates to receive information and reach to the extent possible concerted decisions taking account of all relevant considerations	
• the composition of our board which ensures a significant representation of independent non-executive directors	Our section 172(1) statement on page 78
• the arrangements in place for the effective operation of the board as described in the corporate governance report	The role of the board on page 102 of our corporate governance statement

DISCLOSURES AND STATEMENTS BY DIRECTORS continued

SYSTEMS OF PLANNING AND INTERNAL CONTROL	READ MORE
Governance procedures; risk management frameworks, oversight procedures	
Risk, compliance other assurance statements	
• our risks management processes described in the strategic report	Our risk management model on page 60
• the review of our principal risks including to take account of the impact of the final determination and of Covid-19 on our risk profile. Our principal risks and related mitigations are relevant to several of the considerations set out in this table and provide additional details on how the company manages the impact of Covid-19	Our principal risks on page 61
• our company monitoring framework setting out how we ensure the accuracy and reliability of the information we publish which is available at: **southeastwater.co.uk/cmf**	
• our risk and compliance statement	Our risk and compliance statement on page 230
Internal and/or external audit policies, processes, activities and/or reports	
• the role of our audit and risk committee in monitoring the effectiveness of our risk management processes and internal controls	Our data assurance summary on page 226
• the internal and external assurance processes that were followed for the preparation of our annual report and this annual performance report including information relevant to this certificate as described in our data assurance summary	
Systems for maintaining supply / business continuity, stated action plans	
• our incident management processes and other processes in place under SEMD and the satisfactory outcome of the independent SEMD audit	
• our cyber security and data compliance processes, relevant certifications and the satisfactory outcomes of the testing and audit of these processes	
• the ongoing review of incidents and improvements based on lessons learnt reported to the board	
• our good water quality performance in the year and the monthly reporting on water quality to the board	
• the annual review of our risks register by the board and the regular review of the risks register by our executive team	
• our resilience action plan	
• the effectiveness demonstrated by management in implementing new methods of working to respond to Covid-19	
• the company's preparation in respect of the potential disruption that may arise from a "hard Brexit"	

SYSTEMS OF PLANNING AND INTERNAL CONTROL	READ MORE
Policies to prevent fraud and other unethical behaviour; whistleblowing policy	
• our whistleblowing policy, anti-bribery policy and conflicts of interest policy and the review by the audit and risk committee of the processes in place and of any report made under these policies	
• the consideration during the audit process of risks of fraud and misstatement and the external audit of management override and internal controls including automated journal entry testing	
RIGHTS AND RESOURCES OTHER THAN FINANCIAL RESOURCES	
Corporate missions and/or values	
Policies to encourage an integrated approached and 'systems thinking'	
• the adoption of our purpose to be embedded into our articles of association and of our corporate governance framework promoting an integrated thinking approach in our day to day decision making	Our corporate governance framework on page 93
• the ongoing work for the implementation of our resilience action plan	
• the approach to the preparation of our corporate plan for 2020 to 2025 including operational delivery plans by each relevant function and related action plans from relevant support functions	Our purpose and values on page 26
• our long term planning integrating climate change adaptation with the progressive implementation of TCFD scenarios and financial reporting	Our carbon and emission reporting and strategy on page 49
Technology and other systems for ensuring checks and balances	
Planning systems	
• our internal systems of control and assurance described above	Our WRMP on page 30
• our published Water Resources Management Plan and Drought Plan and existing processes for the development of our long term plans	
Assets maintenance / insurance factors	
• our established processes for the management of our assets and of the delivery of our investment plans, including the PAS 55 certification process	
• the review of our insurance policies renewals	

DISCLOSURES AND STATEMENTS BY DIRECTORS continued

CONTRACTING	READ MORE
Position/status of key contracts in place	
All contracts between the Appointee and all Associated Companies were checked for compliance with licence requirements on standards	
Note on transactions between the Appointee and any Associated Company	
Compliance with licence provision on cross-subsidies between the Appointee and any Associated Company (Condition I)	
No Guarantees or Cross-Default Obligations given without Ofwat's written consent	
• the external assurance (as described above) applying to our reporting included in relation to transactions with associates	Our reporting on transactions with associates on page 223
• that no new arrangements were entered into that included cross-default obligations or other new arrangement requiring the consent of Ofwat	
MATERIAL ISSUES OR CIRCUMSTANCES	
• the impact of Covid-19 to date and for the rest of 2020/21 and beyond, including the experience to date of the business in implementing new methods of working to ensure services to customers and critical facilities are maintained while protecting the health of our employees, customers and suppliers and the experience to date of supporting our vulnerable customers, the review of the company's principal risks and Covid-19 related mitigations, and through the forecasting and analysis carried out for the long term viability statement. More details are set out in our section 172(1) statement and the review of our principal risks	Our section 172(1) statement on page 78 Our principal risks on page 61

LONG TERM VIABILITY STATEMENT

Our long term viability statement is set out on page 71 of the Strategic Report. Details of our risk management process and of our principal risks may be found on pages 61 to 70 of the Strategic Report.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

- ensuring that proper accounting records are maintained by the appointee to enable compliance with the requirements of Condition F and to prepare a set of regulatory accounting statements, in respect of the twelve months ending on 31 March in each charging year, which are in accordance with the Regulatory Accounting Guidelines
- ensuring that South East Water maintains an investment grade credit rating (licence condition I30)
- ensuring that South East Water has adequate resources to continue as a going concern for the foreseeable future (licence condition I17)

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 £3.3 million in profit before tax includes capitalised interest of £2.8 million, the removal of depreciation on capitalised interest of £0.2 million and pension costs adjustments of £0.7 million
- in the statement of financial position, cumulative capitalised interest less depreciation of £20.3 million has been excluded from fixed assets

TRANSACTIONS WITH ASSOCIATE COMPANIES

LOANS FROM ASSOCIATE COMPANIES

Associate	Interest	Loan period	2020 £000
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		44,986
South East Water (Finance) Limited	Index linked plus 0.01% margin fee	Repayable in December 2037	100,000
	Indexation		19,652

INTEREST AND RELATED FEES PAYABLE TO ASSOCIATE COMPANIES

Associate	Nature of transaction	Terms of supply	2020 £000
South East Water (Finance) Limited	Interest, RPI indexation and margin fees on intercompany loans (see below)	(See above)	31,426
South East Water (Finance) Limited	Ambac fees on £166 million	Monoline fees	547
South East Water (Finance) Limited	Facility fees	Commitment fees on loan facilities	346

LOANS TO ASSOCIATE COMPANIES

Associate	Interest	Loan period	2020 £000
South East Water (Holdings) Limited	LIBOR plus 2%	Repayable in July 2034	136,013

INTEREST RECEIVABLE FROM ASSOCIATE COMPANIES

Associate	Nature of transaction	Terms of supply	2020 £000
South East Water (Holdings) Limited	Interest on intercompany loans of £136 million	LIBOR plus 2%	4,469

To the best of the directors' knowledge, all appropriate transactions with associated companies have been disclosed in compliance with condition I and RAGs 3.11 and 5.07.

DISCLOSURES AND STATEMENTS BY DIRECTORS continued

TAX STRATEGY AND CURRENT TAX RECONCILIATION

South East Water Ltd is committed to the effective, sustainable and active management of our tax affairs in support of our overall business performance and, as with all other aspects of our business, to maximise shareholder value and minimise customer bills as any tax payable is required to be funded via the prices set by Ofwat.

We are committed to pay tax according to the law and conducting our tax affairs according to clear principles. We seek to maintain good working relationships with tax authorities, sharing our views either directly or through trade associations.

South East Water believes it is important to state our views on tax in the context of corporate responsibility. We believe our obligation is to pay the amount of tax legally due and observe all applicable rules and regulations relating to tax compliance. However, at the same time we also have an obligation to maximise shareholder value, minimise customer bills and to manage financial and reputational risk. This includes controlling our overall liability to taxation.

We do not condone either personal or corporate tax evasion under any circumstances and were such issues to be identified, full disclosure of the activities undertaken would be required to be made to the tax authorities.

Our aim is to have a constructive relationship with the tax authorities on an on-going basis. Nevertheless we recognise that there may be some areas that are not free from doubt or differing legal interpretations may be possible. Where disputes arise with the tax authorities with regard to interpretation and application of tax law, we are committed to addressing the matter promptly and seek resolutions in a responsible manner. A more detailed explanation of our tax policy is available on our website.

For the year ended 31 March 2020 a UK corporation rate of 19 per cent has been used as enacted on 26 October 2015 by Finance Act 2013. The reduction in the UK corporation tax rate due to come into effect on 1 April 2020 bringing the rate to 17 per cent was cancelled in the budget announcement in March 2020 and the tax rate remains at 19 per cent from this date.

The deferred tax on temporary differences as at 31 March 2020 have been calculated in full under the balance sheet method at the rate applicable to the year in which the temporary differences are expected to reverse.

The table below shows a comparison between the amount funded within the final determination (FD) and the tax charge within the regulatory accounts.

WHOLESALE TAX RECONCILIATION:

	2019/20 Prices £000
Final determination (2012/13 prices)	1,915
Indexation	359
Final determination	2,274
Actual in regulatory accounts	1,182
Retail tax	(584)
Wholesale tax	598

THE RECONCILIATION OF WHOLESALE TAXATION TO FUNDED TAXATION IS AS FOLLOWS:

	2019/20 Prices £000
Wholesale tax	598
Contributions and Infrastructure charges	(868)
Capital allowances	2,768
Variance in operating profit	(608)
Corporation tax rate reduction	114
Other	270
Final determination	2,274

THE RECONCILIATION OF CURRENT APPOINTED TAX IS AS FOLLOWS:

	2019/20 Prices £000
Profit before tax	25,695
Taxation at 19%	4,882
Expenses not deductible	6
Income not chargeable to corporation tax	(10)
Capital allowances exceed depreciation	(2,667)
Pension movements	(1,029)
Current tax charge for the year	1,182
Adjustment in respect of prior years	(141)
UK corporation tax charge	1,041

DATA ASSURANCE SUMMARY

OUR INTERNAL CONTROLS AND BOARD OVERSIGHT

In 2015/16 Ofwat issued new reporting requirements for the annual performance report which would incorporate a number of tables and information previously contained in the regulatory accounts. Further changes to reporting requirements were issued by Ofwat in 2017/18, with the introduction of the financial flows metric and additional cost assessment tables. 2018/19 saw the financial flows incorporated into the annual performance report. We have included these changes into our annual reporting and have chosen to publish the cost assessment tables (4J to 4W) as a separate document alongside our annual performance report.

The internal data assurance that we have undertaken for the contents of the annual performance report section of the annual report also covers the annual performance report content of our Performance, People and Planet (PPP) report.

Our governance and assurance process for the preparation of our annual performance report and PPP report were based on our well-established systems of internal control for all regulatory and performance reporting and incorporated oversight by the board and scrutiny by the audit and risk committee following reviews by the executive directors, and the requirement for heads of department and/or manager level sign off.

The assurance methodology that we have adopted is in line with our approach set out in our company monitoring framework with the three levels of assurance as described below:

LEVEL 1

- peer review – data and information must be checked by a separate individual
- manager review/sign off – data and information is required to be checked by the line manager responsible for the individual completing the submission
- independent review is undertaken of the reporting requirements to ensure all required changes and actions are identified
- the changes identified are circulated and assigned to an owner
- formal review of last year's Ofwat queries and audit issues are circulated to the owners to ensure required actions are adopted
- data owners are required to complete pre audit check lists which cover all areas of compliance including, Ofwat's reporting requirements

LEVEL 2

Internal review

- data and process audit – data validity is tested through taking a sample and verifying the data for critical data such as PCs, ODIs and 'C' grade areas
- the methodology document is reviewed to ensure that the process and internal controls are complete and being followed
- any required changes are controlled by the Regulatory Assurance Manager. A log has been maintained to track sign off at all the assurance stages and provide an audit trail to the source data
- the process for areas of high risk and importance are reviewed and additional assurance added. For example, all interruption events are separately reviewed and signed off by the manager
- internal consistency checks have been undertaken on the data within the annual performance report and against other published documents
- a master set of APR tables is linked to our source data to provide an audit trail. This is separately managed and controlled
- independent review is undertaken to check the tables are populated with the audited data
- the master set of data tables and submission version is checked manually cell by cell by an independent reviewer and by an automatic electronic lookup. These are used to try to eliminate any input errors arising from the manual entry process required for the submission version of the tables
- independent check to ensure all the formatting requirements have been met
- internal consistency checks on the APR tables with APR commentary

External review

- data, process and submission audit – this process is undertaken by an external assurance partner
- a review of methodology, data sampling and internal controls is undertaken
- meetings undertaken with senior managers and those who produce the data to ensure a thorough understanding is obtained. The external auditors attend the pre audit meetings to review preparations for the audits and any potential issue that may arise
- external consistency checks have been carried out on our APR Tables, by our independent assurance partner Jacobs
- independent review is undertaken to check the tables are populated with the audited data

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 managers and head of departments taking ownership of sections of the reporting and supporting material. Each data table has data providers assigned for each line and each section and table has an overarching table owner who is a head of department, reporting to an executive director. The data providers are responsible for collecting, compiling and reporting the data to the table owner and the table owner is responsible for reviewing such data.

The board considered and approved the final processes used for the generation of the 2019/20 annual reporting. The audit and risk committee also scrutinised the annual performance report and related narrative, the risk and compliance statement and PPP report. This committee reported to the board before the board approved the annual reports.

A summary of the performance by the company in 2019/20 against our performance targets including comments and recommendations received from our independent assurance partner, Jacobs, were reviewed by the committee. The committee and board also reviewed the annual performance report, the risk and compliance statement and PPP report. Our annual performance tables have been prepared under the scrutiny of our audit and risk committee, which also considered the declarations to be provided under conditions I and K of the Licence, and have been approved by the board.

OUR EXTERNAL ASSURANCE

As the processes and associated data items are complex and detailed, the board focuses on the process followed to prepare and review data, the robustness and clarity of the reported information, and obtains additional information and analysis from the executive directors. In addition, the board assures itself of the robustness of data by gaining assurance from Jacobs.

Jacobs are our independent assurance partners whose role is to assist the board to ensure, completeness of the annual reporting, compliance with relevant duties and obligations, and to ensure that the information we provide to demonstrate compliance with our relevant duties and obligations is consistent, comparable, reliable and robust. They presented their summary report and findings to the audit and risk committee which reports into the board.

During 2019/20 Jacobs undertook a half year review of some of our performance commitments providing feedback on any potential improvements identified.

Details of the work performed by Deloitte on our annual performance report are provided in the Independent Auditor Report on page 232.

For the current reporting period Jacobs have reviewed all of our performance commitments. This is done through separate audits for each of the PCs, ODIs and sub measures, enabling additional information to be reviewed on a yearly basis and enabling the auditors to provide a more robust challenge. Final audits of the APR tables are then undertaken (Tables 3A, 3B, 3C, 3D and 3S). The following annual performance report tables are also audited by Jacobs:

- 2B – Totex analysis – wholesale water and wastewater
- 2C – Operating cost analysis – retail
- 3A – Outcome performance table
- 3C – AIM table
- 3D – SIM table
- 4A – Non-financial information
- 4B – Wholesale totex analysis

DATA ASSURANCE SUMMARY continued

- 4C – Impact of AMP performance to date on RCV
- 4D – Wholesale totex analysis – water
- 4F – Cost analysis – household retail

Jacobs also reviewed the following tables not included within the annual performance report, but which are included in the annual performance report tables:

- 3S – Shadow reporting of new definition data
- 4J – Atypical expenditure by business unit – wholesale water
- 4P – Non-financial data for WR, WT and WD – wholesale water
- 4Q – Non-financial data – Properties, population and other – wholesale water
- 4V – Operating cost analysis – water resources

Deloitte, our financial auditors have audited:

- Section 1, except lines 1F.10 to 1F.12, 1F.14 to 1F.18 and 1F.20 of table 1F
- Section 2

Deloitte have performed agreed upon procedures for the following tables:

- 4G – Wholesale current cost financial performance
- 4H – Financial metrics
- 4I – Financial derivatives

Deloitte also performed agreed upon procedures in relation to the lines not covered in their audit of table 1F detailed above as follows:

- Agree line 1F.10 is the sum of lines 1F.5 to 1F.9
- Agree line 1F.15 is the sum of lines 1F.11 to 1F.14
- Agree line 1F.16 is the sum of lines 1F.3, 1F.10 and 1F.15
- Agree line 1F.18 is the sum of line 1F.16 plus 1F.17
- Agree line 1F.20 is the sum of line 1F.18 minus 1F.19

The findings from annual audits will be incorporated into the process of updating our company monitoring framework which will be published in autumn 2020.

OUR COMPANY MONITORING FRAMEWORK

In June 2015 Ofwat published guidance on its company monitoring framework. In which it stated:

"The company monitoring framework is a tool to challenge all companies to provide information for customers and stakeholders that is reliable, timely, appropriate to the audience, and for companies to be transparent with customers and stakeholders about the data assurance they put in place."

Each autumn we publish our company monitoring framework which sets out what we do to ensure that the data and information we publish is reliable, transparent, timely and appropriate to the audience. We publish our strengths, risks and weaknesses statement and the subsequent draft assurance plan we have developed in order to address any risks that have been identified. In March each year we publish our final assurance plan for the year which takes into account any feedback we have received as a result of the publication of our draft assurance plan.

Our company monitoring framework can be found using the following link: **southeastwater.co.uk/cmf**

OFWAT'S 2018 ASSESSMENT

In January 2019 Ofwat published its Company Monitoring Framework Assessment in which we were commended for the quality of the performance information we publish for some areas, but identified as having some minor concerns in some of the other areas.

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

The conclusion of this report saw us drop from the highest category of self-assured, which we earned in 2017, to the targeted category.

To read Ofwat's full report for the 2018 assessment see: **ofwat.gov.uk/publication/company-monitoring-framework-2018-assessment-individual-company-report-south-east-water**

OUR PLANS FOR PUBLISHING OUR FUTURE COMPANY MONITORING FRAMEWORKS

In their assessment, Ofwat said: *"The company met our expectations in many areas and exceeded our expectations in two areas, the assurance plan and water resources management plan (WRMP) and market information. However, we had minor concerns in four areas; the financial monitoring framework, changes engagement, PR19 business plan data consistency and PR19 business plan data quality. Given the number of concerns we consider that the company has not consistently met the high standards expected in order to be assessed as self-assurance."*

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

All companies in the targeted assurance band were required to:

- identify the risks, strengths and weaknesses in providing the quality of information that stakeholders want and trust
- carry out an exercise with stakeholders to target issues to address
- consult on our draft assurance plans to ensure that they are sufficient to address the issues identified
- publish a statement on this in the autumn of each year

We will be producing a new company monitoring framework and assurance plan for 2020/21 and publishing this in autumn 2020. The findings from our annual audits for 2019/20 will be incorporated into the process of updating our risk assessments and assurance plans. In particular, we will be reviewing our risks and the minor concerns identified by Ofwat.

COMPANY MONITORING FRAMEWORK: OFWAT FEEDBACK

Ofwat has not carried out a formal review of our company monitoring framework since their 2018 assessment, but they have provided some informal feedback which we have set out below.

Our action plan has reviewed Ofwat's concerns in detail and put in place actions to try to resolve these concerns.

ANNUAL PERFORMANCE REPORT (APR) SUBMISSION

In their feedback, Ofwat said: *"We identified a few small errors in the information published, and also an area which we consider would have benefited from further clarity. We did not consider that the minor errors had a material impact on the overall reliability of the data."*

We have addressed these issues by adding additional level of sign off to check for errors. We will also provide enhanced commentary to cover issues that may not be obvious to all readers.

FINANCIAL FLOWS

Ofwat stated that; *"We noticed a significant error in the company's adjustment to base return due to the exit of the NHH retail market."*

We have addressed this issue by providing company data in line with Ofwat addition guidance. Additional levels of checking and sign off have also been added.

DIVIDEND POLICY

Within their feedback, Ofwat stated: *"We noted the following concerns in relation to the company's current dividend policy, if this policy were to be considered against the key components of our back in balance position statement which sets out our expectations for companies' dividend policies for 2020-25. We expect these points to be addressed in the company's dividend policy for 2020-25."*

These issues have been addressed in our updated dividend policy.

LONG TERM VIABILITY STATEMENT (LTVS)

Ofwat stated that: *"The company completed a LTVS which covered 10 years. The company's statement met expectations in a number of areas, however a small number of minor concerns were noted in some areas."*

The further details required are provided in the 2019/20 Annual Report.

Read more

Our full Data Assurance Summary report for 2019/20 is available at: **southeastwater.co.uk/finance-reports**

RISK AND COMPLIANCE STATEMENT

As directors of South East Water, we have relied on the established systems of internal control the company operates to ensure that it delivers its statutory, regulatory and Licence obligations and manages its risks in order to prepare this statement, the regulatory accounts, the annual performance report and all related narrative.

We have also relied on comprehensive and transparent controls and assurance mechanisms which set out clear accountability for data collection, analysis and verification following the approach defined in our company monitoring framework. The data and control processes themselves have been thoroughly reviewed by external financial and technical auditors to ensure that the information we publish is robust and of high quality. This enables us to have a high degree of confidence in the information presented in this year's regulatory reporting and supporting data on which the declarations of compliance set out at the end of this statement are based.

We describe our risk management systems and our principal risks in our strategic report. We describe our governance and how we comply with the principles of our corporate governance code and the objectives of the board leadership, transparency and governance principles and more particularly on transparency and accountability in our corporate governance report. Our company monitoring framework describes our approach to reporting and to the assurance of our information. A summary of the process we followed to assure the quality of our reporting is set out in our data assurance summary. We have also set out our assessment of the prospects and viability of the company in our long term viability statement taking account of the final determination and of our assessment of the potential impact of the Covid-19 pandemic on the UK economy, our customers and our business. 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 under performance commitment M "We are compliant with other statutory obligations and licence conditions" in respect of which we report any relevant enforcement action and prosecution. This reporting did not identify any reportable deviation from or non-compliance with these obligations in 2019/20.

Our innovative approach on outcomes is based on customer satisfaction. For further information about our customer satisfaction outcomes and the approach we have taken in 2019/20 to improve our customers' experience please see our Performance, People and Planet report. We also provide more information on how the board has regard to the interests of customers and other relevant matters in section 172(1) statement in our strategic 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 2020, and in making this statement we have taken account of the other statements made in compliance with our obligations under conditions F, I and K of our Licence and under section 35A of the Water Industry Act 1991 (which are set out in the directors' remuneration report).

Based on the scope and outcome of the review processes detailed in this statement and in our annual financial and regulatory reporting the board is able to confirm that South East Water:

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

Approved by the Board and signed on its behalf by:

PAUL BUTLER	ANDREW FARMER
MANAGING DIRECTOR	FINANCE DIRECTOR
.....	.....
15 JULY 2020	15 JULY 2020

INDEPENDENT AUDITOR'S REPORT

TO THE WATER SERVICES REGULATION AUTHORITY (THE WSRA) AND THE DIRECTORS OF SOUTH EAST WATER LIMITED

REPORT ON THE AUDIT OF THE REGULATORY ACCOUNTING STATEMENTS

OPINION

We have audited certain sections of South East Water Limited's ("the Company") Annual Performance Report for the year ended 31 March 2020 ("the Regulatory Accounting Statements") which comprise:

- the regulatory financial reporting tables comprising the income statement (table 1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D), the net debt analysis (table 1E), Lines 1F.1 to 1F.9, Line 1F.13, Line 1F.19, Line 1F.21 to Line 1F.23 of the statement of financial flows (table 1F) and the related notes; and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of grants and contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G), the non-household wastewater revenues by customer type (table 2H), the revenue analysis & wholesale control reconciliation (table 2I), the infrastructure network reinforcement costs (table 2J), the infrastructure charges reconciliation (table 2K) and the related notes.

We have not audited Lines 1F.10 to 1F.12, 1F.14 to 1F.18, and 1F.20 of table 1F, the Outcome performance table (tables 3A to 3S) and the additional regulatory information in tables 4A to 4W.

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

BASIS FOR OPINION

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

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

EMPHASIS OF MATTER – SPECIAL PURPOSE BASIS OF PREPARATION

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

The Regulatory Accounting Statements are separate from the statutory financial statements of the Company and has not been prepared under the basis of International Financial Reporting Standards as adopted by the European Union ("IFRSs"). Financial information other than that prepared on the basis of IFRSs does not necessarily represent a true and fair view of the financial performance or financial position of a Company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

The Regulatory Accounting Statements on pages 208 to 225 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from IFRS. A summary of the effect of these departures from Generally Accepted Accounting Practice in the Company's statutory financial statements is included in the tables within section 1.

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

Our opinion is not modified in respect of this matter.

CONCLUSIONS RELATING TO GOING CONCERN

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

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

INDEPENDENT AUDITOR'S REPORT continued

OTHER INFORMATION

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

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

We have nothing to report based on these responsibilities.

RESPONSIBILITIES OF THE DIRECTORS FOR THE ANNUAL PERFORMANCE REPORT

As explained more fully in the Statement of Directors' Responsibilities set out on page 222, the directors are responsible for the preparation of the Annual Performance Report in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.11, appendix 2).

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

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

AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE REGULATORY ACCOUNTING STATEMENTS WITHIN THE ANNUAL PERFORMANCE REPORT

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

A further description of our responsibilities for the audit of the Regulatory Accounting Statements is located on the Financial Reporting Council's website at: **www.frc.org.uk/auditors/audit-assurance/auditor-s-responsibilities-for-the-audit-of-the-fi/description-of-the-auditor%E2%80%99s-responsibilities-for**. This description forms part of our auditor's report.

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

OPINION ON OTHER MATTERS PRESCRIBED BY CONDITION F

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

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

USE OF THIS REPORT

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

Our opinion on the Regulatory Accounting Statements is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2020 on which we reported on 15 July 2020, 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
London, United Kingdom
15 July 2020

REGULATORY REPORTING – ANNUAL PERFORMANCE REPORT

The following tables are set out following the order defined in Appendix 1 of the regulatory accounting guidance 3.11. Where the tables include line items which do not require a data entry, the line has been omitted from the table.

Additional tables have been included under each of the financial statements in section 1 to provide a reconciliation of the differences between applying RAGs and IFRS.

As detailed earlier, we have opted to not include tables 3S and 4J to 4W within the annual performance report and these will instead be published separately.

1A – INCOME STATEMENT

FOR THE 12 MONTHS ENDED 31 MARCH 2020

		Adjustments			
	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities
	£000	£000	£000	£000	£000
Revenue	243,481	(1,269)	11,749	(13,018)	230,463
Operating costs	(174,327)	(806)	(7,130)	6,324	(168,003)
Other operating income	12,199	(12,149)	-	(12,149)	50
Operating profit	81,353	(14,224)	4,619	(18,843)	62,510
Other income	-	13,468	-	13,468	13,468
Interest income	5,308	(633)	-	(633)	4,675
Interest expense	(52,895)	(115)	(132)	17	(52,878)
Other interest expense	-	633	-	633	633
Profit before tax and fair value movements	33,766	(871)	4,487	(5,358)	28,408
Fair value gains/(losses) on financial instruments	-	(2,713)	-	(2,713)	(2,713)
Profit before tax	33,766	(3,584)	4,487	(8,071)	25,695
UK Corporation tax	(1,894)	-	(853)	853	(1,041)
Deferred tax	(15,017)	-	-	-	(15,017)
Profit for the year	**16,855**	**(3,584)**	**3,634**	**(7,218)**	**9,637**
Dividends	(11,000)	-	(3,634)	3,634	(7,366)

1A – INCOME STATEMENT continued

FOR THE 12 MONTHS ENDED 31 MARCH 2020

		Adjustments			
	Statutory	Differences between statutory and RAG definitions	Non-appointed	Total adjustments	Total appointed activities
Tax analysis	£000	£000	£000	£000	£000
Current year	2,035	-	853	(853)	1,182
Adjustments in respect of prior years	(141)	-	-	-	(141)
UK Corporation tax	1,894	-	853	(853)	1,041

Analysis of non-appointed revenue	Non-appointed £000
Imported sludge	-
Tankered waste	-
Other non-appointed revenue	11,749
Revenue	11,749

The impact of the adoption of IFRS 16 on table 1A of the annual performance report has been:

	Total appointed activities pre IFRS 16 £000	Adjustment for the adoption of IFRS 16 £000	Total appointed activities post IFRS 16 £000
Operating costs	(168,015)	12	(168,003)
Operating profit	62,498	12	62,510
Interest expense	(52,768)	(110)	(52,878)
Profit before tax and fair value movements	28,506	(98)	28,408
Profit before tax	25,793	(98)	25,695
Profit for the year	**9,735**	**(98)**	**9,637**

1A – INCOME STATEMENT continued

for the 12 months ended 31 March 2020

Adoption of IFRS 16 has resulted in an adjustment to net operating costs of £12,000. This represents the removal of the rental charges of £319,000 offset by the depreciation change of £307,000 on the right of use assets, which have been included in the balance sheet at 1 April 2019.

Further, the interest chargeable on the lease finance has been accrued to 31 March 2020 resulting in a finance charge of £110,000.

The value of payments under leases in the year has been £332,000.

Differences between statutory and RAG definitions	Revenue £000	Operating costs £000	Other operating income £000	Operating profit £000
Movement of Contributions Income	(1,378)	-	-	(1,378)
Movement of Infrastructure Income	(5,751)	-	-	(5,751)
Movement of New Connections Income	(5,818)	-	-	(5,818)
Movement of Laboratory Income	2,467	-	(2,467)	-
Movement of Billing Commissions	7,607	-	(7,607)	-
Movement of Other Sundry Income	1,604	-	(1,604)	-
Removal of Depreciation on Capitalised Interest	-	187	-	187
Adjust Pension Contributions	-	(943)	-	(943)
Movement of Profit/(Loss) on Disposal of Fixed Assets	-	(50)	50	-
Movement of Rental Income	-	-	(521)	(521)
Movement of Return Made on Pensions	-	-	-	-
Movement of Fair Value Gains/(Losses)	-	-	-	-
Removal of Interest Capitalised	-	-	-	-
Total differences	**(1,269)**	**(806)**	**(12,149)**	**(14,224)**

Differences between statutory and RAG definitions	Other income £000	Interest income £000	Interest expense £000	Other interest expense £000
Movement of Contributions Income	1,378	-	-	-
Movement of Infrastructure Income	5,751	-	-	-
Movement of New Connections Income	5,818	-	-	-
Movement of Laboratory Income	-	-	-	-
Movement of Billing Commissions	-	-	-	-
Movement of Other Sundry Income	-	-	-	-
Removal of Depreciation on Capitalised Interest	-	-	-	-
Adjust Pension Contributions	-	-	-	-
Movement of Profit/(Loss) on Disposal of Fixed Assets	-	-	-	-
Movement of Rental Income	521	-	-	-
Movement of Return Made on Pensions	-	(633)	-	633
Movement of Fair Value Gains/(Losses)	-	-	2,713	-
Removal of Interest Capitalised	-	-	(2,828)	-
Total differences	**13,468**	**(633)**	**(115)**	**633**

1A – INCOME STATEMENT continued

FOR THE 12 MONTHS ENDED 31 MARCH 2020

Differences between statutory and RAG definitions	Profit before tax and fair value movements £000	Fair value gains/(losses) on financial instruments £000	Profit before tax £000	Profit for the year £000
Movement of Contributions Income	-	-	-	-
Movement of Infrastructure Income	-	-	-	-
Movement of New Connections Income	-	-	-	-
Movement of Laboratory Income	-	-	-	-
Movement of Billing Commissions	-	-	-	-
Movement of Other Sundry Income	-	-	-	-
Removal of Depreciation on Capitalised Interest	187	-	187	187
Adjust Pension Contributions	(943)	-	(943)	(943)
Movement of Profit/(Loss) on Disposal of Fixed Assets	-	-	-	-
Movement of Rental Income	-	-	-	-
Movement of Return Made on Pensions	-	-	-	-
Movement of Fair Value Gains/(Losses)	2,713	(2,713)	-	-
Removal of Interest Capitalised	(2,828)	-	(2,828)	(2,828)
Total differences	**(871)**	**(2,713)**	**(3,584)**	**(3,584)**

1B – STATEMENT OF COMPREHENSIVE INCOME

FOR THE 12 MONTHS ENDED 31 MARCH 2020

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Non-appointed £000	Total adjustments £000	Total appointed activities £000
Profit for the year	16,855	(3,584)	3,634	(7,218)	9,637
Actuarial gains/(losses) on post-employment plans	3,828	-	-	-	3,828
Total comprehensive income for the year	**20,683**	**(3,584)**	**3,634**	**(7,218)**	**13,465**

1C – STATEMENT OF FINANCIAL POSITION

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Statutory £000	Adjustments: Differences between statutory and RAG definitions £000	Adjustments: Non-appointed £000	Adjustments: Total adjustments £000	Total appointed activities £000
Non-current assets					
Fixed assets	1,608,845	(10,751)	-	(10,751)	1,598,094
Intangible assets	9,568	(9,568)	-	(9,568)	-
Investments – loans to group companies	135,941	-	-	-	135,941
Retirement benefit assets	35,912	-	-	-	35,912
Total non-current assets	1,790,266	(20,319)	-	(20,319)	1,769,947
Current assets					
Inventories	689	-	-	-	689
Trade & other receivables	84,063	-	4,246	(4,246)	79,817
Cash & cash equivalents	12,981	-	-	-	12,981
Total current assets	97,733	-	4,246	(4,246)	93,487
Current liabilities					
Trade & other payables	(75,994)	-	(4,246)	4,246	(71,748)
Capex creditor	(22,735)	-	-	-	(22,735)
Borrowings	(30,000)	-	-	-	(30,000)
Provisions	(9,875)	-	-	-	(9,875)
Total current liabilities	(138,604)	-	(4,246)	4,246	(134,358)
Net current assets/(liabilities)	(40,871)	-	-	-	(40,871)
Non-current liabilities					
Trade & other payables	(4,997)	-	-	-	(4,997)
Borrowings	(1,029,326)	-	-	-	(1,029,326)
Retirement benefit obligations	(3,115)	-	-	-	(3,115)
Deferred income – G&C's	(3,438)	-	-	-	(3,438)
Deferred tax	(166,352)	-	-	-	(166,352)
Total non-current liabilities	(1,207,228)	-	-	-	(1,207,228)
Net assets	**542,167**	**(20,319)**	**-**	**(20,319)**	**521,848**
Equity					
Called up share capital	(49,312)	-	-	-	(49,312)
Retained earnings & other reserves	(492,855)	20,319	-	20,319	(472,536)
Total equity	**(542,167)**	**20,319**	**-**	**20,319**	**(521,848)**

1C – STATEMENT OF FINANCIAL POSITION continued

FOR THE 12 MONTHS ENDED 31 MARCH 2020

Differences between statutory and RAG definitions	Fixed assets £000	Intangible assets £000	Total non-current assets £000	Net assets £000	Retained earnings & other resources £000	Total equity £000
Removal of Capitalised Interest	(21,122)	-	(21,122)	(21,122)	21,122	21,122
Removal of Depreciation on Capitalised Interest	803	-	803	803	(803)	(803)
Movement of Computer Software Cost	26,009	(26,009)	-	-	-	-
Movement of Computer Software Depreciation	(17,883)	17,883	-	-	-	-
Movement of Computer Software Work in Progress Cost	1,442	(1,442)	-	-	-	-
Total differences	**(10,751)**	**(9,568)**	**(20,319)**	**(20,319)**	**20,319**	**20,319**

Under IFRS, computer software is recorded as an intangible asset in the company's financial report and accounts. However, the annual performance report requires that computer software is reported as part of tangible fixed assets, hence the balance of intangible assets of £9.568 million in the statutory accounts has been restated under tangible fixed assets in the above table.

1C – STATEMENT OF FINANCIAL POSITION

FOR THE 12 MONTHS ENDED 31 MARCH 2020

The impact of the adoption of IFRS 16 on table 1C of the annual performance report has been:

	Pre adoption on IFRS 16 £000	Impact of adoption of IFRS 16 £000	Post adoption of IFRS 16 £000
Fixed assets	1,593,718	4,376	1,598,094
Total non-current assets	1,765,571	4,376	1,769,947
Borrowings	(1,025,087)	(4,239)	(1,029,326)
Total non-current liabilities	(1,202,989)	(4,239)	(1,207,228)
Net assets	**521,711**	**137**	**521,848**
Retained earnings & other reserves	(472,399)	(137)	(472,536)
Total equity	**(521,711)**	**(137)**	**(521,848)**

The following tables show the movement in the year in the values of right of use assets and lease financing liabilities.

	Right of use assets £000
Balance at 1 April 2019 on adoption of IFRS 16	3,098
Additions from new lease arrangements	1,585
Depreciation	(307)
Balance at 31 March 2020	**4,376**

	Lease financing liabilities £000
Balance at 1 April 2019 on adoption of IFRS 16	3,098
Additions from new lease arrangements	1,363
Capital element of lease payments	(222)
Balance at 31 March 2020	**4,239**

1D – STATEMENT OF CASH FLOWS

FOR THE 12 MONTHS ENDED 31 MARCH 2020

		Adjustments			
	Statutory £000	Differences between statutory and RAG definitions £000	Non-appointed £000	Total adjustments £000	Total appointed activities £000
Operating profit	81,353	(14,224)	4,619	(18,843)	62,510
Other income	-	13,468	-	13,468	13,468
Depreciation	54,664	(187)	-	(187)	54,477
Changes in working capital	4,674	811	-	811	5,485
Pension contributions	(4,896)	132	-	132	(4,764)
Movement in provisions	(1,280)	-	-	-	(1,280)
Profit/Loss on sale of fixed assets	(50)	-	-	-	(50)
Cash generated from operations	134,465	-	4,619	(4,619)	129,846
Net interest paid	(37,069)	-	(132)	132	(36,937)
Tax paid	55	-	(853)	853	908
Net cash generated from operating activities	97,451	-	3,634	(3,634)	93,817
Investing activities					
Capital expenditure	(98,269)	-	-	-	(98,269)
Disposal of fixed assets	94	-	-	-	94
Net cash used in investing activities	(98,175)	-	-	-	(98,175)
Net cash generated before financing activities	**(724)**	**-**	**3,634**	**(3,634)**	**(4,358)**
Cash flows from financing activities					
Equity dividends paid	(11,000)	-	(3,634)	3,634	(7,366)
Net loans received	12,098	-	-	-	12,098
Net cash generated from financing activities	**1,098**	**-**	**(3,634)**	**3,634**	**4,732**
Increase/(decrease) in net cash	**374**	**-**	**-**	**-**	**374**

1D – STATEMENT OF CASH FLOWS continued

FOR THE 12 MONTHS ENDED 31 MARCH 2020

Differences between statutory and RAG definitions	Operating profit £000	Other income £000	Depreciation £000	Changes in working capital £000	Pension contribution £000
Operating Profit as per Table 1A	(14,224)	-	-	-	-
Movement of Rental Income	-	521	-	-	-
Movement of Infrastructure Income	-	5,751	-	-	-
Movement of Contributions Income	-	1,378	-	-	-
Movement of developer contributions immediately recognised in income statement	-	5,818	-	-	-
Removal of Depreciation on Capitalised Interest	-	-	(187)	-	-
Inclusion of Pension Asset	-	-	-	811	-
Inclusion of Pension Contributions	-	-	-	-	132
Total differences	**(14,224)**	**13,468**	**(187)**	**811**	**132**

Differences between statutory and RAG definitions	Cash generated from operations £000	Net cash generated from operating activities £000	Net cash generated before financing activities £000	Increase/ (decrease) in net cash £000
Operating Profit as per Table 1A	(14,224)	(14,224)	(14,224)	(14,224)
Movement of Rental Income	521	521	521	521
Movement of Infrastructure Income	5,751	5,751	5,751	5,751
Movement of Contributions Income	1,378	1,378	1,378	1,378
Movement of developer contributions immediately recognised in income statement	5,818	5,818	5,818	5,818
Removal of Depreciation on Capitalised Interest	(187)	(187)	(187)	(187)
Inclusion of Pension Asset	811	811	811	811
Inclusion of Pension Contributions	132	132	132	132
Total differences	**-**	**-**	**-**	**-**

1E – NET DEBT ANALYSIS

AT 31 MARCH 2020

Interest rate risk profile	Fixed rate £000	Fixed rate £000	Index linked £000	Total £000
Borrowings (excluding preference shares)	346,229	150,000	570,384	1,066,613
Total borrowings				1,066,613
Cash				(12,981)
Net Debt				**1,053,632**
Gearing (%)				74.55
Adjusted Gearing (%)				-
Full year equivalent nominal interest cost	14,866	3,164	32,723	50,753
Full year equivalent cash interest payment	14,866	3,164	17,070	35,100
Indicative interest rates				
Indicative weighted average nominal interest rate (%)	4.29	2.11	5.74	4.76
Indicative weighted average cash interest rate (%)	4.29	2.11	2.99	3.29
Weighted average years to maturity	12	4	16	13

The total borrowings in the above table differs to the borrowings in table 1C as follows:

	£000
Short term borrowing per table 1C	30,000
Long term borrowing per table 1C	1,029,326
Total borrowings per table 1C	1,059,326
Removal of unamortised loan arrangement costs	7,287
Borrowing per table 1E above	**1,066,613**

1F – FINANCIAL FLOWS

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	%		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	5.56	3.68	5.56
Actual performance adjustment 2010-2015	0.09	0.06	0.09
Adjusted return on regulatory equity	5.65	3.74	5.65
Regulatory equity (£000)	441,280	441,280	291,777
Financing			
Gearing	-	1.63	1.63
Variance in corporation tax	-	0.23	0.35
Cost of debt	-	(0.01)	(0.03)
Financing total	5.65	5.59	7.61
Operational performance			
Totex out/(under) performance	-	(0.05)	(0.08)
ODI out/(under) performance	-	0.11	0.16
Retail out/(under) performance	-	1.14	1.73
Operational performance total	-	1.20	1.81
Total earnings	5.65	6.78	9.42
RCV growth from RPI inflation	2.59	2.59	2.59
Total shareholder return	8.24	9.37	12.01
Net dividend	4.00	0.55	0.84
Retained value	**4.24**	**8.82**	**11.17**
Dividends reconciliation			
Gross dividend	4.00	1.41	2.13
Interest received on intercompany loans	-	(0.85)	(1.29)
Net dividend	4.00	0.55	0.84

1F – FINANCIAL FLOWS continued

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	£000		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	24,535	16,223	16,223
Actual performance adjustment 2010-2015	397	263	263
Adjusted return on regulatory equity	24,392	16,485	16,485
Financing			
Gearing	-	4,768	4,768
Variance in corporation tax	-	1,024	1,024
Cost of debt	-	(60)	(73)
Financing total	24,932	22,217	22,204
Operational performance			
Totex out/(under) performance	-	(242)	(242)
ODI out/(under) performance	-	477	477
Retail out/(under) performance	-	5,040	5,040
Operational performance total	-	5,275	5,275
Total earnings	24,932	27,492	27,479
RCV growth from RPI inflation	11,429	11,429	7,557
Total shareholder return	36,361	38,922	35,036
Net dividend	17,651	2,439	2,439
Retained value	**18,710**	**36,483**	**32,597**
Dividends reconciliation			
Gross dividend	17,651	6,201	6,201
Interest received on intercompany loans	-	(3,762)	(3,762)
Net dividend	17,651	2,439	2,439

1F – FINANCIAL FLOWS continued

FOR THE 12 MONTHS ENDED 31 MARCH 2020

Actual returns and actual regulatory equity when compared to notional returns and notional regulatory equity show a difference on the retained shareholder return of 6.93 per cent. This is largely due to the differences between actual and notional gearing of 1.63 per cent and net dividend of 3.16 per cent along with an outperformance on retail of 1.73 per cent compared to the final determination.

The difference between the notional and actual gearing conveys the different structure of the company compared to the gearing level assumed by Ofwat. The actual gearing level of the company based on average net debt, calculated using the opening and closing net debt values for the year ending 31 March 2020 was 75.52 per cent. The assumed gearing ratio was 62.50 per cent. The variance in this, together with the difference between the allowed return on regulated equity and the allowed cost of debt results in a saving in financing on the average regulatory capital value of £4.8 million.

In the year net dividends paid were substantially lower than the notional value of £17.7 million, with gross dividends of £6.2 million being paid which are partially offset by interest received from South East Water Limited's parent company, South East Water (Holdings) Limited, on an intercompany loan of £3.8 million resulting in a net dividend payment of £2.4 million.

In addition to this the Company outperformed against its allowed household retail cost by £5.1 million. This was reduced slightly by an underperformance on allowed non-household retail costs of £0.1 million, resulting in an overall outperformance on retail costs of £5.0 million. This represents a benefit of 1.73 per cent on the Company's actual regulatory equity base.

1F – FINANCIAL FLOWS AVERAGE FOR AMP6

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	%		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	5.62	3.27	5.62
Actual performance adjustment 2010-2015	0.15	0.09	0.15
Adjusted return on regulatory equity	5.77	3.36	5.77
Regulatory equity (£000)	424,524	424,524	246,974
Financing			
Gearing	-	2.18	2.18
Variance in corporation tax	-	0.10	0.17
Cost of debt	-	(0.62)	(1.37)
Financing total	5.77	5.01	6.75
Operational performance			
Totex out/(under) performance	-	0.80	1.37
ODI out/(under) performance	-	(0.02)	(0.04)
Retail out/(under) performance	-	1.10	1.90
Other exceptional items	-	0.37	0.64
Operational performance total	-	2.25	3.87
Total earnings	5.77	7.26	10.62
RCV growth from RPI inflation	2.52	2.52	2.52
Total shareholder return	8.29	9.78	13.14
Net dividend	4.00	1.81	3.11
Retained value	**4.29**	**7.97**	**10.03**
Dividends reconciliation			
Gross dividend	4.00	2.82	4.84
Interest received on intercompany loans	-	(1.00)	(1.73)
Net dividend	4.00	1.81	3.11

1F – FINANCIAL FLOWS AVERAGE FOR AMP6 continued

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	%		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Return on regulatory equity	23,858	13,880	13,880
Actual performance adjustment 2010-2015	637	370	370
Adjusted return on regulatory equity	24,495	14,250	14,250
Financing			
Gearing	-	5,374	5,374
Variance in corporation tax	-	427	427
Cost of debt	-	(2,651)	(3,376)
Financing total	24,495	17,400	16,675
Operational performance			
Totex out/(under) performance	-	3,377	3,377
ODI out/(under) performance	-	(88)	(88)
Retail out/(under) performance	-	4,686	4,686
Other exceptional items	-	1,583	1,583
Operational performance total	-	9,558	9,558
Total earnings	24,495	26,958	26,233
RCV growth from RPI inflation	10,698	10,698	6,224
Total shareholder return	35,193	37,656	32,457
Net dividend	16,981	7,689	7,689
Retained value	**18,212**	**29,967**	**24,768**
Dividends reconciliation			
Gross dividend	16,981	11,955	11,955
Interest received on intercompany loans	-	(4,266)	(4,266)
Net dividend	16,981	7,689	7,689

Actual returns and actual regulatory equity when compared to notional returns and notional regulatory equity for the AMP show a difference on the retained shareholder return of 5.74 per cent. This is largely due to the difference between actual and notional gearing of 2.18 per cent coupled with outperformances on totex and retail of 1.37 per cent and 1.90 per cent respectively compared to the final determination.

The difference between the notional and actual gearing conveys the different structure of the Company compared to the gearing level assumed by Ofwat. The variance between the actual average gearing and the notional gearing ratio of 62.50 per cent assumed by Ofwat, coupled with the difference between the allowed return on regulated equity and the allowed cost of debt results in an average saving in financing on the average regulatory capital value of £5.4 million over the AMP.

The average outperformance on Totex over the four year period from 1 April 2015 to 31 March 2019 equated to £3.4 million which represents 1.37 per cent of the Company's average actual regulatory equity base for the same period. Calculated over the same period, the average outperformance on Retail equated to £4.7 million representing a benefit of 1.90 per cent on the Company's average actual regulatory equity base.

2A – SEGMENTAL INCOME STATEMENT

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Retail		Wholesale			Total
	Household	Non-household	Water Resources	Water Network+	Wholesale Total	
	£000	£000	£000	£000	£000	£000
Revenue – price control	21,749	(28)		207,484	207,484	229,205
Revenue – non-price control	-	-		1,258	1,258	1,258
Operating Expenditure	(18,563)	(85)	(14,592)	(80,286)	(94,878)	(113,526)
Depreciation – tangible fixed assets	(27)	(11)	(7,979)	(46,460)	(54,439)	(54,477)
Other operating income	-	-	-	50	50	50
Operating profit/(loss) before recharges	3,159	(124)			59,475	62,510
Operating profit/(loss)	**3,159**	**(124)**			**59,475**	**62,510**

At the point at which we exited the non-household retail market on 1 May 2018, transferring our non-household retail business to Invicta Water Limited, one of our group companies which was then later sold by the group to Castle Water Ltd, all customer accounts were invoiced up to the 30 April 2018. In instances where no meter read was available to bill up to the point of exit, the meter readings were estimated based on the customer's average consumption.

During the year, on receiving corrective meter readings, a number of non-household customer's bills were adjusted in order to reimburse the over-estimation of bills at the point at which we exited the non-household retail market. These reimbursements have led to negative revenue of £0.028 million in the year as reported in the table above, in respect of the non-household retail business.

2B – TOTEX ANALYSIS – WHOLESALE WATER ONLY

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Water Resources £000	Water Network+ £000	Total £000
Operating expenditure			
Power	5,173	12,956	18,129
Abstraction charges/discharge consents	2,892	177	3,069
Bulk supply/bulk discharge	943	4,606	5,549
Other operating expenditure:	4,647	45,228	49,875
Other operating expenditure excluding renewals	937	16,843	17,780
Local authority and Cumulo rates			
Total operating expenditure excluding third party services	14,592	79,810	94,402
Third party services	-	476	476
Total operating expenditure	14,592	80,286	94,878
Capital expenditure			
Maintaining the long term capability of the assets – infra	-	21,827	21,827
Maintaining the long term capability of the assets – non-infra	1,566	35,363	36,929
Other capital expenditure – infra	242	16,723	16,965
Other capital expenditure – non-infra	6,211	15,269	21,480
Infrastructure network reinforcement	-	3,525	3,525
Total gross capital expenditure (excluding third party)	8,019	92,707	100,726
Total gross capital expenditure	8,019	92,707	100,726
Grants and contributions			
Grants and contributions	-	(13,044)	(13,044)
Totex	22,611	159,949	182,560
Cash expenditure			
Pension deficit recovery payments	562	3,392	3,954
Totex including cash items	**23,173**	**163,341**	**186,514**

2C – OPERATING COST ANALYSIS – RETAIL

HOUSEHOLD

Overall expenditure for household retail remains below final determination (FD) expectations, with total operating costs (excluding third party services) at £18.6 million versus an FD of £20.7 million. However, household retail cost has increased from the previous period which was £15.91 million. This is primarily a consequence of the doubtful debt provision increasing by £2.7 million from £1.7 million to £4.4 million. The majority of the additional charge is due to an increase in the level of our older debt (£2.0 million), with a further £0.7 million having been provided as additional expected credit loss relating to the Covid-19 bad debt risk. The impact has therefore led to cost to serve increasing from the previous period, the table below provides a comparison versus the previous period and FD expectations.

Cost to serve	2019/20 Actual £	2018/19 Actual £	2019/20 FD £
Unmeasured	19.36	16.13	18.71
Measured	21.59	18.87	24.50

NON-HOUSEHOLD

Overall expenditure for non-household retail is £0.1 million. A release of £0.2 million has been adjusted for to recognise the better than expected cash receipts in 2019/20 for the retail non-household legacy debt. We also continue to record service to developer costs to non-household.

	Household £000	Non-household £000	Total £000
Operating expenditure			
Customer services	6,308	-	6,308
Debt management	355	-	355
Doubtful debts	4,421	(211)	4,210
Meter reading	831	-	831
Service to developers	-	296	296
Other operating expenditure	6,648	-	6,648
Total operating expenditure excluding third party services	18,563	85	18,648
Total operating expenditure	18,563	85	18,648
Depreciation – tangible fixed assets	27	11	38
Total operating costs	**18,590**	**96**	**18,686**
Debt written off	2,565	(3)	2,562

2D – HISTORIC COST ANALYSIS OF FIXED ASSETS – WHOLESALE & RETAIL

	Wholesale		Retail		Total
	Water Resources £00	Water Network+ £000	Household £000	Non-household £000	£000
Cost					
At 1 April 2019	123,792	1,649,671	6,350	1,663	1,781,476
Disposals	-	(1,654)	-	-	(1,654)
Additions	8,019	92,707	914	-	101,640
At 31 March 2020	131,811	1,740,724	7,264	1,663	1,881,462
Depreciation					
At 1 April 2019	(33,871)	(196,400)	(115)	(46)	(230,432)
Disposals	-	1,541	-	-	1,541
Charge for the year	(7,979)	(46,460)	(27)	(11)	(54,477)
At 31 March 2020	(41,850)	(241,319)	(142)	(57)	(283,368)
Net book amount at 31 March 2020	89,961	1,499,405	7,122	1,606	1,598,094
Net book amount at 1 April 2019	89,921	1,453,271	6,235	1,617	1,551,044
Depreciation charge for year					
Principal services	(7,979)	(46,460)	(27)	(11)	(54,477)
Total	**(7,979)**	**(46,460)**	**(27)**	**(11)**	**(54,477)**

The net book value includes £57.0 million in respect of assets in the course of construction.

2E – ANALYSIS OF CAPITAL CONTRIBUTIONS AND LAND SALES – WHOLESALE

	Fully recognised in income statement £000	Capitalised and amortised (in income statement) £000	Fully netted off capex £000	Total £000
Grants and contributions – water				
Connection charges	5,819	-	-	5,819
Infrastructure charge receipts	5,751	-	-	5,751
Requisitioned mains	-	819	-	819
Other contributions (price control)	-	142	-	142
Diversions	-	513	-	513
Total	**11,570**	**1,474**		**13,044**
Value of adopted assets	-	-		-

There were no assets adopted during the year.

Movements in capitalised grants and contributions	Water £000
Balance sheet	
Brought forward	4,637
Capitalised in the year	1,474
Amortisation (in income statement)	(1,210)
Carried forward	**4,901**
Land sales	
Proceeds from disposals of protected land	-

There were no sales of protected land during the year.

2F – HOUSEHOLD REVENUE BY CUSTOMER TYPE

	Wholesale charges revenue £000	Retail revenue £000	Total revenue £000	Number of customers 0	Average household retail revenue per customer £
Unmeasured water only customer	18,069	1,769	19,838	89,327	20
Measured water only customer	143,745	19,980	163,725	779,618	26
Total	**161,814**	**21,749**	**183,563**	**868,945**	**25**

2G – NON-HOUSEHOLD WATER – REVENUE BY TARIFF TYPE

	Wholesale charges revenue £000	Retail revenue £000	Total revenue £000	Number of connections 0	Average non-household retail revenue per connection £
Total non-default tariffs	-	-	-	-	-
Default tariffs					
Potable water – unmetered	961	(1)	960	2,074	-
Potable water – metered 0 to 2.5 Ml/a	20,942	(27)	20,915	40,944	(1)
Potable water – metered 2.5 to 5 Ml/a	6,029	-	6,029	1,056	-
Water supplies 5 to 50 Ml	12,417	-	12,417	696	-
Water supplies 50 Ml and over	5,321	-	5,321	36	-
Total default tariffs	45,670	(28)	45,642	44,806	(1)
Total	**45,670**	**(28)**	**45,642**	**44,806**	**(1)**

	Number of customers 0	Average non-household retail revenue per customer £
Revenue per customer		
Total	44,806	(1)

2G – NON-HOUSEHOLD WATER – REVENUE BY TARIFF TYPE continued

In the year, we identified an error within our reporting of the non-household number of connections in 2018/19. The values reported for both unmetered and metered 0 to 2.5 Ml/a were overstated as a result of our use of the "count" function within the MOSL settlement reports. Analysis identified duplications of properties within the report which overstated the average number of connections in the year. The effect of this error on our reporting in 2018/19 is detailed within the table below.

		2018/19 Reported values		2018/19 Corrected values	
	Retail revenue £m	Number of connections 0	Average non-household retail revenue per connection £	Number of connections 0	Average non-household retail revenue per connection £
Potable water – unmetered	0.009	3,856	2	2,211	4
Potable water – metered 0-2.5 Ml/a	(0.332)	43,952	(8)	43,255	(8)

2I – REVENUE ANALYSIS AND WHOLESALE CONTROL RECONCILIATION

The wholesale revenue for 2019/20 is lower than allowed revenue in the Final Determination (FD) and is due to lower consumption and lower non-household properties experienced in the year due to the actual phasing of the new non-household properties being behind that forecast in the FD. During the year we have seen an increase in the number of non-household properties changed to vacant status by the retailer in the non-household market. We have also seen a reduction in consumption as a result of Covid-19.

This is part offset by an additional number of new connections and higher infrastructure income compared to the FD.

The table below reconciles the allowed and actual wholesale revenues.

	£000
Allowed revenue for the year	231,339
Reduction due to lower consumption	(9,013)
Reduction due to mix of properties	(6,184)
Increase due to new connections	1,693
Increase due to infrastructure income	3,021
Reduction due to capital contributions	(841)
Actual revenue for the year	220,015

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.

2I – REVENUE ANALYSIS AND WHOLESALE CONTROL RECONCILIATION continued

	Household £000	Non-household £000	Total £000
Wholesale charge – water			
Unmeasured	18,069	961	19,030
Measured	143,745	44,709	188,454
Wholesale total	161,814	45,670	207,484
Retail revenue			
Unmeasured	1,769	(1)	1,768
Measured	19,980	(27)	19,953
Retail total	21,749	(28)	21,721
Principal services – non-price control			
Other appointed revenue			1,258
Total appointee revenue			**230,463**

	Water £000
Wholesale revenue governed by price control	207,484
Grants & contributions	12,531
Total revenue governed by wholesale price control	220,015
Amount assumed in wholesale determination	225,366
Adjustment for WRFIM	5,974
Total assumed revenue	231,340
Difference	**(11,325)**

2J – INFRASTRUCTURE NETWORK REINFORCEMENT COSTS

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Network reinforcement capex £000	On site / site specific capex (memo only) £000
Wholesale water network+ (treated water distribution)		
Distribution and trunk mains	3,483	13,470
Pumping and storage facilities	42	-
Other	-	758
Total	**3,525**	**14,228**

2K – NEW CONNECTIONS – INFRASTRUCTURE CHARGES RECONCILIATION

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Water £000
Impact of infrastructure charge discounts	
Infrastructure charges	5,751
Discounts applied to infrastructure charges	-
Gross infrastructure charges	5,751
Comparison of revenue and costs	
Variance brought forward	1,144
Revenue	5,751
Costs	(3,525)
Variance carried forward	**3,370**

Across the south east we have a high number of new developments and based on data from Government and local planning authorities this is expected to continue over the next 25 years. As a large proportion of our network is already distributing water at its maximum capacity, particularly during peak demands, we have to charge developers for offsite reinforcement work to ensure our existing customers and associated network are not negatively affected. When a developer applies for new connections we carry out detailed modelling to understand the effect on the existing network and identify areas that require reinforcement. All of our schemes are then planned and completed on a risk based approach to avoid impacting our existing customers but to deliver a quality supply to our new customers.

We receive the infrastructure charge from developers when they apply for new connections to our network, but due to a number of constraints the work required may not always be carried out in the same financial year. On many of our schemes we have to consider environmental impacts and plan in the mitigation to protect and enhance the local biodiversity and this can mean a number of species surveys which are only carried out at certain times of the year. Where environmental concerns arise the schemes often have to be delivered during times that least impact the local environment and this can be outside of the financial year in which the contribution was received. Another reason for the difference is highways approvals to deliver schemes, particularly along busy roads or where other utility works are already planned. A number of schemes have to be delivered during school holidays; particularly longer schemes which are only allowed in summer holidays; leaving a short window to deliver the schemes and often pushing them into the next financial year.

As our schemes are planned and completed using a risk based approach we know some of the lower risk schemes with a longer build programme can be moved in the programme to accommodate the higher risk schemes and therefore they may fall outside of the financial year in which the payment was received. There are also some schemes which were not yet completed in the 2019/20 financial year and therefore a proportion of the costs will be reported in future years.

Although there is approximately a £3.4 million difference between the revenue earnt from the charges and the actual costs of delivering the work for the financial year, the work associated with the charges will be delivered in subsequent years to ensure our network continues to provide a reliable service to all of our customers. Also included in the variance is infrastructure charges owed for previous years. Any variance for in year infrastructure will be taken into account when calculating the five year rolling average moving forward.

3A – OUTCOME PERFORMANCE SUMMARY

The following table shows the performance against the company's 25 outcomes for 2019/20.

2019/20 PERFORMANCE

For commentary on our performance for the year please see our 2019/20 Performance, People and Planet report **southeastwater.co.uk/performance**

For performance commitment J1: Number of breaches of abstraction licences, discharge consents and environmental permits we have reported 21 breaches compared to 11 the previous year. This is broken down as one annual abstraction breach, four discharge consent breaches and 16 daily abstraction breaches.

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.

2019/20 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.

2019/20 OUTPERFORMANCE PAYMENT OR UNDERPERFORMANCE PAYMENT – ODIs PAYABLE AT THE END OF AMP6

Where in-year performance is better than target and above the outperformance payment deadband 'outperformance payment' has been selected and the accrued amount has been added in to the adjacent column.

Where in-year performance is worse than target and above the underperformance penalty deadband 'underperformance penalty' has been selected and the accrued amount has been added in to the adjacent column.

Where in-year performance is within the dead bands either 'outperformance payment deadband' or 'outperformance penalty deadband' is selected, the adjacent column is then blank.

For service incentive mechanism (SIM) underperformance penalty has been calculated by Ofwat during the PR19 Final Determination and is not included in this table.

If the measure is a reputational performance commitment 'Not applicable' has been selected and the adjacent column is blank.

This financial year we have accrued £0.098 million underperformance penalty for our customer satisfaction performance measures. Performance has remained stable from last year in all measures except satisfaction with taste and odour of water where there has been an improvement. Satisfaction with the level of water restrictions has incurred an outperformance payment of £0.048 million. A company wide effort is being made to improve these scores but maintaining a stable score recognises that we are continually improving to meet rising customer expectations.

In 2019/20, we have achieved a leakage performance of 86.4 Ml/d compared to a leakage target of 88.1 Ml/d equating to a reward of £0.220 million. This has been achieved by improvements in our leakage programme, including investment in the latest technology and increases in the number of technicians.

We have incurred a £0.266 million outperformance payment for ending the year below our target for interruptions to customers' water supply in 2019/20. Our overall interruption performance for the year was 10.0 minutes against a target of 12.0 minutes.

We received a £0.013 million outperformance payment due to maintaining the number of properties at risk of low pressure in our region due to continual investment in schemes which will affect these properties.

In 2019/20 we received an outperformance payment of £0.075 million for our discolouration contacts performance commitment. We have achieved 0.53 contacts per 1,000 population compared to a target of 0.58. This is a 55 per cent reduction from 2014/15.

3A – OUTCOME PERFORMANCE SUMMARY

Performance commitment	2018/19 performance level – actual	2019/20 performance level – actual	2019/20 PCL met?
WHOLESALE PERFORMANCE			
A1: Customer satisfaction – appearance of water	4.5	4.5	No
B1: Customer satisfaction – taste and odour of water	4.2	4.3	Yes
C1: Customer satisfaction – level of leakage	3.6	3.6	No
C2: Leakage (actual reported leakage per Ml/d per year)	86.9	86.4	Yes
D1: Customer satisfaction – direct interaction experience	4.3	4.3	No
D2: Service Incentive Mechanism (SIM)	85.4	78.4	No
E1: Customer satisfaction – bills are value for money and affordable	73%	74%	No
F1: Customer satisfaction – water supply is of sufficient pressure	4.3	4.3	No
F2: Number of properties at risk of low pressure, as recorded on the DG2 register	47	25	Yes
G1: Customer satisfaction – frequency and duration of supply interruptions	4.6	4.6	No
G2: Average time lost per property (measured in minutes, per property served)	14.2	10.0	Yes
H1: Customer satisfaction – frequency of water use restrictions	4.4	4.4	Yes
H2: Meeting the water resource deficit	-	-	Yes
I1: Mean zonal compliance (MZC)	99.98%	99.96%	No
J1: Number of breaches of abstraction licences, discharge consents and environmental permits	11	21	No
J2: Number of pollution incidents (category 1-2)	1	3	No
K1: Number of breaches of health and safety regulations, as defined by the Health and Safety Executive	-	-	Yes
L1: Number of breaches of National Security obligations (Security and Emergency Measures Direction)	-	-	Yes
M1: Number of compliance breaches with statutory obligations and licence conditions, not already reported in performance on outcomes I through to K	1	-	Yes
N1: Discolouration contacts	0.59	0.53	Yes
N2: Above ground asset performance assessment	Stable	Stable	Yes
N3: Number of company sites at risk of flooding	2	-	Yes
N4: Water mains bursts	2,826	2,289	Yes
O1: Kg of carbon emissions per customer per year	36.3	35.9	Yes
O2: We will monitor our abstractions at low flows at environmentally sensitive sites (in line with AIM)	-0.10	-0.27	Yes

3A – OUTCOME PERFORMANCE SUMMARY continued

Performance commitment	2019/20 outperformance payment or underperformance payment payable at the end of AMP6	2019/20 outperformance payment or underperformance payment payable at the end of the AMP6 £m
WHOLESALE PERFORMANCE		
A1: Customer satisfaction – appearance of water	Underperformance payment deadband	-
B1: Customer satisfaction – taste and odour of water	-	-
C1: Customer satisfaction – level of leakage	Underperformance payment	(0.0777)
C2: Leakage (actual reported leakage per Ml/d per year)	Outperformance payment	0.2205
D1: Customer satisfaction – direct interaction experience	Underperformance payment	(0.0016)
D2: Service Incentive Mechanism (SIM)	-	-
E1: Customer satisfaction – bills are value for money and affordable	-	-
F1: Customer satisfaction – water supply is of sufficient pressure	Underperformance payment	(0.0243)
F2: Number of properties at risk of low pressure, as recorded on the DG2 register	Outperformance payment	0.0133
G1: Customer satisfaction – frequency and duration of supply interruptions	Outperformance payment deadband	-
G2: Average time lost per property (measured in minutes, per property served)	Outperformance payment	0.2660
H1: Customer satisfaction – frequency of water use restrictions	Outperformance payment	0.0432
H2: Meeting the water resource deficit	-	-
I1: Mean zonal compliance (MZC)	Underperformance payment deadband	-
J1: Number of breaches of abstraction licences, discharge consents and environmental permits	-	-
J2: Number of pollution incidents (category 1-2)	-	-
K1: Number of breaches of health and safety regulations, as defined by the Health and Safety Executive	-	-

3A – OUTCOME PERFORMANCE SUMMARY continued

Performance commitment	2019/20 outperformance payment or underperformance payment payable at the end of AMP6	2019/20 outperformance payment or underperformance payment payable at the end of the AMP6 £m
WHOLESALE PERFORMANCE continued		
L1: Number of breaches of National Security obligations (Security and Emergency Measures Direction)	-	-
M1: Number of compliance breaches with statutory obligations and licence conditions, not already reported in performance on outcomes I through to K	-	-
N1: Discolouration contacts	Outperformance payment	0.0750
N2: Above ground asset performance assessment	-	-
N3: Number of company sites at risk of flooding	-	-
N4: Water mains bursts	-	-
O1: Kg of carbon emissions per customer per year	-	-
O2: We will monitor our abstractions at low flows at environmentally sensitive sites (in line with AIM)	-	-

3A – OUTCOME PERFORMANCE SUMMARY continued

Performance commitment	2018/19 performance level – actual	2019/20 performance level – actual	2019/20 PCL met?
HOUSEHOLD RETAIL PERFORMANCE			
A1: Customer satisfaction – appearance of water	4.5	4.5	No
B1: Customer satisfaction – taste and odour of water	4.2	4.3	Yes
C1: Customer satisfaction – level of leakage	3.6	3.6	No
D1: Customer satisfaction – direct interaction experience	4.3	4.3	No
D2: Service Incentive Mechanism (SIM)	85.4	78.4	No
E1: Customer satisfaction – bills are value for money and affordable	73%	74%	No
F1: Customer satisfaction – water supply is of sufficient pressure	4.3	4.3	No
G1: Customer satisfaction – frequency and duration of supply interruptions	4.6	4.6	No
H1: Customer satisfaction – frequency of water use restrictions	4.4	4.4	Yes

Performance commitment	2019/20 outperformance payment or underperformance payment payable at the end of AMP6	2019/20 outperformance payment or underperformance payment payable at the end of the AMP6 £m
HOUSEHOLD RETAIL PERFORMANCE		
A1: Customer satisfaction – appearance of water	Underperformance payment deadband	-
B1: Customer satisfaction – taste and odour of water	-	-
C1: Customer satisfaction – level of leakage	Underperformance payment	(0.0333)
D1: Customer satisfaction – direct interaction experience	Underperformance payment	(0.0064)
D2: Service Incentive Mechanism (SIM)	-	-
E1: Customer satisfaction – bills are value for money and affordable	-	-
F1: Customer satisfaction – water supply is of sufficient pressure	Underperformance payment	(0.0027)
G1: Customer satisfaction – frequency and duration of supply interruptions	Outperformance payment deadband	-
H1: Customer satisfaction – frequency of water use restrictions	Outperformance payment	0.0048

3B – SUB-MEASURE PERFORMANCE

Unique ID	PC / sub-measure ID	PC / sub-measure	2018/19 performance level – actual	2019/20 performance level – actual	2019/20 PCL met?
PR14SEWWSW_N2	00	N2: Above ground asset performance assessment	Stable	Stable	Yes
PR14SEWWSW_N2	01	WTW coliforms non-compliance	0.04	0.03	Yes
PR14SEWWSW_N2	02	Service reservoir coliforms non-compliance	-	-	Yes
PR14SEWWSW_N2	03	Turbidity non-compliance	-	1	Yes
PR14SEWWSW_N2	04	Enforcement incidents	-	-	Yes

3C – AIM (ABSTRACTION INCENTIVE MECHANISM)

Abstraction site	2019/20 AIM performance (ML)	2019/20 normalised AIM performance	Cumulative AIM performance 2016/17 onwards (ML)	Cumulative normalised AIM performance 2016/17 onwards	Contextual information relating to AIM performance
Windmill Hill	(36.4)	(0.14)	(184.4)	(0.57)	-
Kingston	(8.5)	(0.13)	(92.5)	(0.21)	-
Total	**(44.9)**	**(0.27)**	**(276.9)**	**(0.78)**	**-**

3D – SIM (SERVICE INCENTIVE MECHANISM) SCORE

SIM Score	Score
Qualitative SIM score	
1st survey score	4.10
2nd survey score	4.16
3rd survey score	4.26
4th survey score	4.24
Qualitative SIM score (out of 75)	59.81
Quantitative SIM score	
Total contact score	19.15
Quantitative SIM score (out of 25)	18.62
Total annual SIM Score (out of 100)	**78.43**

4A – NON-FINANCIAL INFORMATION

for the 12 months ended 31 March 2020

Retail – household	Unmeasured 000	Measured 000
Number of void households	4.230	19.427
Per capita consumption (excluding supply pipe leakage) l/h/d	213.83	138.72

Wholesale	Water
Volume (Ml/d)	
Bulk supply export	-
Bulk supply import	56.560
Distribution input	521.496

4B – WHOLESALE TOTEX ANALYSIS

At the beginning of the AMP6 Period we set up a new team whose focus was on efficient delivery of the capital programme. The programme definition and optimisation team (PDOT) was challenged with identifying significant savings over the five year period. The focus of their work includes:-

- working with the supply chain to identify innovation
- profiling the programme so that our supply partners could deliver the programme more efficiently
- identifying alternative approaches to dealing with complex problems
- providing better information to our supply chain earlier to help them with their resource management
- reviewing our standards to see if alternative approaches provide the same outcome without impacting on risk

In addition to this, we have found further efficiencies by reviewing some of our key strategies. An example being our leakage strategy, where we have spent additional money in the AMP, which has reduced leakage and allowed us to defer a £4.0 million water resources scheme from the programme. This water resources scheme had potential environmental impacts.

Our engineering and assets teams have developed new contracts with the supply chain, incentivising them on efficiency targets. For instance Jacobs, our delivery partner, is incentivised on OPEX as well as CAPEX, ensuring we optimise TOTEX.

We have made efficiency savings in our domestic metering programme and have delivered the metering plan set out in both our water resources management plan (WRMP) and business plan.

Expenditure for 2019/20 has seen us deliver our SOSI regulated commitments such as SEMD, DWI and SOSI projects and also refurbishments of water treatment works and water mains.

	Current Year Water £000	Cumulative 2015-20 Water £000
Actual totex		
Actual totex	186,514	856,076
Less: Items excluded from the menu		
Third party costs	476	2,025
Pension deficit recovery payments	3,954	17,301
Other 'Rule book' adjustments	120	2,543
Total items excluded from the menu	4,550	21,869
Adjusted actual totex		
Adjusted actual totex	181,964	834,207
Adjusted actual totex base year prices	153,185	742,203
Allowed totex		
Allowed totex based on final menu choice – base year prices	148,400	776,700

4C – IMPACT OF AMP PERFORMANCE TO DATE ON RCV

TABLE CONTENT SUMMARY

This table tracks year on year changes to the regulatory capital value (RCV) and reports a 'shadow' RCV as a result of actual totex and any ODI adjustments.

BACKGROUND AND PURPOSE

This information is intended to show the rolling impact on the RCV of changes in investment activity relative to the determination and ODI performance over the year.

TABLE COMPLETION METHODOLOGY

Key inputs to the table and their sources are summarised in the table below: Some of the methodologies require some choices which are discussed further in the following section.

Line	Description	Source data and analysis
4C.1	Cumulative totex over/underspend so far in the price control period	This line is calculated as the difference between the actual totex (4B L8) and the baseline totex (4B L9) (at base year prices) inflated to current year prices using the actual RPI.
4C.2	Customer share of cumulative totex over/underspend	The customer share of the cumulative totex over/underspend is 50 per cent as per the baseline menu choice.
4C.3	RCV element of customer share of cumulative totex over/underspend	The RCV element of customer share of cumulative totex over/underspend is calculated using the totex menu reconciliation model issued by Ofwat as part of the FD19. The cumulative totex over/underspend from line 4C.1 is entered into the model along with the baseline of 100 from our final menu choice. The model applies an adjustment for the time value of money (WACC) and takes into account the movement from the implied menu choice (103.1) to the actual menu choice (100.0). The RCV adjustment is then inflated to outturn using the issued RPI of 292.6.
4C.4	Adjustment for ODI rewards or penalties	The 2015 to 2020 cumulative ODI adjustment has been included. These are end of period adjustments.
4C.5	RCV determined at FD at 31 March	RCV at 31 March 2020 as reported in Ofwat's published RCV-PR14_2020 Regulatory Capital Values document. £1,413.237m.

TABLE COMPLETION METHODOLOGY DISCUSSION

The line definitions specify that the RCV is to be inflated to March 2020 using the March RPI. This correctly reports the RCV at a 'year end' position.

4C – IMPACT OF AMP PERFORMANCE TO DATE ON RCV continued

Our year by year PAYG ratio reported in table A2.5 of our FD company specific appendix (p26) is given below:

FD TABLE A2.5 SOUTH EAST WATER'S WHOLESALE WATER PAYG RATES (P26)

2015/16	2016/17	2017/18	2018/19	2019/20	Total
61.6%	58.2%	56.4%	59.7%	64.1%	59.9%

Ofwat guidance has specified that the weighted average PAYG ratio is to be used for this calculation.

The weighted average PAYG ratio is 59.9 per cent. This is consistent with the populated totex menu reconciliation model issued by Ofwat as part of the PR14 Rulebook and the final determination FD19.

TABLE CALCULATIONS

Line	Description	Unit		
	Price base RPI index		2012/13 av 244.7	Mar-20 y/e 292.6
4C.1	Cumulative totex over/underspend so far in the price control period (4B L8 – 4B L9 in outturn prices)	£000		(41,254)
4C.2	Customer share of cumulative totex over/underspend (4C L1 * 50%)	£000		(20,627)
4C.3	RCV element of customer share of cumulative totex over/underspend (calculated using the totex menu reconciliation model issued by Ofwat as part of FD19)	£000	(15,292)	(18,287)
4C.4	Adjustment for ODI rewards or penalties	£000	(273)	(327)
4C.5	RCV determined at FD at 31 March	£000		1,413,237
4C.6	Projected 'shadow' RCV	£000		1,394,623

CHANGES IN METHODOLOGY SINCE PRIOR YEARS

The model used for the calculation of the RCV element of cumulative totex overspend is the model published by Ofwat with the FD19 files. It has been adjusted for 2019/20 actual inflation and actual totex.

RISKS TO DATA ACCURACY AND ROBUSTNESS

None.

	Water £000
Cumulative totex over/underspend so far in the price control period	(41,254)
Customer share of cumulative totex over/underspend	(20,627)
RCV element of cumulative totex over/underspend	(18,287)
Adjustment for ODI outperformance payment or underperformance payment	(327)
RCV determined at FD at 31 March	1,413,237
Projected 'shadow' RCV	**1,394,623**

4D – WHOLESALE TOTEX ANALYSIS – WATER

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Water resources		Network+				
	Abstraction licences £000	Raw water abstraction £000	Raw water transport £000	Raw water storage £000	Water treatment £000	Treated water distribution £000	Total £000
Operating expenditure							
Power	-	5,173	125	-	1,589	11,242	18,129
Abstraction charges/ discharge consents	2,892	-	-	-	177	-	3,069
Bulk supply	-	943	-	-	4,606	-	5,549
Other operating expenditure							
Other operating expenditure excluding renewals	16	4,631	301	6	15,589	29,332	49,875
Local authority and Cumulo rates	-	937	194	212	1,417	15,020	17,780
Total operating expenditure excluding third party services	2,908	11,684	620	218	23,378	55,594	94,402
Third party services	-	-	-	-	-	476	476
Total operating expenditure	2,908	11,684	620	218	23,378	56,070	94,878
Capital expenditure							
Maintaining the long term capability of the assets – infra	-	-	38	-	155	21,634	21,827
Maintaining the long term capability of the assets – non-infra	-	1,566	-	-	13,575	21,788	36,929
Other capital expenditure – infra	-	242	10	-	74	16,639	16,965
Other capital expenditure – non-infra	3,180	3,031	-	-	13,875	1,394	21,480
Infrastructure network reinforcement	-	-	-	-	-	3,525	3,525
Total gross capital expenditure (excluding third party)	3,180	4,839	48	-	27,679	64,980	100,726
Total gross capital expenditure	3,180	4,839	48	-	27,679	64,980	100,726
Grants and contributions	-	-	-	-	-	(13,044)	(13,044)
Totex	6,088	16,523	668	218	51,057	108,006	182,560
Cash expenditure							
Pension deficit recovery payments	4	558	16	-	1,416	1,960	3,954
Totex including cash items	6,092	17,081	**684**	**218**	**52,473**	**109,966**	**186,514**

4D – WHOLESALE TOTEX ANALYSIS – WATER continued

FOR THE 12 MONTHS ENDED 31 MARCH 2020

Unit cost information (operating expenditure)	Licenced volume available	Volume abstracted	Volume transported	Average volume stored	Distribution input volume – water treatment	Distribution input volume – treated water
Total operating expenditure	2,908	11,684	620	218	23,378	56,070
Volume (Ml)	270,746.542	178,665.366	33,637.607	675.216	193,475.123	193,475.123
Unit cost (£/Ml)	10.741	65.396	18.432	322.860	120.832	289.805
Population (000's)	2,259.195	2,259.195	2,259.195	2,259.195	2,259.195	2,259.195
Unit cost (£/pop)	1.287	5.172	0.274	0.096	10.348	24.819

4F – OPERATING COST ANALYSIS – HOUSEHOLD RETAIL

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Household unmeasured water only £000	Household measured water only £000	Total £000
Operating expenditure			
Customer services	590	5,718	6,308
Debt management	37	318	355
Doubtful debts	457	3,964	4,421
Meter reading	-	831	831
Other operating expenditure	656	5,992	6,648
Total operating expenditure excluding third party services	1,740	16,823	18,563
Total operating expenditure	1,740	16,823	18,563
Depreciation – tangible fixed assets			
On assets existing at 31 March 2015	2	16	18
On assets acquired since 1 April 2015	1	8	9
Total operating costs	**1,743**	**16,847**	**18,590**
Capital expenditure	**94**	**820**	**914**

Other operating expenditure includes the net retail expenditure for the following retail activities which are part funded by wholesale:

Household	£000
Demand-side water efficiency – gross expenditure	259
Demand-side water efficiency – expenditure funded by wholesale	(196)
Demand-side water efficiency – net retail expenditure	**63**
Customer-side leak repairs – gross expenditure	1,443
Customer-side leak repairs – expenditure funded by wholesale	(916)
Customer-side leak repairs – net retail expenditure	**527**

4G – WHOLESALE CURRENT COST FINANCIAL PERFORMANCE

FOR THE 12 MONTHS ENDED 31 MARCH 2020

	Water £000
Revenue	208,742
Operating expenditure	(94,878)
Capital maintenance charges	(70,380)
Other operating income	50
Current cost operating profit	43,534
Other income	13,468
Interest income	4,675
Interest expense	(52,878)
Other interest expense	633
Current cost profit before tax and fair value movements	9,432
Fair value gain/(losses) on financial instruments	(2,713)
Current cost profit before tax	**6,719**

4H – FINANCIAL METRICS – RETURN ON REGULATED EQUITY

TABLE/LINE CONTENT SUMMARY

This parameter reports the return on regulated equity (RORE) which is a measure of the return to shareholders allowing for any out/(under) performance in the year.

BACKGROUND AND PURPOSE

RORE is a measure of the return to shareholders allowing for any out/(under) performance in the year primarily from:

- totex out/(under) performance (adjusted for RCV runoff)
- retail household costs out/(under) performance
- any reward/(penalty) from ODIs in the year
- debt financing costs out/(under) performance compared to the cost of debt set by Ofwat in the final determination
- the above are adjusted for the impact net of tax

RORE is referenced against the notional balance sheet and the allowed cost of equity in the WACC assumed by Ofwat in the final determination. For PR14 Ofwat set a notional gearing level for all companies of 62.50 per cent and a base return to equity of 5.60 per cent.

4H – FINANCIAL METRICS – RETURN ON REGULATED EQUITY continued

TABLE/LINE COMPLETION METHODOLOGY

The Ofwat line definition for RORE is given below.

Line	Description	Definition
5	RORE (return on regulatory equity)	RORE calculates the return on a regulatory basis by reference to the notional gearing level of 62.50 per cent for PR14 and average RCV for each year. Where a regulated business ceases to undertake a particular activity (e.g. exiting the non-household retail market), then a note should be included setting out how this has impacted on the RORE compared to the base RORE set at FD. The base RORE set at the final determination should be adjusted for the following factors net of any tax impact. 1) The company share of totex out or under performance. This should reflect genuine out or under performance only. Any totex over or underspend which is due to timing (i.e. re-profiling of expenditure within the AMP) should not be recognised as out or under performance for the purpose of the calculation of RORE. 2) The company share of any out or underperformance on retail costs. 3) The impact of any ODI or SIM outperformance payment or underperformance payment earned in the year, even if they are not payable/receivable until the following AMP. 4) The difference between the actual average interest rate paid on borrowings (in real terms) and the allowed interest rate (real) on notional debt. This should be calculated based on the notional capital structure i.e. difference in actual interest rate and allowed interest rate multiplied by notional net debt. When calculating the actual real interest rate paid from the actual nominal interest rate paid (nominal interest paid/average net debt) the actual year average inflation rate should be used to deflate the nominal rate to a real rate. 5) The impact of tax on the above should be calculated using the headline rate. RORE should be presented: • for the year under report • on an average basis (calculated as an arithmetic average of the annual figures in the AMP to date) and should recognise gains and losses made in the period from the start of the AMP to the date of the APR The Fisher equation should be used to translate from nominal to real interest rates; (1+n)=(1+r)*(1+i).

4H – FINANCIAL METRICS – RETURN ON REGULATED EQUITY continued

Key inputs to the calculation of RORE and the sources of data are summarised in the table below:

Line	Description
Base RORE	Base RORE is 5.60 per cent (source: Ofwat populated SEW FD RAT model) The base RORE is converted to £m for each year using the FD notional regulated equity using the regulatory notional balance sheet gearing of 62.50 per cent. Base RORE = RCV x (100.00%-62.50%) x 5.60%.
Totex out/(under) performance	The outperformance is calculated as: Adjusted actual totex – converted to base year prices (APR Table 4B Line 8) less the Allowed totex based on final menu choice – base year prices (SEW FD company specific report – Table A2.4 Line 6). This outperformance is adjusted for any re-profiling of expenditure over the AMP. This is adjusted for tax at the current rate.
Retail costs out/(under) performance	The outperformance is calculated as: Retail Household ("HH") – Actual retail HH costs (APR Table 2C Line 12) – outturn prices, less the Allowed retail HH costs (calculated as actual property numbers times the ACTS for measured and unmeasured properties from SEW FD company specific report – table A3.10 Lines 9&10) – outturn prices. The actual retail HH costs are adjusted to exclude any depreciation on assets existing at March 2015. The difference between allowed and adjusted actuals are converted to base year prices for consistency on inclusion in RORE. Retail Non-household ("NHH") – SEW's retail NHH business was sold on 30 April 2018. Any remaining costs are included here. Both items are adjusted for tax at the current rate.
RCV runoff on totex out/(under) performance	Calculated using the above out/(under) performance on totex and FD RCV runoff rates for new RCV expenditure additions.
Impact of ODI/ SIM penalties/ rewards in year	Although any reward/(penalty) from the ODIs are not due to be recovered from customers until the next price review, for the purposes of the RORE calculation the impact is considered in the year of occurrence. The net £m reward/(penalty) from ODIs is taken from SEW APR Table 3A. Items are adjusted for tax at the current rate.
Difference between actual interest charge (real terms) and allowed interest (real) on notional debt.	Allowed real interest rate comes from the Ofwat FD model for SEW. Actual interest costs on a nominal basis (excluding fees and bank charges) is taken from the P&L interest note supporting APR Table 1A. This is divided by the average net debt for the year. This actual nominal figure is converted to a real figure by using actual RPI in the fisher formula: (1+real) x (1+RPI) = (1+nominal). The difference between allowed and actual real interest (%) is multiplied by notional debt to generate a £m out/(under) performance on debt costs.
RORE (in year)	Sum of above in £m converted to % return on regulated equity.
RORE (cumulative)	A simple average of the in year and prior year RORE %'s.

4H – FINANCIAL METRICS – RETURN ON REGULATED EQUITY continued

SUMMARY CALCULATION

Calculation of RORE 2012/13 prices	Unit	2015/16	2016/17	2017/18	2018/19	2019/20
Year average RCV	£m	1,082.7	1,105.9	1,134.0	1,160.5	1,176.6
Notional gearing	%	62.50	62.50	62.50	62.50	62.50
Notional debt	£m	676.7	691.2	708.8	725.3	735.4
Regulatory equity	£m	406.0	414.7	425.3	435.2	441.2
Base RORE – appointee	%	5.60	5.60	5.60	5.60	5.60
Base case return	£m	22.7	23.2	23.8	24.4	24.7
Adjustments to base case return						
Company share of totex out/(under) performance	£m	1.9	4.7	6.7	0.4	(0.2)
Company share of out/(under) performance on retail costs	£m	1.0	2.3	2.7	2.4	1.4
Impact on RCV runoff of the out/(under) performance of totex	£m	-	(0.1)	(0.2)	(0.3)	(0.3)
Impact on ODI/SIM in year	£m	0.2	0.4	(1.4)	-	0.5
Difference between actual interest charge and allowed on notional debt	£m	(6.1)	(2.8)	1.6	(1.1)	2.4
Other	£m	-	-	-	7.6	(0.4)
Adjustments to base case return	£m	(3.1)	4.5	9.3	9.0	3.4
Adjusted return	£m	19.7	27.7	33.2	33.4	28.1
Regulatory equity	£m	406.0	414.7	425.3	435.2	441.2
Outturn annual RORE	%	4.84	6.68	7.80	7.67	6.38
Outturn cumulative RORE (arithmetic average)	%	4.84	5.76	6.44	6.75	6.67

4H – FINANCIAL METRICS – RETURN ON REGULATED EQUITY continued

COMMENTARY ON RESULTS

RORE for the year was 6.38 per cent compared to the base case RORE of 5.60 per cent. A breakdown of the RORE components is shown below.

Breakdown of RORE components	2015/16	2016/17	2017/18	2018/19	2019/20
Base RORE – appointee	5.60	5.60	5.60	5.60	5.60
1. Company share of totex out/(under) performance	0.46	1.13	1.58	0.10	(0.04)
2. Company share of out/(under) performance on retail costs	0.25	0.57	0.63	0.56	0.33
3. Impact on RCV runoff of the out/(under) performance of totex	-	(0.02)	(0.05)	(0.07)	(0.07)
4. Impact on ODI/SIM in year	0.04	0.09	(0.34)	(0.01)	0.11
5. Difference between actual interest charge and allowed on notional debt	(1.51)	(0.67)	0.37	(0.26)	0.53
6. Other	-	-	-	1.74	(0.08)
Outturn RORE	4.84	6.68	7.80	7.67	6.38

The outperformance on RORE for the year was primarily driven by outperformance on retail costs and debt costs. The improvement in the performance in debt costs was a result of a major refinancing of debt in the year.

RORE to date is 6.67 per cent, calculated on an arithmetic average basis. A breakdown of the RORE components is shown below.

Breakdown of RORE components	2015/16	2016/17	2017/18	2018/19	2019/20
Base RORE – appointee	5.60	5.60	5.60	5.60	5.60
1. Company share of totex out/(under) performance	0.46	0.79	1.06	0.82	0.64
2. Company share of out/(under) performance on retail costs	0.25	0.41	0.48	0.50	0.47
3. Impact on RCV runoff of the out/(under) performance of totex	-	(0.01)	(0.03)	(0.04)	(0.04)
4. Impact on ODI/SIM in year	0.04	0.06	(0.07)	(0.05)	(0.02)
5. Difference between actual interest charge and allowed on notional debt	(1.51)	(1.09)	(0.60)	(0.52)	(0.31)
6. Other	-	-	-	0.43	0.33
Outturn RORE	4.84	5.76	6.44	6.75	6.67

CHANGES IN METHODOLOGY SINCE PRIOR YEARS

We received a query from Ofwat after the submission of our 2018/19 APR relating to our treatment of exiting the non-household retail market (SEW-APR-FG-001).

In the line definition for 4H.26: Other factors, it states the following:

The total impact of any other factors, including the ongoing effect on earnings from cessation of activities. These factors should be described in a note to the table. Net proceeds from the disposal of such activities should be disclosed as a note to the table.

4H – FINANCIAL METRICS – RETURN ON REGULATED EQUITY continued

Firstly, there is an element that reduces base RORE as a result of exiting the market and no longer making a return on that business.

Secondly, there is an element from the profits on the disposal of the NHH retail business.

We provided an updated version of our RORE calculation and table 4H that takes into account these two elements of the RORE calculation. The figures above reflect that change.

RISKS TO DATA ACCURACY AND ROBUSTNESS

None.

4H – FINANCIAL METRICS

Financial Indicators	Current Year	AMP to date
Net debt (£m)	1,053.632	
Regulated equity (£m)	359.605	
Regulated gearing (%)	74.55	
Post tax return on regulated equity (%)	8.38	
RORE (return on regulated equity) (%)	6.38	6.67
Dividend yield (%)	0.81	
Retail profit margin – Household (%)	1.72	
Retail profit margin – Non-household (%)	(0.27)	
Credit rating	BBB	
Return on RCV (%)	5.36	
Dividend cover (dec)	3.33	
Funds from operations (FFO) (£m)	88.332	
Interest cover (cash) (dec)	3.52	
Adjusted interest cover (cash) (dec)	2.05	
FFO/Debt (dec)	0.08	
Effective tax rate (%)	3.66	
RCF (£m)	80.966	
RCF/capex (dec)	0.82	

4H – FINANCIAL METRICS continued

Revenues and earnings	Current year
Revenue (actual) (£m)	229.205
EBITDA (actual) (£m)	115.679

Movement in RORE	Current Year	AMP to date
Base return (%)	5.60	5.60
Totex out/(under) performance (%)	(0.11)	0.60
Retail cost out/(under) performance (%)	0.33	0.47
ODI out/(under) performance (%)	0.11	(0.02)
Financing out/(under) performance (%)	0.53	(0.31)
Other factors	(0.08)	0.33
Regulatory return for the year (%)	**6.38**	**6.67**

Borrowings	Current year
Proportion of borrowings which are fixed rate (%)	32.46
Proportion of borrowings which are floating rate (%)	14.06
Proportion of borrowings which are index linked (%)	53.48
Proportion of borrowings due within 1 year or less (%)	2.81
Proportion of borrowings due in more than 5 years but no more than 20 years (%)	71.31
Proportion of borrowings due in more than 20 years (%)	25.88

41 – FINANCIAL DERIVATIVES

	Nominal value by maturity (net) at 31 March 2020			Total Value at 31 March 2020	
	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Nominal value (net) £m	Mark to Market £m
Interest Rate Swap (sterling)					
Floating to fixed rate	-	-	-	-	-
Floating from fixed rate	-	-	-	-	-
Floating to index linked	-	-	-	-	-
Floating from index linked	-	-	-	-	-
Fixed to index linked	-	-	-	-	-
Fixed from index linked	-	-	-	-	-
Total	-	-	-	-	-
Other financial derivatives	-	-	-	-	-
Total financial derivatives	**-**	**-**	**-**	**-**	**-**

	Total accretion at 31 March 2020	Interest rate (weighted average for 12 months to 31 March 2020)	
	£m	Payable %	Receivable %
Interest Rate Swap (sterling)			
Floating to fixed rate	-	-	-
Floating from fixed rate	-	-	-
Floating to index linked	-	-	-
Floating from index linked	-	-	-
Fixed to index linked	-	-	-
Fixed from index linked	-	-	-
Total	-	-	-
Other financial derivatives	-	-	-
Total financial derivatives	**-**	**-**	**-**

RETIREMENT BEST WISHES

Paul Butler, Managing Director receives his award following 25 years' service. He is retiring this summer and we wish him all the best for the future