Annual Report and Financial Statements

For the year ended 31 March 2020

from
Southern Water®

Welcome to the Annual Report and Financial Statements 2019–20.

Ensuring water for life, together.

We provide essential water services to 2.6 million customers, and wastewater services to more than 4.7 million customers across Sussex, Kent, Hampshire and the Isle of Wight.

from Southern Water®

Delivering value to our stakeholders

Without water, life would be impossible, so Southern Water's stakeholder base is diverse.

- Communities
- Customers
- Employees
- Environment
- Regulators
- Suppliers

Read more about our **Section 172(1) statement** on pages 162 to 163

What we do and where we do it

We provide vital water and wastewater services to homes and businesses across the South East.

Read more on pages 02 to 03

Our purpose and strategic priorities

We provide water for life to enhance health and wellbeing, protect and improve the environment, and sustain the economy, in order to create a resilient water future for our customers.

Read more on pages 16 to 17

Our business plan 2020–25

We continue to transform our business to deliver our most challenging five-year plan yet, following a comprehensive consultation with our customers and stakeholders.

Read more on pages 36 to 39

Our approach to governance

We have a duty to take into account the interests of our stakeholders, including our customers, employees, suppliers, local communities and shareholders as well as the impact of our operations on the environment.

Read more on **our approach to governance** on pages 150 to 153

In this report

Registered office

Southern Water
Southern House, Yeoman Road
Worthing, West Sussex BN13 3NX

Registered no: 02366670

Navigating the report

Read more in this report

Read more online

What we do

Our purpose

We provide water for life to enhance health and wellbeing, protect and improve the environment, and sustain the economy

Key facts about our operations

Water

2.6
People served (millions)

1.1
Number of properties (millions)

985,774
Number of metered properties

542
Average daily water supply (millions of litres per day)

207
Number of service reservoirs

84
Number of water treatment works

13,959
Length of water mains (kilometres)

Wastewater

4.7
People served (millions)

2.0
Number of properties (millions)

745
Average daily wastewater recycled (millions of litres per day)

367
Number of wastewater treatment works

3,420
Number of pumping stations

39,872
Length of sewers (kilometres)

WATER for LIFE from Southern Water

Stakeholder engagement

To create a resilient water future, we must work with our stakeholders to co-imagine and co-create in all aspects of our process, and in any setting.

Read more on pages 46 to 47

2020–25 and beyond

Over the next five years, Southern Water is investing £3.2 billion across the region. This will create jobs, benefit the local environment and ensure the resilience of our water and wastewater networks.

Read more on pages 36 to 39

Where we do it

Creating a resilient water future for our customers in the South East

Traversing over 700 miles of coastline, national parks and forests, as well as numerous Areas of Outstanding Natural Beauty, our region is as diverse as the populations we serve. Each area presents its own resource and service challenges and opportunities as we plan for the future.

£800m

invested over the next 10 years in Hampshire alone

Hampshire

Balancing supply and demand while protecting river habitats is a key focus. We are investing £800 million over the next 10 years to make up supply deficits in the area, looking at desalination, water recycling, new pipelines from neighbouring water companies, reducing leakage and improving water efficiency.

Kent

We are accommodating large-scale growth, and at least two new garden towns, while also exploring opportunities to support longer-term sustainable approaches, such as water recycling. We continue to work hard to replace ageing sewers and Victorian infrastructure to protect homes and the environment.

2

new garden towns supplied in Kent

Isle of Wight

The island's bathing waters were the cleanest they have ever been this year with 12 rated at excellent and two at good. We have invested over £9 million to increase water supply capability and improve the wastewater screening process at Sandown. While a community outreach programme has improved engagement with more than 300 residents on the most remote parts of the island.

East and West Sussex

We are collaborating with local farmers and landowners to deliver improved water quality and innovative environmental solutions to our challenges. Through the Greater Brighton Infrastructure Panel, we are driving a step-change in economic and environmental resilience. To support growth in the Chichester area, we are investing in a 10km sewer pipeline running from west Chichester across the north of the city and through to west Tangmere.

12

excellent bathing waters on the Isle of Wight

10km

of new sewer pipeline for Chichester

Highlights and challenges

Read more about our **operational performance** on pages 62 to 99

Operational

Responsive customer service

Our performance 2019–20:

- Despite poor performance in pre-reporting for Ofwat's new C-MeX (customer satisfaction) measure, in 2019–20 we have worked towards our aims to improve the experience and service we deliver to our customers.
- The Consumer Council for Water has acknowledged our 'significant strides' to improve our service. However, we know we still have more work to do.
- In response to the COVID-19 pandemic, we changed our processes, making them quicker and easier for those customers needing help to pay their bills.

Moving into the next five-year period:

- C-MeX reporting starts April 2020.
- Improving our self-serve capability for customers by rebuilding our online portal.
- Helping our customers use their channel of choice.
- Simplifying our bill, working directly with our customers to meet their needs.

A constant supply of high-quality drinking water

Our performance 2019–20:

- We achieved 99.95% (2019: 99.98%) compliance with the Drinking Water Inspectorate's (DWI) water quality measures.
- Our leakage was above target at 94 Ml/d (2019: 102 Ml/d). Although an improvement, we missed our five-year target, incurring a penalty of £2.7 million. This was due to the extreme weather of 2018 and 2019. Since then we have seen a reduction of 15%, our commitment for 2020–25.
- We were able to limit the number of customers' properties at risk of experiencing low pressure to 203 in 2019–20, well below our target of 257.

Moving into the next five-year period:

- The DWI has introduced new compliance metrics: Compliance Risk Index (CRI) and Event Risk Index (ERI). These are weighted by population, so will better highlight risks to individual consumers. These new metrics will apply from 2020 onwards.
- We will continue our Catchment First programme, working with farmers and landowners to design and deliver solutions that address water quality at the source, which will deliver benefits to all parties.

Removing wastewater effectively

Our performance 2019–20:

- We reported 453 incidents of internal flooding in 2019–20 (2019: 389), meaning we missed our target of keeping these incidents below 392.
- We undertook a £34.5 million rehabilitation project of the century-old Thanet sewers. This was the second phase of a three-phase scheme to overhaul the area's sewer network.

Moving into the next five-year period:

- We will continue to work closely with the Environment Agency to provide regulator updates on our progress, in order to achieve better environmental outcomes.
- Our Pollution and Flooding Resilience team will continue its work to proactively define and deliver best-practice reduction programmes throughout our region.

Looking after the environment

Our performance 2019–20:

- Our Bathing Water Enhancement Programme (BWEP) continues to deliver results, with 62 bathing waters achieving excellent status, 56 against our target of 54 plus a further six improved by the BWEP.
- Our pollutions performance is unacceptable with seven serious (category one and two) and 427 less serious (category three) incidents*. We continue to invest in our systems and assets, £54 million in 2019–20, to improve this performance.

Moving into the next five-year period:

- We will be working with colleagues and our key environmental stakeholders to embed natural capital assessments and biodiversity 'net gain' as part of our overall approach.
- We will continue to deliver our Pollution Reduction Plan, which has around 50 separate actions under eight Critical Success Factors and has seen us improve our self reporting to 86.5% (2018: 83%); read more in the looking after the environment section on pages 91 to 99.

* As reported previously, we have identified a number of issues with spill data. The details of the steps taken, and that continue to be taken, to improve the robustness of the spill data collection, the data processing systems and the assurance of that data, have been shared with the Environment Agency and Ofwat. As those steps have not yet reached completion, the data supplied would continue to have an error band of up to 10%.

The outcome of Ofwat's investigation into our wastewater treatment works and an update to the ongoing Environment Agency prosecution and investigation are explained in more detail on page 27.

Better information and advice

Our performance 2019–20:

- While the number of unwanted customer contacts* about billing and account issues is still far too high, we are reviewing our end-to-end billing journey, including our C-MeX and complaint improvement plans.
- The amount of water our individual customers use continues to be among the lowest in the UK, at 126.5 litres per day. The national average is 144 litres per person, per day. Our performance over the five-year period in reducing consumption earned us a reward of £6.9 million.

Moving into the next five-year period:

- Through a combination of incentives, home visits and behaviour change campaigns, our Target 100 programme aims to help customers reduce their individual daily water consumption to 100 litres by 2040. In turn, this would reduce demand on our limited water resources in the South East.
- Our wastewater teams will continue to work with customers and local businesses to reduce the number of blockages and pollution incidents that impact our network and the local environment.

* Unwanted from a customer point of view.

Affordable bills

Our performance 2019–20:

- We continue to increase the number of customers on our various support schemes and tariffs, while working with our community partners to better identify those in vulnerable circumstances needing access to priority services. This became increasingly important as the COVID-19 crisis developed in early 2020.
- We continue to drive efficiency savings, transforming people, processes and systems, in order to help keep bills affordable for all of our customers.

Moving into the next five-year period:

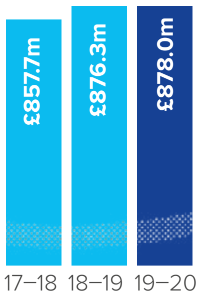
- We will expand our partnerships in the community to increase access to our Priority Services Register for those who find themselves in vulnerable circumstances.
- By 2025, our domestic bills will have fallen by 18.4% (before adjustment for inflation), so the average household bill for water and wastewater will be equivalent to £343 a year.

Highlights and challenges continued

Financial

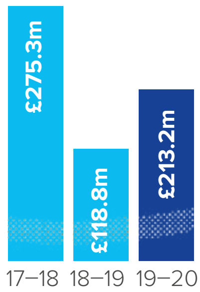
Turnover[1] (before regulatory settlement)

£878.0m



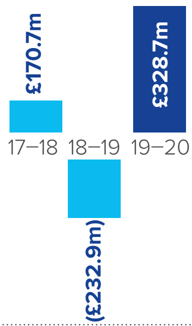
Profit before interest and tax

£213.2m



(Loss)/profit for the financial year[2]

£328.7m



Read more about our **financial performance** on pages 102 to 108

Capital investment

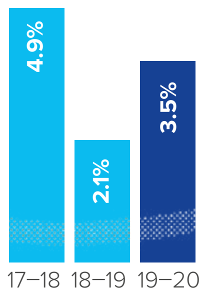
£501.9m

Non-current assets (excluding debt)

£6,397.0m

Return on capital employed (ROCE)[3]

3.5%

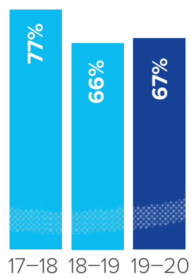


Regulatory Capital Value[4] (RCV)

£5,142m

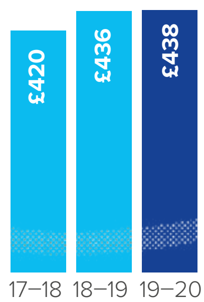
Net debt/RCV[5]

67%



Average water and wastewater customer bill

£438



The results for 2017–18 were restated following the transition to IFRS15 as explained in note 3 to the financial statements for 2018–19.

1 Following its investigation into our wastewater treatment works compliance reporting Ofwat imposed a penalty under Section 22A of the Water Industry Act and we are making rebates to customers over the period from 2020 to 2025. We provided in full for this proposed regulatory settlement in the financial statements for 2018–19.

2 The loss of £232.9 million in 2018–19 was as a result of the provision made for the regulatory settlement of £138.5 million together with the fair value movement on derivative financial instruments.

3 ROCE is presented as the ratio of profit before interest and tax (£213.2 million) to non-current assets excluding debt (£6,397.0 million) less current liabilities excluding borrowings and lease liabilities (£301.5 million) from the Statement of Financial Position.

4 Regulatory Capital Value (RCV) a measure of the value of our regulatory capital asset base as published by Ofwat.

5 The net debt to RCV ratio is calculated as short and long-term senior borrowings, less cash and short-term deposits to the RCV (all values taken from our Regulatory Accounts).

Pictured opposite
We have invested £9 million in 2019–20 to improve wastewater screening on the Isle of Wight

Chairman's statement

Keith Lough
Chairman

As an essential public utility, maintaining services to our customers at all times is vital. Our model is both sustainable and resilient

As the industry looks ahead to the next 30 years, expectations of environmental and supply resilience are growing; we need to achieve better outcomes for all

Highlights

- Improved Board governance, and significant investment in people, processes and systems to drive transformation.
- Public Interest Commitments to protect and improve the environment and support social mobility demonstrate collaboration and focus on a national agenda.
- A plan to 2025, created with our customers, focusing on priorities that they identified.
- A refreshed Board and Executive.
- Rapid transformation to support our customers during the COVID-19 pandemic.
- Open, fair and transparent relationships with our regulators.

I joined Southern Water as Chairman on 1 August 2019, bringing a background in regulation and regulatory environments, having spent seven years on the board of Ofgem. Prior to this, I spent many years in energy-related businesses, including the UK nuclear industry, where I led the financial restructuring of British Energy.

On joining, I knew that Southern Water needed to rebuild trust with many stakeholders, and that the Board, executive, shareholders and our regulators all want us to succeed in that mission. I have seen how our people have responded to severe winter flooding, and the COVID-19 pandemic, both with ongoing effects. I am quite certain that, while we are on a long road of transformation, we do have what it takes to do the right thing for our stakeholders.

Southern Water has a painful legacy, and there are ongoing investigations into our past behaviours and performance record. There is, alongside this, a powerful commitment among our employees to make the changes to culture, processes and systems that will not just prevent a repetition of past mistakes, but will guide us all to do the right things for our customers. Our CEO, Ian McAulay, and his wider team, have taken great strides in our cultural and operational transformation, and they are wholly supported by the Board in working to a clear set of values and principles that are right for the delivery of our essential services.

We have taken steps to improve our Board governance, and invest in the systems and skills needed to take the business forward. It is my responsibility to find and develop the 'golden threads' of alignment that will tie all our stakeholders into helping Southern Water succeed in our mission for customers.

Read more about **ongoing investigations** on page 27

Read more about **our COVID-19 response** on page 28

Our plans for 2020–25

On 14 January 2020 I wrote to Ofwat on behalf of the Board accepting the Final Determination on our current price review. It was, in some respects, in the middle of the range of all settlements, but the industry-wide settlement itself is the toughest ever and is the subject of a number of challenges, including from historically high-performing companies. In my letter to Ofwat, and recently in a submission to the Competition and Markets Authority (CMA), we have spoken of our wish that the preferences of our customers for long-term environmental and system resilience had been reflected more clearly in the Final Determination.

Unlike energy markets, where companies may serve customers from Caithness to Cornwall, water companies are drawing water and cleaning waste from where our customers are. It must be the case that priorities for Southern Water customers may not work for other wetter areas or areas with lower population growth so, for the future, we will seek a stronger alignment between what our customers say they want and what we may be permitted to deliver for them. To that particular end, we will want to contribute towards regulatory conversations that can more dynamically reflect the priorities for living and the environment that emerge in a post-COVID-19 world.

Committed to tackling issues facing the water industry

Over the past 30 years, water companies have provided major benefits to customers and the environment. As the industry looks ahead to the next 30 years, expectations of environmental and supply resilience are growing; we need to achieve better outcomes for all.

In April 2019, Southern Water signed up to a number of pledges, which demonstrate the company's commitment to meeting these expectations. These Public Interest Commitments complement our business plan by showing leadership at a national level.

As part of the commitments, UK water companies have agreed to work together towards five challenging goals:

- Triple the rate of leakage reduction across the sector by 2030.
- Make bills affordable, as a minimum, for all households with water and sewerage bills which are more than 5% of their disposable income by 2030, and develop a strategy to end water poverty.
- Achieve net zero carbon emissions for the sector by 2030.
- Prevent the equivalent of four billion plastic bottles ending up as waste by 2030.
- Be the first sector to achieve 100% commitment to the Social Mobility Pledge.

These goals were based on feedback from communities and national stakeholders, and mean we need to go beyond regulatory compliance to demonstrate long-term stewardship of the environment, deliver social good, and give people a meaningful say as we develop our plans for the future. Although challenging, these pledges are achievable. The Board is determined to introduce the changes needed to make them a reality.

Read more about **our plans for 2020–25** on pages 36 to 39

Pictured
We have pledged to prevent the equivalent of four billion plastic bottles ending up as waste by 2030

Chairman's statement continued

[Our customers] were clear that they wanted a focus on keeping bills affordable but also wanted investment in long-term resilience

42k

customers helped shape our business plan 2020–25

Operating in the public interest

As a provider of essential services, we have a duty of care to our communities, which is why we spoke to more than 42,000 customers when developing our latest business plan from 2020–2025. We are a community utility, so we should be measured by how well we engage with and support our local communities. The first meeting I asked for, when I arrived at Southern Water, was with our Vulnerability Lead. I wanted to know how Southern Water addresses the needs of vulnerable customers and how that work integrated with our day-to-day customer work. I was pleased by what I saw and heard, and that our business plan submission in this area was accepted without amendment; it is a litmus test of who we really are. It is vital that we identify and help the most vulnerable in our community, and our customers have told us that supporting those in financial hardship and those in need of tailored services is crucially important.

Our long-term vision to create a resilient water future for customers across the South East has been well articulated. We are listening to what people want, and it is clear they want a focus on long-term resilience and better environmental outcomes. We have developed partnerships with organisations such as rivers and wildlife trusts. We understand that protecting future resources is a shared responsibility, and this sits at the heart of our purpose to provide Water for Life.

But there is still an inconsistency between what our customers have asked for and what we will be able to provide following our Final Determination from Ofwat for 2020–25. When we talked to our customers about our plans, they were clear they wanted a focus on keeping bills affordable but also wanted investment in long-term resilience of supplies and in schemes to protect and improve the environment. We built our vision and purpose around this.

Southern Water's relationship with the environment is integral to the business – the company's Environmental Policy reflects an ambition, which includes providing sustainable services that prevent pollution and minimise emissions, supporting sustainable development, and protecting the environment by promoting the efficient use and conservation of water, energy and natural resources. This year we have secured £825 million in sustainable bonds to support the financing of investments and activities that deliver sustainable outcomes. This is the largest ever sustainable deal for a UK utility company.

To tackle the realities of population growth and climate change in the South East, we need to start investing in connected infrastructure and better ways of working collaboratively across the region. However, the investments we make will be constrained by the requirement to significantly reduce customer bills; over the next five years and beyond, we will need to work with our regulators on how we better understand and address our customers' needs. We will also be monitoring carefully the appeals to the CMA by four companies in the sector against their Final Determinations as these appeals reflected a number of our core concerns.

A journey of rebuilding trust

Our values – succeeding together, doing the right thing and always improving – are at the centre of everything we do. These commitments, supported by strong leadership and a focus on detail, have helped us to develop our relationships with the Environment Agency, the Drinking Water Inspectorate and Ofwat. However, we understand that to consolidate this improvement we need to show tangible improvements in performance. In late 2019, as part of our recognition of past failings, we gave a number of important undertakings to Ofwat, including to improve our processes and assets, to recompense our customers and to improve our transparency and reporting. The Board takes compliance with these undertakings extremely seriously.

It has been acknowledged elsewhere that Southern Water has been too reactive in the past, resulting in short-term decision making that created problems that the company has been identifying since 2016. Our executive management have been focusing on changing that thinking, encouraging colleagues to consider the impact of their decisions on the business as a whole. Ian McAulay has brought in the right people, from within the sector and elsewhere, to share their knowledge and help Southern Water gain a better understanding of its processes, assets and systems, and how to improve them.

Our pollutions performance for 2019–20 was unacceptable, but by mining data and using new technology, we can now predict problems more accurately. For example, through better forward planning and data tracking, the company successfully managed the worst effects of storms Ciara and Dennis in early 2020.

In overall performance for 2019–20, for a number of internal and external factors, operating costs were higher than anticipated, and we start the next five-year period from a challenging position. While our performance is well below where it needs to be, we have made good progress over the past three years in preparation: our capital delivery programme is back on track, we have transformed contractual arrangements with our suppliers, and made process improvements across the business.

Leadership and governance

As Chairman, I aim to ensure alignment between shareholders, our Board and the Executive. Our shareholders have been supportive of our transformation plans, even though this has meant receiving a poor return on their investment for some time. Getting things right for our customers will mean getting things right for our shareholders.

Our non-executive directors support our executive management team, reviewing performance against company and regulatory ambitions, and providing feedback and guidance on the company's plans. That notwithstanding, I believe there is an opportunity for our non-executive directors to be even more engaged in the assessment of risk and the development of strategy. Between them, our Board members have a breadth of sectoral and customer-focused experience, with many specific skills. Closely involved in the development of Southern Water's business plan to 2025, they must continue to ensure it is living its values, following its compliance framework and doing the right thing.

Ensuring the company has an engaged workforce is a key priority at this time of change. In compliance with the regulatory framework, I am pleased that Kevin McCullough has agreed to take on the role of Board member with responsibility for engagement with the workforce. Kevin's operational background and passion for honest debate will stimulate interest in this area.

Other recent Board appointments include Dame Gillian Guy. As Chief Executive Officer of the independent charity Citizens Advice, Gillian brings particular expertise in advocating the interests of those in vulnerable circumstances, including financial difficulty – all the more important given the disruptions to so many people's lives due to the COVID-19 crisis. I also welcome her broader contribution to Board debate.

The new chair of our Audit Committee, Malcolm Cooper, brings experience from the regulated energy sectors. I thank Rosemary Boot for chairing on an interim basis. That committee plays a vital role in supporting the Board's scrutiny of performance and controls, including meeting the obligations and undertakings of the business.

I am also pleased to welcome Marykay Fuller, who joined the Board as representative of Greensands Holdings Limited in June 2020.

Confidence and assurance

Our Board, Executive Leadership Team (ELT) and wider management, have been responding to the challenges raised in the Ofwat investigation into misreporting at our wastewater treatment works. The investigation found that between 2010 and 2017 we did not have adequate systems, planning, governance and internal controls to manage these works effectively. Compounding this, failings at a cultural and governance level included insufficient checks on the integrity of performance reporting to the Board.

In late 2019 we gave a number of important undertakings to Ofwat, including to improve our processes and assets, to recompense our customers and to improve our transparency and reporting

Read more about **our approach to governance** on pages 150 to 153

Pictured
We have developed partnerships with organisations such as the rivers and wildlife trusts

Chairman’s statement continued

£123m

in rebates to our customers have now started to be paid

There has been external recognition of further advances in the quality and content of our data and performance reporting, in relation to which we will continue to look at ways to improve. This focus on compliance and assurance is welcomed and supported by the Board.

The Board is helping the executive team embed the values and culture of the company, and we are monitoring the progress of various initiatives. These include our relaunched ‘Speak Up’ process, a new Code of Ethics, ELT face-to-face meetings at all our sites (‘Around our sites in 80 days’) and weekly all-staff calls, led by Ian McAulay, throughout the COVID-19 pandemic.

We have also revised our remuneration policy. This now demonstrates more clearly how executive pay is linked to overall and individual performance, and how annual bonuses are based on targets relating to customers, stakeholders and communities. Our Remuneration Committee closely monitors the policy and executive pay. We publish this policy annually, with an explanation of its application at **southernwater.co.uk/our-performance/reports/annual-reporting.**

We support Ofwat’s revised Board, leadership, transparency and governance principles, which applied from 1 April 2019, and liaised with them in developing these. You can read more about our approach to governance on pages 150 to 153.

Outlook

On behalf of the Board, I would like to thank everyone at Southern Water, and our partners and contractors, for their hard work in this challenging year.

I have met many colleagues and others in our supply chain who, in difficult circumstances, simply want to do their jobs as well as they can for the benefit of our customers, stakeholders and wider communities. In many cases, they are part of those communities themselves, and that is part of their urgency for change. If I return to where I began, I said on a recent all-staff call that if we needed to rebuild trust – and we do – then what they have done through this long winter of flooding and through COVID-19 has been almighty work, and I am proud to play any small part in that.

I would also like to thank our shareholders for their patience and support as Southern Water continues its transformation; they too wish to see us as a trusted and efficient business.

The outcome of the Ofwat investigation means we paid a £3 million fine, and have agreed to £123 million in rebates to our customers, which began in April 2020. The ongoing Environment Agency prosecution and investigation, and the Enforcement Orders with the Drinking Water Inspectorate, mean we are still rebuilding trust. We will continue to do this through honest conversations about the changes to our processes and culture, and through regular updates on our performance.

KGLough

Keith Lough
Chairman
10 July 2020

Pictured opposite
The quality of the bathing waters at beaches like Brighton in East Sussex is something our customers told us was a priority for them

WATER for LIFE

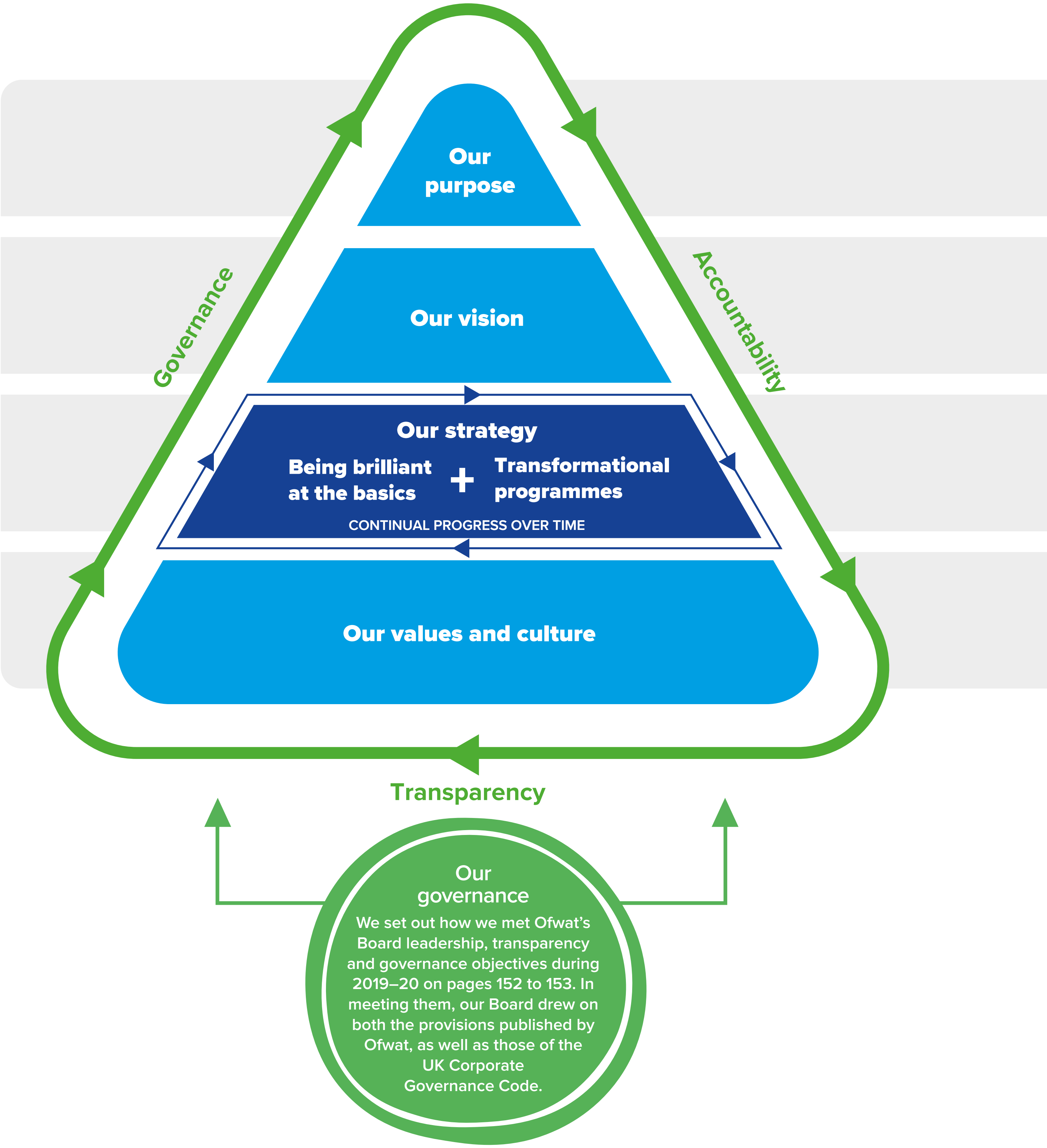
Strategic Report

from Southern Water

Our purpose and strategic priorities

Our purpose is to provide water for life. This is reinforced by every interaction we have with colleagues, customers and our wider communities. Our values govern how we do things and allow us to build a solid decision-making framework across everything we do.

These foundations enable us to better deliver on our strategic priorities, and the commitments we make to our customers.



Our purpose

We exist to provide water for life. Without water, life as we know it would be impossible.

We provide water for life to enhance health and wellbeing, protect and improve the environment, and sustain the economy.

Read more on pages 162 to 165

Our vision

Our region faces a future of more people and less water, so we need to work together with our communities to keep it flowing for the future.

To create a resilient water future for customers in the South East.

Our strategy

Customers and stakeholder priorities drive our strategy. Our plan for 2020–25 includes 47 commitments aligned to outcomes created with them.

The next five-year planning period: our plan for 2020–25

Read more on pages 36 to 39

Our values

Our three values underpin everything we do and are part of our ethical decision-making framework.

- Succeeding together
- Doing the right thing
- Always improving

Our culture

Ethical decision-making and modern compliance frameworks, alongside our vision, purpose and values, help our leadership team, employees and partners make better decisions every day.

Read more about **our people** on pages 50 to 55

Read more about **how the Board monitors culture** on page 164

Chief Executive's summary

Ian McAulay
Chief Executive Officer

We are continuing our transformation, making the changes needed for our people, processes and systems, to better serve our customers and deliver a resilient water future for them

Many of our employees are key workers, whose tasks are critical to keeping water and wastewater services flowing for our customers

Highlights

- Our key workers, other colleagues and supply partners have been keeping services running 24/7 for customers through the COVID-19 crisis, adapting to new ways of working, both at home and out in the field.
- More customers than ever before have been supported with financial assistance and priority services.
- 62 bathing waters rated at Excellent across our region, up from 43 in 2015.
- Our Water for Life Business Plan 2020–25 is broad and ambitious. We are now at the start of a £3.2 billion investment to ensure we supply water and wastewater services responsibly and sustainably, while protecting the environment.

Going beyond our statutory duties as a water company

In our region we have some of the rarest chalk streams in the world, some of the best bathing-water quality, more than 700 miles of coastline, two National Parks, four Areas of Outstanding Natural Beauty, a world-heritage biosphere and more than 200 Sites of Specific Scientific Interest. We have a responsibility to look after all of this, and to improve it where we can. This is in addition to our statutory licence obligations to supply water and wastewater services to our customers.

Our vision is to deliver a resilient water future for the region. To do that we need to face up to many challenges, including the effects of climate change and the need to be continuously reducing our own environmental impact and footprint. We are pushing forward with a number of strategic programmes under our Water for Life brand, which genuinely resonates with our customers, employees and other stakeholders.

After first summarising below our performance over the year, I will expand on some of the priorities we see ahead of us.

Our performance and key challenges 2019–20

Any report on a financial year end of March 2020 will obviously need to address the extraordinary events of the final few weeks, in which the whole country went into government-mandated lockdown in response to the COVID-19 pandemic. We have adapted remarkably well and continue to deal with the developing situation. We are a provider of an essential public service, and many of our employees are key workers whose tasks are critical to keeping water and wastewater services flowing for our customers. We moved in just one week from business as usual to a well-rehearsed Business Continuity Plan running against four simple priorities:

- Maintaining provision of essential services at all times;
- Protecting the health, safety and wellbeing of our employees, including our supply chain, and our customers;
- Providing the maximum practicable level of assistance to our vulnerable customers; and
- Protecting the financial stability of our business.

300k
customers provided with financial support

126.5
litres of water used per person, per day – below the national average of 144 litres

Read more about **how we measure our success** on pages 60 to 61

Read more about **our COVID-19 response** on page 28

I am deeply proud of the way that our people, and the business as a whole, has performed against all four of these priorities. That is particularly so for our frontline workers, who have taken on a higher degree of risk for themselves and their families, to ensure that water has flowed and wastewater been treated continuously. It is unimaginable to think about facing the challenges of COVID-19 without a reliable water supply.

Customer service

Over the past five years, we have helped almost 300,000 customers who may have found it difficult to pay their water bills, exceeding our target of 194,700 by more than 100,000.

We are fully aware that some of our customers' circumstances have changed drastically and unexpectedly as a result of COVID-19. Therefore, we made our processes easier for people who need to discuss or apply for help with their bills. We also made it possible for third parties to apply for priority services on behalf of vulnerable friends and family.

Our performance in other customer service areas this year has been mixed. We have celebrated helping our customers reduce their water consumption, with the per-person consumption of 126.5 litres a day – well below our target and the average for the rest of the UK. This establishes an excellent foundation for Target 100 – our long-term commitment to take average consumption below 100 litres per person, per day, by 2040.

However, it is clear we need to make more progress in other areas. Throughout the year, Ofwat has been testing its new customer satisfaction measures – C-MeX and D-MeX. I support this move towards more comprehensive measures of customer satisfaction, where we are judged across the full breadth of our customer base. Our early C-MeX score is behind most of our peers, but we have initiated a number of projects and plans to improve, e.g. offering a much wider mix of channels for customers to communicate with us, simplifying our bills to make them easier to understand, and providing important messages.

We have had incidents in the year that resulted in us paying for service failures under the Guaranteed Standards Scheme provisions. We made nearly 5,000 individual payments, significantly exceeding our target of 2,291. These were mostly due to large-scale supply interruptions, but also partly due to failures in our process for referring debt to collection agencies. In our drive to be as transparent as possible, and ensure historic performance has been properly stated, we have also been auditing and investigating how we have made and kept appointments since 2015 and found some process flaws. As a result, we are making backdated payments to a number of customers under the same provisions.

[During the COVID-19 pandemic] we made it possible for third parties to apply for priority services on behalf of vulnerable relatives

Read more about **customer service improvements** on pages 62 to 71

Pictured
We will be investing in our high-risk assets in the coming years to meet our regulators' standards

Chief Executive's summary continued

Through storms Ciara and Dennis we maintained supply for all customers; something not all utilities could manage

84%

customers told us that their bills were affordable (2019)

As we continue to improve and manage our customer service, we have entered into a significant partnership with Capita. This meant a difficult transition period of restructuring teams and losing a number of people, and relocating some services to Rotherham. However, I believe our work with Capita will continue to assist us with the transformation of our customer experience.

Operations

On the operational side of the business, performance has also been mixed, with some very significant challenges being addressed.

Most scientific climate change predictions suggest we will experience wetter winters and drier summers in future, with an increased likelihood of more intense rainfall leading to flooding. During the year, we saw some of the most concentrated periods of rainfall on record, and demonstrated our improved ability to deal with them. I thank my colleagues for their dedication and energy in achieving this. Through storms Ciara and Dennis we maintained supply for all customers; something not all utilities could manage. However, as a result of some large-scale incidents in autumn 2019, we missed our target for supply interruptions.

We have improved our overall water resilience by reducing the volume of asset outage, but we did not achieve our five-year leakage target despite additional investment. This was due to how we were impacted by the effects of the extraordinary 2018 winter and droughts of 2018 and 2019. The impacts of these events caused an increase of around 13 Ml/d in reported base leakage. We are delighted that we have reduced that since 2018, by close to 15% in the most stressed part of our region, which is our committed reduction percentage for the next five-year period.

Our bathing water performance stands out as a highlight, with 62 bathing waters categorised as excellent. In addition, our Fat, Oils and Grease (FOG) team picked up several awards for making a real difference in its work with restaurants close to bathing waters.

We are an outlier on the Drinking Water Inspectorate's new ERI and CRI water-quality measures, but are delivering a number of plans, including further investment in our high-risk assets, to bring our numbers down. Provisional figures for 2019 to December were: CRI 7.656; ERI 1,433.477; against an industry average of CRI 2.868; ERI 688.694.

I am also very pleased that we kept our commitment to avoiding water-use restrictions throughout the five-year regulatory period.

Disappointingly though, the number of pollution incidents related to our assets was significantly higher than our targets, with seven serious (category 1 and 2) and 427 category 3 incidents*. This is not acceptable to us and we continue to invest in our systems and assets, £54 million in 2019–20, to improve this performance. The Pollution Reduction Plan we have put in place has been built with eight Critical Success Factors and has improved root cause analysis, risk understanding, site resilience, cultural awareness and self-reporting, now at 86.5% (2018: 83%). The plan is now published on our website and progress is regularly reviewed with the Enviroment Agency and our Board.

* As reported previously, we have identified a number of issues with spill data. The details of the steps taken and that continue to be taken, to improve the robustness of the spill data collection, the data processing systems and the assurance of that data, have been shared with the EA and Ofwat. As those steps have not yet reached completion, the data supplied would continue to have an error band of up to 10%.

Ofwat investigation

Following a lengthy investigation into how Southern Water's wastewater business was run between 2010 and 2017, with which we co-operated throughout, Ofwat published its final decision in October 2019. In addition to a fine of £3 million, the report set out a number of agreed actions, supported by undertakings given by the company, including the making of rebates to current customers and payments to former customers, and a commitment to greater transparency on environmental performance.

We have been taking significant steps to improve our wastewater business and we are working hard to regain our customers' trust. We conducted workshops to explain what had happened, how we would be making reparation and how we were putting the right checks and balances in place. In addition, our customers have been receiving explanations with their bills since April 2020.

Environment Agency investigations

Like other wastewater operators, in the normal course of operations we occasionally face Environment Agency investigations following wastewater incidents. In addition to those, the company has been subject to a detailed investigation regarding permit breaches at some of our wastewater treatment works in two locations during the period 2010–15. A case was opened in

Maidstone earlier this year in relation to these events and we agreed it should be elevated to the Crown Court. We have already entered guilty pleas to the charges presented to the court and are focused on transparency and doing the right thing for our customers and other stakeholders. We are limited in what we can write about the case at this stage, but we will be letting the court have details of all of the plans we have put in place to address the issues raised, and all of our environmental improvement plans. We are also committed to assisting the Environment Agency with its additional investigation into sampling compliance and reporting issues. Read more on page 27.

Financial performance

As already described, 2019–20 has been a challenging year in which we have continued our transformation journey and responded to a number of significant operational events. The costs associated with these are reflected in our operating profit for the year (excluding regulatory settlement), which fell by £44.1 million to £212.3 million.

The operational challenges of dealing with the impact of the wet and stormy weather over the winter, improving our wastewater asset maintenance to improve compliance, and reacting to a number of large sewer repairs, increased our wastewater operating costs by £13.9 million.

We spent an additional £3.2 million this year increasing the size of the leakage team and our collaboration with partners to help reduce leakage levels. While I am pleased that we have seen a very large reduction in overall levels compared to the previous year, we still have further to go to meet the targets we have set for the period to 2025.

We also incurred one-off costs of £7.7 million due to restructuring teams and our cost base as part of preparations for the delivery of our business plan for 2020–25. This included setting up the partnership with Capita to help transform our customer experience, as well as making changes to pension arrangements for our employees.

As a result of COVID-19, we have also reviewed our provision for bad and doubtful debts. The impact of the pandemic on the economy and the financial position of individuals has been dramatic and is anticipated to last for many months to come. Therefore, we have made an additional provision of £16.0 million in the year to reflect the potential impact this may have on the collectability of our outstanding customer debt at 31 March 2020.

In 2019–20, our capital investment programme continued at pace as we completed the final year of our current business plan. In total we spent over £500 million investing in our assets during the year. This included the finalisation of the redevelopment of our Woolston wastewater treatment works, improvements to our sewer network in Thanet, improvements to wastewater assets across our area, to improve compliance and performance, and the creation of a new IT data centre.

We secured £825 million in sustainable bonds in one of the biggest public market financing issues for the water sector in May 2020

Read more about **our financial performance** on pages 102 to 108

Pictured
In total we spent over £500 million investing in our assets during the year

Chief Executive's summary continued

47

performance commitments for 2020–2025, co-created with customers and stakeholders

Net zero

by 2030

We also successfully secured £825 million in sustainable bonds in one of the biggest public market financing issues for the water sector in May 2020, establishing an environmental, social and governance (ESG) sustainable financing framework. It demonstrates a set of standards for a company's operations that socially conscious investors use to screen potential investments.

Our business plan for the next regulatory period sets out a number of targets with a significant level of investment. In order to ensure that we maintain the financial stability of the company we are reviewing this as we deal with the current situation.

Our priorities to 2025

In the course of preparing our Water for Life Business Plan 2020–25, we consulted extensively with our customers to ascertain their priorities. They were very clear on four things they wanted us to deliver which were:

- investing in the environment;
- investing in future resilience;
- providing support for those who cannot afford their bills; and
- being fair and transparent on dividends and executive pay.

Eighty-four per cent of customers also told us they thought their bills were affordable.

Our plan reflected these priorities, with 47 performance commitments for the five-year period 2020–25, aligned to key outcomes, to use water wisely, protect and improve the environment, deliver great service and be fit for the future.

Ofwat's detailed scrutiny and challenge of our plan culminated with the publication of its Final Determination in December 2019. It largely accepted the ambitious improvement targets that we set in our plan, but significantly reduced the level of funding available to deliver them and in some cases required improvements to be made more quickly.

While we were disappointed by the outcome of Ofwat's review, we chose not to appeal the decision to the Competition and Markets Authority. We are now focused on making the important changes to address the huge challenge that Ofwat has set us to deliver a step change in performance and efficiency at the same time as reducing bills.

Resilience is at the heart of our strategy so we are focusing on becoming brilliant at the basics while transforming our business. We plan to deliver on our commitments to customers in an integrated, collaborative way, using systems thinking to deliver solutions to regional challenges, namely climate change and population growth.

Examples of this in action would be the work already started on a regional water grid through Water Resources in the South East, or the energy and water strategies created through our work with the Greater Brighton Infrastructure Panel.

Pictured
Our work will mean finding different ways of using water to make sure there is enough to go around

We will be focusing on reducing carbon emissions to get closer to net zero, in line with the Water UK Public Interest Commitments. This will mean being more innovative in the way we think about our infrastructure. We were also the first water company in the UK to have a plastics policy, looking at how we use plastic in our supply chain and the water cycle. We are also discussing some exciting projects with the rivers and wildlife trusts, and I look forward to seeing them develop.

For vulnerable customers, we will be increasing the number on our Priority Services Register so we can offer specific assistance, and we will continue to support customers who struggle to pay their bills.

For more information on our business plan and priorities for 2020–25 see pages 36 to 39.

Engagement and values

In putting together our business plan, we learnt a lot about how best to engage with our stakeholders, setting up the right channels and relationships to make two-way conversation easier. We now spend far more time with our customers than previously. I spend a significant proportion of my time with stakeholders, as do teams across the business, and we are receiving positive feedback.

When we started to review our purpose, vision and values in 2018, the guiding rule was to keep it simple and understandable. Water For Life captures what we do, but it also brings home to people the fact that we are all water citizens.

Our values are, simple and everybody can live up to them. We all know what we can do to succeed together, to always improve and, particularly for this company, do the right thing. It allows people to just take a step back and assess their actions.

These values are now being embedded in the business and we continue to look at ways to ensure they become part of business as usual. I believe our Water for Life story brings us consistency. It is something everyone at Southern Water can identify with and explain to our customers.

Relationships

I thank all of my colleagues at Southern Water, and in the wider supply chain, for their commitment to our transformation journey. Our customers have been patient, and I have been pleased with their feedback. They can see we are changing.

Our relationships with our regulators have also improved immeasurably. We still have a number of issues to solve, and we need to continue to show evidence of real performance improvement. We are also having purposeful conversations with the Government and the National Infrastructure Committee that are starting to move things forward.

Rebuilding trust and looking forward

We have a transformation programme that touches every part of our business, and acknowledges that we needed to make big improvements. We have made key investments in people, processes and systems. We have appointed people with different perspectives – from the retail, energy and telecoms sectors – as well from the water sector, to draw on their experience to better serve our customers.

Keith Lough, who I welcomed as our new Chairman in August 2019, came from a strong regulatory background. In Keith's statement, he explains how we also have people on the Board who understand the different parts of our business.

The ethos of our Board is one of continuous improvement and striving for excellence in all that we do, as that is key to building trust with all who we engage with.

This is at the core of our 'brilliant at the basics' ambition in our Water for Life plan. This is important to my colleagues and me. We face each day with that ambition in mind and, with our core values driving our actions, we will build trust and look forward to a resilient water future.

This is the decade of resilience and it must be delivered. The challenge is enormous, but I know we have the skills, plans, relationships and desire in this business to succeed in our ambition to create a resilient water for the South East. I warmly thank everyone involved at Southern Water for sharing in that vision and helping to deliver it.

I also thank my colleagues for their strength and commitment in dealing with COVID-19 so effectively and maintaining an essential service throughout.

Ian McAulay
Chief Executive Officer

10 July 2020

Our progress

Improving our environmental performance, along with reducing pollutions, are key in our transformation

200+

employees have taken part in integrated Risk & Value training

Read about **our wholesale water performance** on pages 78 to 83

Read about **our work to reduce pollutions** on pages 45 and 92

Our journey of delivering better outcomes for our customers and becoming a more resilient organisation

In December 2019 we received our Final Determination from Ofwat, which specifies how much money we have available for 2020–25 to deliver services to our customers, and how much customers' bills will fall. As we begin the next five-year period, it is imperative that we continue to transform our company so we can meet our customer commitments.

The transformation has begun, seeing changes to team structures, processes and systems.

Integrated business planning

Our integrated business plan has given us clarity on what we are aiming to achieve and when, which ensures we have the capabilities to achieve it. It means us translating our desired business outcomes into financial and operational resource requirements, with the overarching objective of maximising efficiencies, while minimising risk. This clear direction, coupled with an agile approach to problem-solving and innovation, is enabling us to assess, review and deliver projects efficiently.

By working smarter, we can demonstrate to our regulators, customers and stakeholders that we have improved our performance and capability, while ensuring a focus on risk management and compliance.

A new approach to risk and value

Our risk and value (R&V) process underpins our new way of working. It is improving our decisions about how to invest, build and run our assets, and allows us to collaborate more effectively with suppliers across our business.

Many of the projects in our business plan for 2020–25 will be put through the R&V process; more than 200 employees have already taken part in integrated team training. We are seeing benefits from this collaborative process, specifically in terms of identifying more cost-effective data-based solutions to business issues.

Delivering operational excellence

The transformation of our frontline operations progressed in January 2020 with the launch of One Way Of Working (OWOW): a new process that governs how we focus our maintenance resources on the most critical issues.

Led by the Operational Excellence team, OWOW has already improved our efficiency and customer experience by redesigning our customer calling cards. Working with the stakeholders, partners and customers, the team simplified the information given to customers. Where there were previously 13 leaflets for various scenarios, there are now just two: one for water issues, and one for waste.

Improving our speed of response

Improving our environmental performance along with reducing water incidents and pollutions are key in our transformation. Speed of response is significant in tackling pollution incidents, and accurate and reliable alarms are a crucial part of that.

Transformation projects in this area have improved information available to our field teams, while an ambitious training programme has given them the knowledge and tools to collaborate and make quick, effective decisions on site without needing support from the Control Centre.

Better relationships with our regulators

In 2017, we had four outstanding Final Enforcement Orders from the Drinking Water Inspectorate (DWI): three were associated with new asset improvement schemes, and one with improvements in water quality sampling and information management. Three years on, we have successfully closed three of these orders, with the most recent being revoked in January 2020. One remains in place – a final asset improvement scheme at Shoreham water supply works.

The DWI specifically complimented the commitment and competence of those involved across diverse sections of the business. The work required many new and improved processes, as well as bringing together teams that were not previously connected.

Celebrating new partnerships

We have established more collaborative and efficient contracts and relationships with service partners who share our values. A new Supplier Code of Conduct, coming soon, will ensure we have a clear set of agreed expectations.

We have also established relationships with community partners, including the rivers and wildlife trusts, to develop projects that deliver joint benefits.

By improving engagement with our partners, and getting the basics right, we can innovate and deliver enhanced services for our customers and create a resilient water future for the South East.

Find out more:

Our people

The best thing about Southern Water is our people, and we are committed to supporting their continued development.

Read about our **people** on pages 50 to 55

Our strategic priorities

Our customers and stakeholders define our strategic direction, so we are committed to delivering a level of performance they would expect.

Read about our **strategic priorities** on pages 36 to 39

Our approach to governance

Our Code of Board leadership, transparency and governance draws on both Ofwat's provisions as well as the appropriate principles and provisions of the UK Corporate Governance Code.

Read about **governance** on pages 150 to 153

Transparency and accountability

As a supplier of essential services, we have a duty of care to the communities we serve and, as such, our performance is independently scrutinised.

Read about **transparency and accountability** on pages 174 to 180

Remuneration policy

The remuneration policy applies to all employees. The Board has approved the policy at the recommendation of the Remuneration Committee.

Read about our **remuneration policy** on pages 182 to 199

The market we operate in

The water sector

Access to clean water and sanitation is vital to prevent the spread of disease. Piped water has only been available for the majority of England and Wales since the 18th century, with the first sewers developed later to provide people with access to adequate sanitation.

By the early 20th century each area organised its own water supply services, which meant that by 1945 there were more than 1,000 bodies involved, and another 1,400 delivering wastewater services.

Over the past 60 years this role has shifted to several privately owned companies. Today, more than 50 million households and commercial customers receive good quality water, sanitation and drainage services every day in England and Wales. These are provided by 10 licensed water and wastewater companies, with a handful of smaller licensed companies providing water-only services to customers.

Since the water and sewerage industry was privatised in 1989, a regulatory framework has been in place to ensure that customers receive a good standard of service at a fair price. This framework has seen these companies invest billions of pounds maintaining and improving assets and services.

Over the coming years, the water industry must change significantly with population growth and climate change, which present challenges to the future delivery of water and wastewater services.

In 25 years from now within Southern Water's region, we are anticipating to have lost a third of our water sources through climate change, a reduction in the amount of water we are allowed to take from rivers and underground sources, and our population will have grown by 15%. Without action, we predict a supply and demand deficit by 2030, equivalent to around 50% of our current supply.

The regulatory environment

The *Department for Environment, Food and Rural Affairs (Defra)* determines the overall water and sewerage policy framework in England, setting standards, drafting legislation and creating special permits, e.g. drought orders.

defra.org.uk

Ofwat is the economic regulator of the water and sewerage sectors. It protects the interests of consumers by promoting appropriate competition, making sure water companies properly carry out their functions and ensure they have the adequate finance in place.

ofwat.gov.uk

The *Environment Agency* is the environmental regulator of the water and wastewater sector in England. It is the principal adviser to the government on the environment, and the leading public body improving and protecting the environment of England. They work with a range of organisations to reduce flood risk, promote sustainable development, and secure environmental and social benefits.

gov.uk/government/organisations/environment-agency

The *Drinking Water Inspectorate* is the drinking water quality regulator and enforces the Water Quality Regulations set by the Government. To do this, they check the tests carried out on drinking water by water companies, along with carrying out company inspections.

dwi.gov.uk

The *Consumer Council for Water* represents water and wastewater consumers. It also investigates consumer complaints that have not been satisfactorily resolved by water companies.

ccwater.org.uk

Natural England advises the government by providing practical guidance, grounded in science, on how to best safeguard England's natural wealth. Its purpose is to protect and improve England's natural environment and encourage people to enjoy and get involved with their surroundings.

gov.uk/government/organisations/natural-england

A year of transformation against a challenging backdrop

Customer rebates began in April 2020 and advice on how to claim is published on our website

Ofwat investigations

As previously announced, Southern Water's wastewater treatment compliance was under investigation by Ofwat from June 2017, due to breaches of statutory obligations from 2010–17.

We began investigating issues at its wastewater treatment sites in July 2016 before alerting Ofwat to deeper issues in March 2017.

A key finding from Ofwat was that, between 2010 and 2017, some of our wastewater treatment sites were manipulated by employees to pass sampling tests they otherwise might have failed.

A Final Notice, clearly setting out the plans for Southern Water to make rebates to current customers and payments to former customers, and a commitment to greater transparency on environmental performance, was published by Ofwat in October 2019.

The notice confirmed that the payments to former customers, and the reduction in wastewater charges for current customers, will total £123 million (in 2017–18 prices) together with a £3 million fine*.

The rebates to current customers began with the April 2020 bills. For former customers, advice on how to claim has been published at **southernwater.co.uk/our-performance/making-amends-to-our-customers**.

The notice also contained details of our plans for greater transparency on environmental performance, including information on pollution incidents, flow and spill reporting, wastewater treatment works compliance, regional bathing water compliance results, emissions and river levels; this is published at **southernwater.co.uk/our-performance/environmental-performance** **.

The third commitment from the notice was to ensure that employees did not receive bonuses or incentive payments for personal objectives linked to wastewater compliance when Southern Water fails to meet its relevant performance commitments.

* Customers will not bear any of the costs.

** This is subject to constraints on reporting environmental information or data that is provided by the Environment Agency.

Environment Agency investigations

Like other wastewater operators, in the normal course of operations we occasionally face Environment Agency investigations following wastewater incidents. In addition to those the company has been subject to a detailed investigation regarding permit breaches at some of our wastewater treatment works in two locations during the period 2010–15. In February 2020 the agency presented 51 charges before the court and we have entered guilty pleas to these charges. The exact nature and scale of the permit breaches over the period are still under investigation. We will be as open and transparent as possible and are committed to working with the agency to ensure a swift conclusion to resolve the case. Since Chief Executive Ian McAulay joined in 2017, he has been driving thorough internal reviews of our wastewater business and is leading a major transformation programme.

For the reasons also set out in note 26 to the financial statements (see page 246), supported by legal advice, the Board has concluded that it is not yet possible to make a reliable overall estimate of the financial obligation that will arise from this prosecution, notwithstanding the guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, the Board does recognise that there will be a minimum liability associated with these charges and has therefore recognised a provision of £1.0 million reflecting a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs. The court has a very broad discretion to assess the level of the fine and the provision is not intended to indicate or predict any particular level.

When considering the above it is noted there is no clarity as to how these charges may evolve and how the disputed levels of culpability and environmental harm may be determined. The sentencing guidelines are very wide and there is a requirement for the court to examine the financial circumstances of the organisation in the round. The Board will continue to review the level of provision made as more information becomes available.

We are also committed to assisting the Environment Agency with its separate investigation into sampling compliance and reporting issues between 2010 and 2017 (inclusive). The Board, supported by legal advice, has again and for similar reasons concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from this separate investigation but will also keep this under review.

A year of transformation against a challenging backdrop continued

COVID-19

The COVID-19 pandemic has brought a great amount of uncertainty. However Southern Water's role as a provider of vital water and wastewater services has not changed. What has become apparent is our need to be responsive and agile in our plans to protect public health as the pandemic continues to develop.

We fully recognise the implications, both operationally and financially, to our business are real, severe and lasting. In response, we have developed a COVID-19 continuity plan, with an initial focus on the first three months, which is reviewed and adjusted on a weekly basis, as appropriate. The company's business plan to 2025 was used as the baseline to create our execution plan for the same period. From this plan all decisions and changes, implemented as a result of COVID-19, are managed through existing governance processes.

We know, at the time of publication, we must continue to do all we can to protect our customers and colleagues, particularly those in vulnerable circumstances, by focusing our activities on protecting core operational services. We do not know the scale of the pandemic or the number of our employees and supply chain partners who will be affected or its financial impact, and how that may influence our business priorities in the long term. However, we are tracking COVID-19 costs against our baseline and will continue to assess the situation.

In terms of our domestic customers, many are facing uncertain futures and are struggling to pay their water bills. This means we need support them in the short term, offering payment breaks and increased access to our support tariffs while making sure that we monitor and prepare for the potential of increasing bad debt in the long term.

To keep customers informed, we created a dedicated COVID-19 area on our website, which included a letter from our CEO, Ian McAulay, and answers to common questions about the impact of pandemic on our services, changes to our ways of working, and the support available to them. Our frontline employees were identified by the Government as key workers, so we also published details of essential work that would carry on during the lockdown.

In terms of the business retail market, there is considerable concern as providers see business customers stop using water or stop paying for water (either to save money or as the business has closed). This is going to be a difficult period for the retail market and, as a wholesaler, we are offering support where we can.

As we move towards a new normal, the focus in retail will be on continuing to improve the level of service we offer, supporting our most vulnerable customers, while optimising our activities to deliver further efficiencies.

In terms of our frontline water and wastewater services, we are prioritising work and resources to maintain supplies to customers and protect the environment. As a result of some resource constraints and workforce limitations, it has been necessary for some of our regulatory compliance schemes to be delayed. We have been working with our regulators to agree short-term delays where appropriate, and they have been understanding of the issues and priorities. We are taking a risk-based approach to delaying schemes and we will not be delaying any regulatory scheme that is deemed to be critical.

With more people working from home and families in lockdown, we have seen changes in water usage and demand for water. Business use has dropped, but domestic use of water has significantly increased. This is something we have needed to react to and ensure service levels have been maintained.

At the same time, all water companies have seen an increase in the number of sewer blockages that can ultimately cause sewer flooding and pollution incidents. This has been caused by the flushing more wipes and non-flushable items down toilets. Our frontline teams have been working hard to get on top of this and minimise the impact on our treatment works, and we have issued advice for customers via social and local media channels.

In terms of our supply chain resilience, there are concerns that some chemicals, equipment and manpower may become more difficult to get hold of in the coming months. We have conducted a risk assessment across all our critical supply chain partners to understand their ability to maintain continuity of essential goods and services. We have yet to see any significant impact in this area.

The health and safety of our own employees has been a priority as all teams, both office and field-based, have adapted to new ways of working. We have followed Government guidance and done all we can to make the transition as easy as possible at this difficult time. We continue to monitor the situation and adapt our plans in relation to inevitable staff shortages and limitations on our teams' ability to undertake some routine tasks because of social distancing requirements. Read our full COVID-19 risk assessment at **southernwater.co.uk/media/3520/covid-19-risk-assessment-v10-final.pdf**.

It is clear that the impact of COVID-19 will last for months, if not years, and we will continue to follow all government guidelines in their entirety, doing all we can within these to enable the ongoing operation of the business, while doing everything we can to enable as many colleagues to continue to work 'as normal' during the pandemic.

Pictured
To keep customers informed, we created a dedicated COVID-19 area on our website, which included a letter from our CEO

The market we operate in continued

Key trends	How we are responding	
	Now	In the long term
Engaging customers Water is becoming increasingly important for customers, and there is a greater desire and momentum for them to actively participate in the protection of future water resources. Regulators, stakeholders and customers all recognise this trend and, as a supplier of essential services, we need to take this opportunity to involve them. However, as all of our consumers are individuals, we must provide more appropriate ways for them to engage. To do this, we need to enable customers with access to the right tools and channels, as well as being honest and open with them in regard to any issues.	Our vision, values and purpose have been created with this shared responsibility in mind; it is only by succeeding together that we can deliver water for life and a resilient water future. During 2019–20 we have transformed our approach to engaging with customers by working with our Customer Challenge Group, who have provided independent advice. Our customer engagement strategy is now part of our standard business practice, and we are using insight from this to drive transformation. For example, we have been providing advice, tips and tools to help customers reduce their water usage and maintain these changes in their behaviour. With our programmes such as Beauty of the Beach, we have been empowering third parties and stakeholders by providing them with materials for use across their own channels, so we can share the responsibility for protecting our beaches. A 10% reduction in average water use by 2020 Improved advice on how to prevent blocked drains to reduce blockages	As we move into the five-year period for 2020 to 2025, we are strengthening our collaborative working with communities and partners by scaling up our behaviour change work through Target 100, and FOG and Unflushables campaigns, making it easier for customers to actively participate. We will be working with Customer Action Groups, which bring together panels of consumers over extended periods of time to deliver solutions. We will also be using consumer segmentation, so we have a much better understanding of the personal needs and the relevant approaches to engage with our customers from across our diverse region. Fit for the future – Target 100 Deliver great service – reduce flooding incidents
Affordability Water is an essential service, and households are under growing pressure to support their families, particularly as a result of COVID-19. We are privileged to be a supplier of such an essential service and therefore have a social duty of care. While bills are already considered affordable by many, and costs in 2020 are reducing, our customers are unique and are all in different circumstances, and at varying points in their lives. In ensuring bills are affordable for all, we need to identify how and when to support those customers that need it most. This is a difficult challenge. However, our regulators, stakeholders and customers see supporting those in financial hardship as a priority. We must work collaboratively, using the latest technology, to better provide the personalised support required to ensure our services are affordable for all.	Our Affordability and Vulnerability team has helped thousands of customers who were struggling to pay their water bills. Collaboratively, we have been working with other services to provide holistic support. For example, our Customer Inclusion Panel – a cross-regional group of experts in vulnerability – provide advice in giving the right assistance to those that need it most. We also work with South East Water to provide a single bill where our regions intersect, so that customers can benefit from simplified transactions and a consistent level of support regardless of location. We have also looked wider, working closely with Brighton and Hove City Council, the University of Sussex, and the Consumer Council for Water, to understand the impact water efficiency can have on households struggling with their bill. By targeting water efficiency visits, which also provide affordability support and advice, we have helped customers reduce their water consumption by 6%, and the amount of people receiving financial support has doubled. Customers in financial hardship provided with improved support	We need to go further for those in hardship, which is why we have signed up to a Public Interest Commitment to end water poverty by 2030. During 2020–25 we will be increasing the number of people we support, and will assess the effectiveness of those support measures to ensure we are providing the best support. We will also continue to work across the sector to ensure there is consistency and fairness in identifying customers in vulnerable circumstances, making it easier for everyone to get access to the right support. Deliver great service – Effectiveness of assistance

Key trends	How we are responding	
	Now	**In the long term**
Climate change Climate change, and the extreme weather patterns that result from it, present a significant challenge to water companies across the UK. We are proud of our record of reducing carbon emissions across our network, recycling waste from our wastewater treatment sites and we are pleased to report a continued increase in our use of renewable energy.	We know we need to do more to reduce our environmental impact, so we have committed to the Water UK Public Interest Commitment to achieve net zero carbon emissions for the sector by 2030. We have expanded our Commercial Energy team, increasing our in-house capability to identify energy efficiency opportunities and monitor our performance to reduce energy consumption. Our Optimisation team has continued to expand its monitoring and targeting initiatives to reduce energy consumption of our treatment processes and pumping. Increase the proportion of renewable energy we use to 16.5% by 2020	We plan to continue to reduce our operational emissions by decreasing our energy use and increasing our renewable energy generation. In doing this, we aim to achieve net zero by 2030, in turn delivering financial benefits for our customers and investors. In this five-year period we intend to invest heavily in our renewable energy generation, increasing both our use of renewable energy from self-supply and supply of green energy to the National Grid. We are also exploring how to maximise the contribution of our extensive land bank to reduce greenhouse gas emissions. Fit for the future – increase value from environmental initiatives Fit for the future – increase renewable generation
Increasing customer expectations Our customers' expectations continue to evolve as technology and new ways of working are introduced across different markets. The definition of 'great' service also continues to change. Customers are living fast-paced lives and interacting through new channels that work around their lives. Water is a 24/7 business; customers expect us to be on hand when they need us through a variety of channels. To meet these changing demands, we need to be agile; to exceed them we need to plan for future expectations by innovating around our service.	As part of our transformation we have been laying the foundations to increase the variety of channels we use so, in turn, we deliver great customer service. These channels currently include phone, email, social media, post and web chat. We have been working with our partners at Capita, using their expertise, to transition to a consistent high-quality service for all, ensuring a more tailored service to vulnerable customers directly from Southern Water. Although we have seen improvements in many areas, such as our provision of online chat services, our level of service is not where we want it to be. We are actively working towards the improvements set out in our business plan for 2020–25. Quick and effective resolution of customer queries Direct compensation paid when we let customers down	We know that we need to focus on meeting current expectations as well as future service levels, which is why our innovation hub – bluewave – has been establishing more agile working practices. As we move into 2020 and beyond, bluewave is driving forward service improvements across our business. Our Operational Excellence team is also driving enhancements across our water and wastewater teams. In the coming months, we will be reviewing our online offering to meet our customers' growing desire to interact with us digitally, while ensuring traditional channels are not left behind. Deliver great service – improved satisfaction Affordable and accurate bills for all

The market we operate in continued

Key trends	How we are responding	
	Now	In the long term
Securing long-term resilience Our customers want us to maintain the same level of high-quality water and wastewater services for future generations. Resilience is not just about looking inwards, but also understanding the connection between our organisations' processes and the wider community around us. Unfortunately, the spread of COVID-19 in the early part of 2020 is a prime example of how we need to consider the connections our organisation has with other industries and the communities we serve; it is vital to maintain continuity of service, and innovate and improve for the future. We must continue to collaborate across the industry and across sectors to understand where working practices can be shared, where impacts are felt and how can we deliver solutions together. Working in an honest and open way and seeking partnerships for mutual benefit is imperative.	During 2019 we have built long-lasting partnerships across various sectors to ensure we have the expertise and processes to secure long-term resilience. We signed Memorandums of Understanding with our region's wildlife and rivers trusts to ensure we are considering the best options to protect and improve the environment. We have been a leading partner with the Greater Brighton Infrastructure Panel, looking across industries to bring together processes for water, energy and transportation. We have enhanced our focus on catchment management, working with communities on the ground to understand the local processes and impacts in protecting water resources. We have also been transforming our internal infrastructure by bringing our IT and data management in house and investing in our technology. Efficiency savings made from 2015–20 to keep bills as low as possible	Our Resilience Action Plan shows how we will be taking steps through to 2022 to greatly enhance how we reduce risk, for more detail see case study on page 34. We will continue to collaborate across the industry to bring processes and systems together, such as regional water resources planning across the South East, and the Havant Thicket programme to build a new reservoir in Portsmouth Water's area for Southern Water customers. Fit for the future – develop new sources of water Fit for the future – address long-term issues with our network
Transparency and accountability In recent years, we have seen rapid political and social change. This has led to a climate of uncertainty and unpredictability. In light of unprecedented, life-changing events, such as COVID-19 and Brexit, customers are increasingly looking for their suppliers to be part of the solution and provide positive structure and stability. We are in a privileged position as a trusted provider of an essential service so we need to take the lead in helping customers through these challenging times. We need to be engaging in a transparent and open way, providing information and explanation around the decisions we make and taking accountability for our responsibilities.	Our transformation continues; in 2019–20 we implemented several measures to improve working in a more transparent way. We introduced our Ethical Decision-Making Framework across the organisation and have now started to embed our company values: doing the right thing, succeeding together and always improving. We have used insight to engage with customers with regard to what they want to see from a social contract, and they have provided us with numerous suggestions. By supporting local communities, charities, customers in vulnerable circumstances, our employees, along with putting our customers first, we can fulfil that contract. We have enhanced our transparency of environmental reporting at **southernwater.co.uk/our-performance/environmental-performance**. Better information on how we are providing value for money	We signed up to Public Interest Commitments to enhance social value through ending water poverty, becoming carbon neutral and improving social mobility. We will deliver on our pillars of our social contract by working collaboratively with our partners, such as the rivers and wildlife trusts, and working with our customers through our Customer Action and stakeholder groups – such as our Inclusion and Environment Panels – so they can advise on and challenge our performance. We have also been working with customers on the creation of enhanced performance reporting that provides a more personalised and local view, tailored to what our customers want to see from us. Use water wisely – community engagement

Read more about **our commitments to customers** on pages 58 to 99

Read more about **our plans to 2025** on pages 36 to 39

Pictured opposite
We work with the rivers and wildlife trusts so they can advise on and challenge our performance

Case study

Our work towards creating a resilient future

Alison Hoyle
Director of Risk and Compliance

Link to governance

Read more about **our risks** on pages 116 to 134

Read more about **our Board's long-term approach and its role in approving the RAP** on page 180

Link to strategy

Our commitments to customers (AMP6):

- Leakage
- Time spent without water
- Water pressure
- Internal flooding
- External flooding

Read more about **our performance** on pages 58 to 99

Our Resilience Action Plan (RAP) details what excellent resilience looks like, and what actions we are taking to get there. We have collected these actions and will be delivering them over a two-year period, to 2022.

We are very dependent on the weather, and are highly vulnerable to extreme weather events. The 'Freeze/Thaw' of 2018, for example, highlighted how, in some places, our resilience measures were insufficient. With the increased frequency and severity of such extreme weather events due to climate change, it is vital that we ensure we are as resilient as possible to them, in order to preserve our ability to provide an uninterrupted service to our customers.

Resilience is defined as "... the capacity of an organisation to plan for and adapt to change or disruption through anticipation, protection, responsive capacity and recoverability" (Cockram and Van Den Heuvel, 2012). Therefore, the benefits of the RAP will transform us into an organisation more capable of continuing our services in the face of these significant disruptions.

We have already improved our risk structure, making corporate risk reporting more transparent and comprehensive. Our Investment Strategy team has performed maturity assessments of their function to understand the areas most vulnerable and in need of improvement. Additionally, our incident management capabilities have been improved through the introduction of new monitoring indicators, a process brought in following previous incidents, along with a new system, root cause analysis and regular scenario testing.

Ofwat also recognised the plan in its Final Determination, stating that it "demonstrates a significant improvement from its September 2018 business plan. It includes a number of good elements and meets expectations in most areas".

Ofwat recognised our RAP as a 'significant improvement'

Our business plan 2020–25

Rigorously challenged and assured, our plan ensures the future resilience of our network for our customers and focuses on what is important to them

Read more about **bluewave's innovation approach** on page 45

Read more about **our work with vulnerable customers** on pages 68 to 71

The ambition behind our business plan for the period 2020–25 is to deliver a resilient water future for customers in the South East. The plan was developed following extensive consultation with our customers and stakeholders over a three-year period. Our customers told us that as well as thinking about the challenges of the future, they have an expectation that we will continue to deliver on the basics – clean, high-quality drinking water and effective wastewater systems.

Our plan reflected these expectations, with significant performance improvements planned, including a 15% reduction in leakage, improving 537 kilometres of rivers and supporting 155,000 customers through financial assistance schemes, with bills reducing by 3% in real terms.

Ofwat's detailed scrutiny and challenge of our plan culminated with the publication of their final decisions in December 2019. Ofwat largely accepted the ambitious improvement targets that we set in our plan, but significantly reduced the level of funding available to deliver these improvements and, in some cases, required improvements to be made more quickly. The result is that bills will fall by an average of 18% in 2020–21 (including the impact of the financial penalties associated with our historic misreporting of wastewater compliance data).

While we were disappointed by the outcome of Ofwat's review, we chose not to appeal the decision to the Competition and Markets Authority. We are now focused on making the important changes that will enable us to meet the challenge that Ofwat have set us, to deliver a step change in performance at the same time as reducing bills.

Enabling our ambitions

To support the successful delivery of our plan, during the year we introduced a new integrated business planning methodology, which enables us to take a more holistic approach to investment planning and decision making across the whole business. We have also rolled-out of a new risk and value process to ensure that at each stage of the investment cycle we provide best value for money for our customers.

Innovation

We are always improving the delivery of our service to create a resilient water future for our customers. Examples include our Target 100, and Bathing Water Enhancement programmes, along with innovations in catchment management and our water and sewer networks. If we are to meet the future challenges we face, we will need to continue to innovate. We see innovation as essential to overcome future challenges. To help us deliver our plan we are establishing a fresh approach to innovation to accelerate the process of change and drive the actions we need to take, with our bluewave innovation lab taking the lead.

Resilience

Resilience is at the centre of our strategy, so we become brilliant at the basics while transforming key areas of our business. We believe there is a substantial opportunity to adopt a more integrated

Read more about **what our customers said they wanted** on pages 38 to 39

Process of economic regulation

Our regulated water and wastewater business works in five-year planning cycles. For each five-year period, we develop a business plan that is based on our customers' priorities and is then reviewed by our regulator, Ofwat.

Summer '16	from Oct '16	from Oct '17	from Apr '18	
Start of bespoke stakeholder and customer engagement	Exploratory insight into customer priorities	Developing our customer outcomes	Testing of our proposed plans	Launch of Customer Engagement Strategy as 'business as usual'

CGG challenge and scrutiny of our business plan

2015 → 2016 → 2017 → 2018

Pictured
Helping to maintain river and bathing water quality are key areas of our plan to 2025

approach to the way that we deliver over the 2020–25 period, using systems thinking to look at the bigger picture, and how we might collaborate with our peers and other industries to deliver joint solutions to some of our bigger challenges. An example of this in action is our work to deliver a regional water grid through Water Resources in the South East.

Helping customers who need support

As the provider of an essential service, we must ensure that our services are accessible to all our customers, including those in vulnerable circumstances. Our plan will make bills more affordable for all our customers, while also improving the level of service we provide to those most in need. We are committed to offering a range of financial assistance options to those struggling to pay, making sure we track our performance by specifically measuring the effectiveness of the support we provide. We will do this by asking for customer satisfaction feedback, and whether their individual needs are met. We will also look to expand our partnerships, working with community organisations to identify those who might be at risk.

COVID-19

Our delivery of the ambitious improvements in our plan in 2020–21 will inevitably be impacted by the restrictions imposed as a result of the COVID-19 pandemic. The extent of this impact will need to be carefully assessed and the implications for our business plan delivery will be discussed with Ofwat. During the pandemic our focus has been on ensuring the continuity of essential services to customers, while ensuring we support those customers who find themselves in vulnerable circumstances, physically and financially.

Read more about **our COVID-19 response** on page 28

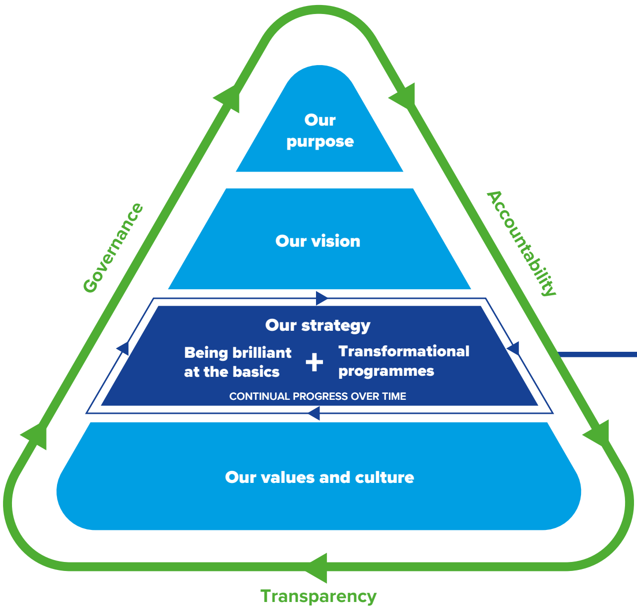
Our plan includes both the forecasted costs for delivery of services and what that means in terms of customers' bills, and sets measurable performance targets aligned to priorities that customers have told us are important to them. These forecasted costs include any penalties or rewards set by Ofwat for past performance.

Sep '18	Jan '19	Apr '19	July '19	Aug '19	Dec '19	Feb '20	Mar '20	Apr '20
Submission of Southern Water's business plan for 2020–25	Ofwat publishes Initial Assessment of plans	Submission of Southern Water's reviewed plan	Ofwat publishes Draft Determination	Submission of Southern Water's final plan	Offwat publishes Final Determination	Southern Water's acceptance of the Final Determination (FD)	Southern Water develops execution plan to deliver FD	2020–25 business plan period begins

CCG providing independent advice challenge

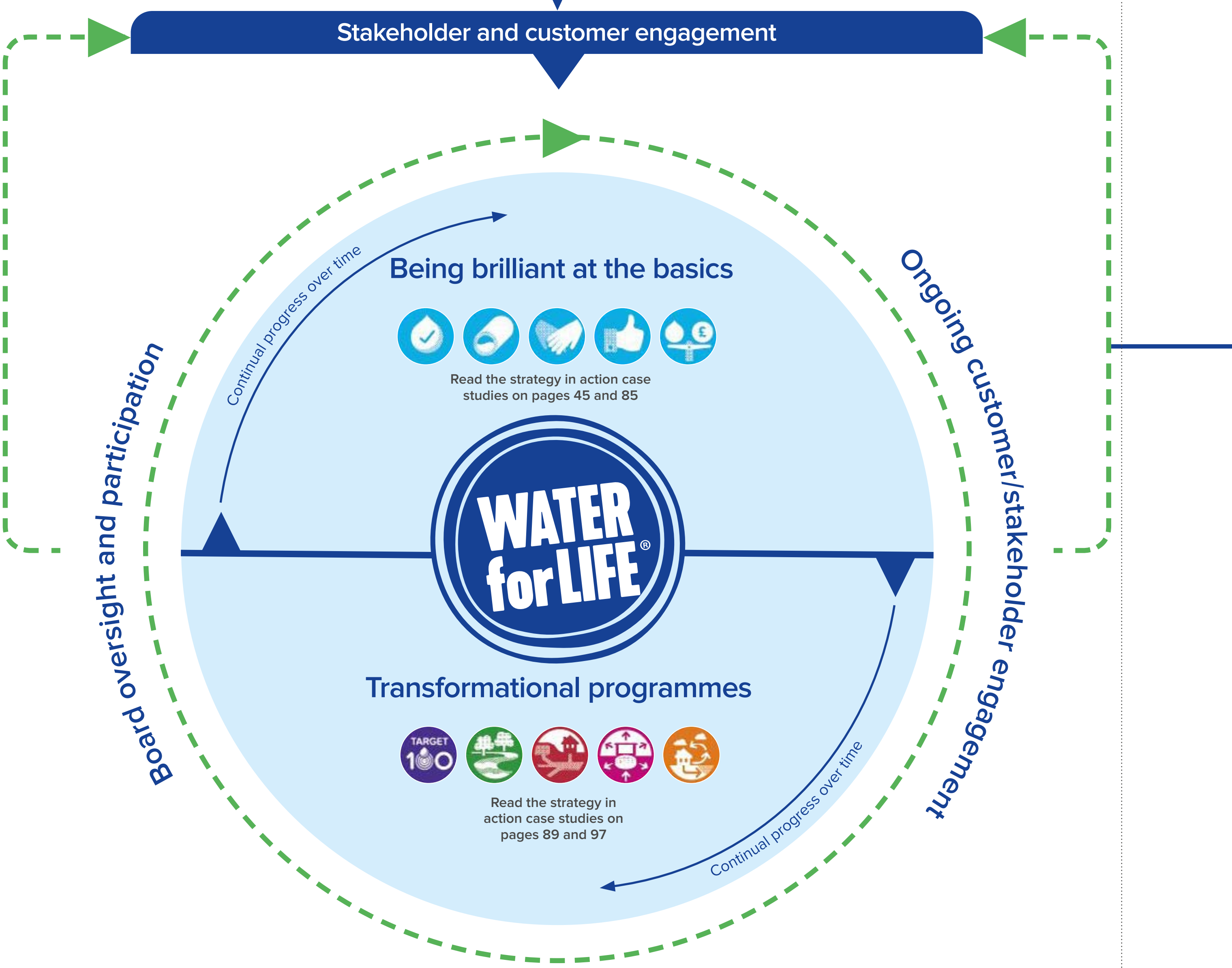
2019 2020

Our business plan 2020–25 continued



Our plan in summary

Following an extensive consultation with our customers and stakeholders, our priorities for 2020–25 are to be brilliant at the basics, delivering clean, safe water, through a reliable network, at a price that everyone can afford, with good quality customer service along the way, while ensuring the future resilience of our network through our transformative programmes.



Final Determination

A challenging Final Determination will see us invest £3.2 billion, at 2017–18 prices, across the region over the next five years. This will create jobs, protect and improve the local environment, and will improve our water and wastewater network. We have developed solutions that align to our customers' priorities: driving outcomes in customer service; support for those in vulnerable circumstances; water quality; flooding; leakage; pollution; and interruptions to supply.

Final Determination outcomes

	Outcome	What this means for customers
1. Protect and improve the environment	We are all responsible for the state of the environment. Customers want to see us protect and improve the environment; doing no harm is the absolute minimum they expect.	• Protection of the environment – focus on pollutions, surface water management, bio-resources recycling, reductions in the amount of water we take from rivers and bathing waters • Improvements to the environment – improve the number of bathing waters at good or excellent status
2. Fit for the future	Customers recognise the challenges we face and expect us to ensure that future generations have access to at least the same level of water services as we do today. Bills are broadly felt to be affordable now, and customers are willing to invest to ensure that there is no deterioration in services in the future.	• Limit the impact of drought • Enable customers to use less water • Identify new sources of water • Address long-term issues with our network • Increase value from environmental initiatives
3. Deliver great service	Good service for most customers means minimal interaction with us and a reduced impact from issues/disruptions on everyday life. Where there is engagement, customers want an efficient, tailored and personalised service that provides holistic assistance to those customers who are in genuine need of support.	• A reliable supply of clear running water • Support for customers in vulnerable circumstances • Reliable wastewater services • Improved consumer experience • Accurate and affordable bills for all
4. Use water wisely	Without water, life would be impossible. The service that goes on behind the scenes to deliver drinking water and remove wastewater can sometimes be taken for granted. When informed, customers recognise the value these services bring to our daily lives, enabling everything that we do. They also understand water is a precious resource that needs to be looked after.	• Reduce water leakage on our network • Educate customers on the value of water so they use less, which reduces demand

Our business model

Resources and relationships we rely on

Resources

- Natural resources – managing water resources, protecting the natural environment and processing waste to generate renewable energy
- Assets (infrastructure) – efficient maintenance of our sites, equipment and networks, significant capital investment to construct new assets and innovation to inform future development
- Financing – maintaining a robust capital structure, long-term cost-effective debt and proactive engagement with investors to maintain access to a range of financial markets
- Our people – developing and motivating our employees, empowering them to deliver the high-quality customer experience that our consumers expect and deserve

Resources

- Active participation – engaging customers with the role we all play in valuing water, encouraging behaviour change to protect resources and sharing ownership for how water is used, viewed and valued
- Suppliers – building a strong relationship with those companies who work on our behalf
- Regulators – ensuring we have a constant, open and honest two-way communication with our regulators, engaging and influencing reform where we can

The water cycle

Our environment is constantly changing, and it is necessary that we can adapt and prepare for the challenges of population growth and climate change. Our use of water and its return to the environment is a continuous cycle, and managing our impact at every stage is critical to protecting future resources.

Maintenance and development

We constantly monitor our water and wastewater sites and networks, conducting maintenance and developing new infrastructure to make sure they are meeting the standards set by our regulators.

Link to value generation (VG)

At each stage of the cycle, value is generated for our varied stakeholders, whether they are customers, communities or the environment itself.

Customers and Communities

Our work puts us at the heart of our communities, so we aim to anticipate and meet changing customers' and wider societal needs throughout any maintenance or construction.

Associated risks (AR)

At each stage of the cycle there are several opportunities and risks, including penalties and rewards applied by Ofwat. We always seek to maximise opportunities, while also identifying, managing and mitigating any risks.

Failure to monitor, maintain and increase capacity of our water and wastewater sites and networks could pose risks to public health, and result in disruptions to supply, injury to our employees or customers, and damage to property.

Our purpose

Our vision

Innovation

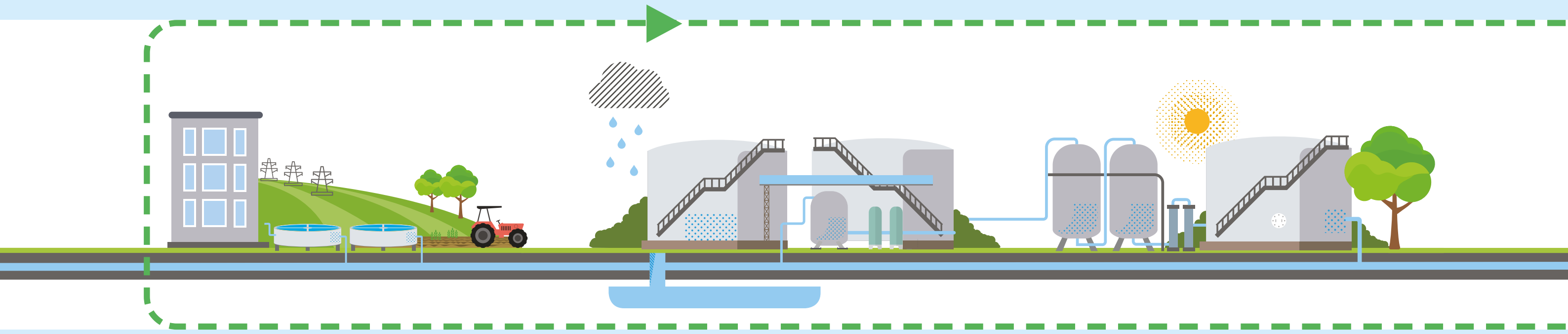
We continually look for new ways to make our services better, safer, faster and cheaper. We are always improving.

Water is collected and cleaned

Our water is mainly drawn from underground storage facilities or aquifers, rivers and boreholes. Our 84 water treatment works clean raw water to the highest standards, making it safe to drink.

Clean water is put into the supply

Our 13,959km network and 207 service reservoirs deliver a continuous supply of clean water to our customers.



Environment

Our sites sit within a rich and diverse mix of habitats, which we must protect and improve wherever possible.

Customers

Working smarter means we can pass savings back to our customers, keeping our bills affordable for all.

Environment

We work hard to manage water demand as we can only take a certain amount from the environment to avoid causing harm to habitats.

Customers and Communities

The water we put into supply meets extremely high standards set for us by the Drinking Water Inspectorate.

There are operational, commercial, reputational and financial risks to constantly innovating. For example, failure to meet quality standards, cost or scheduling requirements, failing to meet customers' needs or simply investing in unsuccessful projects.

In our densely populated and water-stressed region, we must balance the need to supply high-quality water to our customers with the need to preserve our natural resources. Failure of key infrastructure could result in a risk to public health due to reduced water quality and/or disruptions to supply. We use several chemicals in the treatment of water which, if not handled correctly, could result in injuries to employees and/or customers.

If we fail to meet required standards, public health could be put at risk, our customers could experience supply disruption or a reduced water quality. We may also experience increased leakage from our network.

Our values: succeeding together, doing the right thing, always improving

Customers enjoy our water

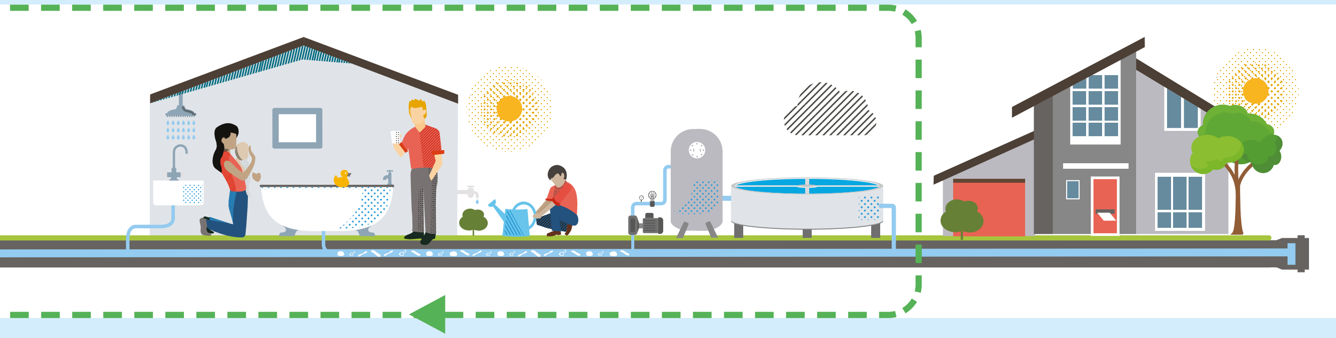
Customers across the South East go about their daily lives enabled by a supply of safe, clean drinking water and the removal of wastewater from their homes and businesses. In 2019–20, we put 541.78 million litres per day into supply.

Wastewater is collected and treated

Our 39,872 kilometres of sewers and 3,420 pumping stations collect wastewater from our customers' homes and businesses, and from the drains outside. Each day, 745 million litres of wastewater are carefully screened, filtered and treated at our 367 treatment works, meeting strict environmental standards before being returned to the environment.

Customers are billed

Our Customer Service Teams calculate and distribute customers' bills and handle any related queries.



Environment

To better manage demand we must ensure that we lose as little water as possible through leakage on our network.

Customers and Communities

Without water, life would not be possible. It enables everything we do, and every industry to operate.

Environment

By supplying safe, clean water and good levels of sanitation, we protect our rivers and oceans from pollution.

Customers and Communities

We are looking into new water recycling methods as a possible way to meet future demand.

Environment

Cleaning wastewater uses a lot of energy, so we use renewable sources where we can to help us power our operations, mainly biogas and solar. By-products of the process – biosolids or sludge – are used by local farmers as fertiliser.

If we do not constantly look to improve and maintain high levels of service and quality, we run the risk of not fulfilling our obligations to customers, to provide high-quality drinking water and protect rivers and bathing waters.

If we do not remove wastewater effectively and manage our network, we may cause sewer flooding, environmental pollution and unnecessary distress to our customers. Potentially hazardous substances and processes are also used that could cause injury to our employees and/or customers.

Climate change and flooding
Varying rainfall patterns, extreme weather events and rising sea levels all contribute to an increased risk of flooding. If our infrastructure is overwhelmed, it could lead to flooding of private land or property, possible contamination of water supplies and infiltration/inundation of our sewers.

Errors in our billing calculations or customer information could lead to poor levels of customer satisfaction, and a rise in contact and complaints, which could damage the company's reputation and increase our operating costs. Failure to properly protect customer data could also lead to significant fines under Data Protection (GDPR) and Networks and Information Systems (NIS) directives.

Case studies

Nick Eves
Head of
Customer Insight

Protecting our rivers by reducing demand

People living in south Hampshire have always relied on the Test and Itchen rivers for their water. A hot summer, coupled with changes to the amount of water we were allowed to take from the rivers by the Environment Agency this year, posed a significant challenge in terms of balancing our customers' demand for water.

Our insight showed that we needed to engage with customers, explain the context of the threat, and then assist them with taking action to reduce the amount of water they consumed, to enable us to take less from the rivers. While sounding simple, we have a variety of different customers and options to consider when constructing a plan.

We began by using our existing research to develop some different messages and visual concepts. An ongoing insight programme was created to support by:

- Pre-testing – through qualitative and quantitative panels to see which routes provoked the most positive response
- Post-testing – through integrating a variety of insight sources (e.g. consumption data, awareness tracking, customer panel feedback) to evaluate the impact and continuously improve

We found customers particularly welcomed practical tips and advice. We delivered a series of news, digital, radio and outdoor adverts over a period of eight months – April through to December – and released them in four phases, each learning from the previous phase. During the festive period we also delivered over 285,000 postcards, and used a local radio campaign to thank customers, showing them the impact they had had on demand, and ultimately local rivers.

Over this eight-month period, we saw an increase in awareness and a reduction in consumption. For example, over the August bank holiday (2018 vs 2019) we saw a year-on-year reduction in consumption of up to 3.6% in targeted areas against an overall increase of consumption elsewhere.

Customers want practical tips and advice

Link to governance

Read more about **stakeholder engagement** on page 164

Read more about **our approach to resilience** on page 180

Link to strategy

Our commitments to customers (AMP6):

- Per Capita Consumption (PCC), customers' daily usage per person, per day
- Distribution input (Ml/d)

Read more about **our performance** on pages 58 to 99

David Lloyd
bluewave
Innovation Lead

Jonny Burke
bluewave
Innovation Consultant

Using systems thinking to reduce pollutions

Link to governance

Read more about **our approach to risk** on pages 179 to 180

Read more about **effectiveness of the Board** on pages 168 to 172

Link to strategy

Our commitments to customers (AMP6):

- Number of serious pollution incidents (cat 1 and 2)
- Number of less serious pollution incidents (cat 3)

Read more about **our performance** on pages 58 to 99

The Pollutions team came to bluewave to review the process of pollutions management. It wanted to reduce the number of pollutions, but needed to see the system quickly, to work out which parts of the process to fix. The team had already initiated an ambitious Pollution Reduction Plan, which is motivated by the need to minimise environmental impact and improve operational efficiency. The costs involved in managing pollution incidents are both financial and reputational.

We started out by looking at best practice across the industry and beyond, to explore what an end-to-end pollutions reduction process might look like for the future. We found new ways of visually mapping processes, looking at the interconnected whole, identifying negative feedback loops and finding key leverage points with which to affect the system. The result was a new process map, embedded with systems thinking, that can be used to make process improvements. The map aims to enable better quality data, improved response times and prevent pollutions through better understanding of our processes.

As part of the mapping project, we uncovered a deeper problem: an undefined approach to embedding processes within the business in a sustainable way. Without proper management of processes, the business would need to redesign and reinvest in a few years to fix the system again.

To tackle this wider problem, we recommended:

- A process management function to design and update new processes;
- Providing frontline staff with better equipment and training;
- Improving communications amongst teams involved in the process;
- Fostering links between teams and the regulator;
- Using existing technology in new and better ways; and
- Creating checks and balances in the system to improve performance.

A new process architect, hired on our recommendation, will use the map, recommendations and systems thinking principals to target improvements in processes focused on pollution reduction.

We found new ways of visually mapping processes

Engaging with our stakeholders

Read more about **how our customers influence our strategy** on pages 36 to 39

We have embedded insight-first decision-making into our communications

Customers

How we engage

In September 2018 we launched our customer engagement strategy that defines our principles of high-quality customer engagement, designed to align with our values. The strategy puts the customer at the heart of our engagement, so we can make it easy and meaningful for them to contribute in our decision-making.

In 2019–20 we have made greater use of new innovative approaches, such as our Customer Action Groups – panels of consumers assembled to assist with co-creating solutions. We have embedded insight-first decision-making into our communications, including behaviour change campaigns, customer communications and strategic planning.

We have worked collaboratively with others across the industry to share best practice and knowledge, including updates with our Customer Challenge Group, and a sharing session with Waterwise, the Environment Agency, and over 10 other water companies, to discuss different approaches to water efficiency.

Where we are going

Doing the right thing – As we move into the next five-year period we will continue to build on this solid foundation to innovate new approaches, including trialling our Customer Action Groups, with members acting as ambassadors to their communities, to bring the voice of more customers into our insight.

Succeeding together – We will use the relationships with other water companies, organisations and stakeholders, to continue collaborative working and sharing of engagement, such as through a joint programme with South East Water and the Behavioural Insights team around water efficiency.

Always improving – We will continue to be challenged to improve by our stakeholders and customers. We will invite our consumers to meet with our technical experts and senior leaders, so they can collaborate on solutions to the critical challenges facing our region.

Customer participation principles

Succeeding together	
1. Shared planning	Working together to ensure our engagement activities happen at the right time
2. Collaboration	With our customers, stakeholders, employees and other water providers
3. Two-way dialogue	Ensuring we engage in a way to allow for open discussion
4. Partnering	Working much closer with our partners to bring in their expertise
Always improving	
5. Innovate our approaches	Innovating and testing new ways to engage
6. Iteration by design	Ensuring we have steps within our engagement to learn as we go
7. Open to challenge	Actively seeking expertise and recommendations to help us improve
8. Comparative learning	Looking inside and outside the industry for best practice
Doing the right thing	
9. Integration	Using the different insight sources together from across our engagement
10. One voice	Triangulating the sources together to have a clear view of customer feedback
11. Participation first	Starting with the customer and how they can play an active role
12. Segmentation evolution	Understanding individual needs and tailoring our engagement

Customer Challenge Group (CCG)

Since its inception, our independent Customer Challenge Group (CCG) has delivered immense value to our business, and has been instrumental in changing our thought processes and culture to ensure the interests of customers, stakeholders and the environment are at the heart of all we do. Many of the customer engagement approaches and processes, developed in conjunction with the CCG, have now been embedded as ‘business as usual’.

From April 2020, and following the conclusion of the Price Review 2019, we are ending our current CCG. This coincides with the conclusion of the 2015–20 five-year regulatory period, and the start of the next five-year period for 2020–25.

We have exciting plans in place to continue the excellent work of the CCG, by evolving and improving the quality of our engagement with customers and stakeholders, and to meet the needs of the communities we serve across Kent, Sussex, Hampshire and the Isle of Wight.

In ending the current CCG, we would like to express our thanks to all the members who have served on the group, particularly its Chair Anna Bradley. The Board, the Executive team, and the many employees who have engaged with the group are immensely grateful for the quality of the advice and the challenge it has provided.

Employees

How we engage

Our employees make our company and we could not deliver our essential services without them. It is important that we constantly look to build relationships with our employees across the region, based on mutual trust. It is also vital that we offer our employees development opportunities that stretch and engage them, fostering an innovative environment, and working with them to improve our services for customers. Our employees know our business and our communities better than anyone, and we celebrate their diverse range of experience by asking them to identify opportunities for improvement.

We have maintained levels of employee engagement, as evidenced by our Gallup survey performance. However, we know there is more to do. Our managers play a key role in driving engagement, by supporting employees with regular one-to-one meetings. We also run a quarterly People Insight Survey, which asks for anonymous feedback on our transformation programme and its strengths and weaknesses, ensuring our leadership has a direct link to the frontline of the organisation. Our employees' perspectives influence key decisions at Executive and Board level. We also have employee-led networks that host forums on Workplace (Facebook).

Where we are going

Our employees' health, safety, security and wellbeing are a priority, so we will continue to invest in awareness campaigns and the equipment and tools they need to ensure everyone goes home safe and well at the end of the day. Investment in training to develop their skills, confidence and competence is also a priority, and we will be unveiling plans for our new training academy in the coming months.

Listening to our employees means we can create an environment people want to work in, which increases job satisfaction. We will continue to improve our employee communications, providing teams across the business with up-to-date information on our performance and plans, so they feel included. Indeed, Kevin McCullough has agreed to take on the role of Board member with responsibility for engagement with the workforce.

We will also continue to support employees through our Speak Up service so they feel safe, protected and supported if they become aware of someone who is not living our core value of doing the right thing. We have also recently reviewed our pension offerings to deliver more flexibility to employees in later life.

Read more about **our people** on pages 50 to 55

Suppliers

How we engage

We spend significant amounts of money with our suppliers each year to deliver maintenance and enhancement projects across our region, and this supports thousands of jobs in the South East. Our suppliers act as an extension of our business and, as such, are valued as part of the organisation in the same way as our own employees.

We rely on our suppliers to deliver our services to customers, but they also have an influence on the availability of goods and services and, ultimately, how we operate. Good relationships with our suppliers are imperative to ensure we can provide great service efficiently, are always looking to improve and create shared value for our communities.

We engage with our supplier network through regular meetings and workshops, including targeted sessions on health, safety, security and wellbeing, customer engagement and innovation. Our partners regularly suggest new ways we can achieve some of our targets, and they offer us new products and services that often help us be more efficient and deliver better service.

Where we are going

Working together with responsible suppliers means we can develop innovations and new technologies to identify solutions that will make our services better in the future, tackling environmental and social issues. Our values, water for life purpose and our upcoming, new Supplier Code of Conduct all support this. They also help us create a consistent experience for our customers through every interaction they have with us and our suppliers.

Read more about **how we work with our suppliers** on page 55

Mark Wintringham
Head of Delivery
Water for Life
Hampshire

Working with customers to co-imagine our water future

Link to governance

- Read more about **our Board's approach to risk and resilience** on pages 179 to 180
- Read more about **our principal risks** on pages 120 to 134

Link to strategy

Our commitments to customers (AMP7): Fit for the future

- Water recycling

Read about **strategy for 2020–25** on pages 36 to 39

Our Water for Life – Hampshire programme, which is looking to secure a resilient water future for the area, has been built with our customer engagement programme at its centre, and the Customer Action Group (CAG) provides us with informed qualitative insight.

The Group includes around 35 customers from across our region, with additional members recruited from Hampshire. Customers are recruited to take part in a series of tasks from home, every month, with new panellists joining and previous members leaving every three months. We then use the interaction between new and existing members as a rich source of insight.

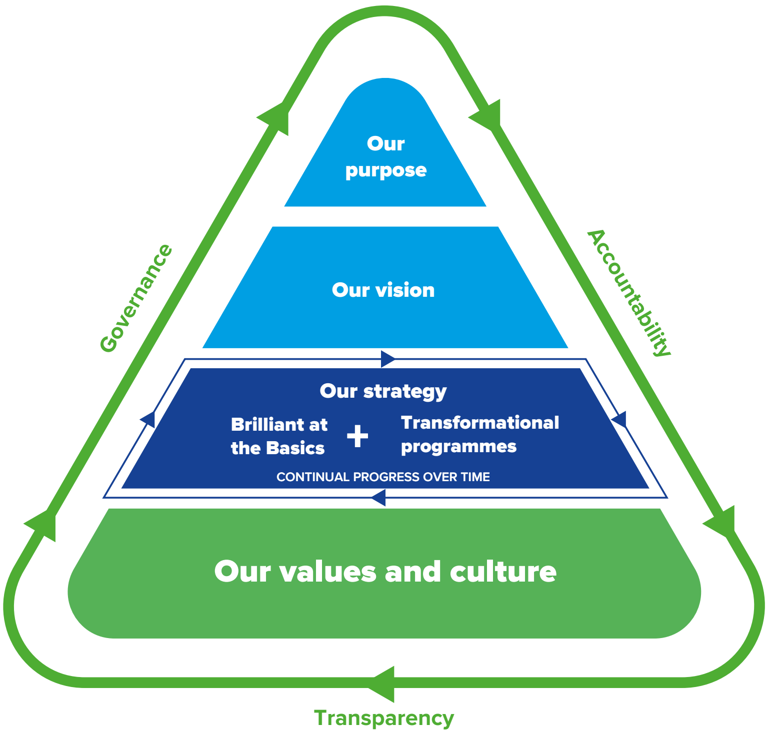
The approach is deliberative, allowing customers to build their understanding and perceptions over time. This way they can understand the more complex issues, future resource challenges and solutions in detail, providing them with a more informed view. The continued two-way dialogue means customers can work alongside the technical teams and evaluate options as they are created, and we can be agile, using that insight immediately.

We set tasks for members to work with their children, family and friends. They then feed back on what they have learnt. The panel is supported by research with harder-to-reach audiences, such as those in vulnerable circumstances, customers of the future and non-households.

The outputs are highly engaging as customers provide video content from their home, which we can then present to project teams internally. We used a mix of this content and our CAG to run a workshop at Testwood Lakes in March 2020, where some panellists, fresh customers, potential community partners and stakeholders, all came together with our technical teams to discuss the company's strategic options face-to-face.

The continued two-way dialogue means customers can work alongside the technical teams, and we are able to gauge perception and acceptability of our solutions as they are developed

Our culture



3
separate customer and stakeholder panels

more than
470
colleagues helped us develop our values

Living our values

A challenging future

Without water, life as we know it would be impossible. Our region faces a future of more people and less water. Our population is growing fast, and climate change is bringing greater risk of both drought and flooding.

A shared responsibility

Southern Water's vision is to create a resilient water future for customers in the South East. Achieving this vision will require individual and collective action, which is why water for life is not just about Southern Water. It is about everyone in the region facing shared challenges and finding shared solutions.

Our values

We will achieve our vision by ensuring our values are integral to our culture, and underpin everything we do.

Succeeding together

Creating our future with collaboration from customers, employees, partners and stakeholders.

Doing the right thing

To protect and improve the environment, and the health and wellbeing of our communities.

Always Improving

Actively seeking new ideas, influences and ways of working to improve our services.

Our people and our community

Committed to providing water for life to enhance health and wellbeing

Employees

To deliver our services across the South East, we directly employ more than 2,100 people in Kent, Sussex, Hampshire and the Isle of Wight, as of 31 March 2020, and not including those employed by our partners.

Collaborating effectively with our partners is key to the success of every aspect of our business. Whether solving IT issues, supporting major construction projects, maintaining the buildings we work in or the systems we use, our partners, working with our employees, enable us to meet our customer priorities.

Promoting gender equality and diversity

We are committed to creating a diverse and inclusive workforce that represents the communities we serve. As an equal opportunities employer, we do not discriminate on the grounds of age, disability, nationality, ethnicity, sex, race, religious or cultural belief, sexual orientation or gender identity. We embrace diversity of all backgrounds, cultures and perspectives, and offer career opportunities based solely on each employee's ability to undertake their duties and responsibilities.

To make sure these values are reflected in our day-to-day activities, we have introduced diversity reporting in many key processes, including performance management and talent reviews, to ensure any gender bias in the process is detected and mitigated. We have also reviewed our suite of family-friendly policies and will be enhancing our family support during the year.

One of our ongoing challenges is attracting female employees to our operational and engineering roles, in what has historically been a male-dominated industry. Overall, only 27% (2018: 28.1%) of our employees are female across the entire company. To address this, we are working to ensure our recruitment processes attract all genders and are free from bias.

Meanwhile, we marked International Women's Day, as we do every year, by sharing interviews – with both men and women – about their experiences. We also hosted a panel discussion in partnership with WaterAid, which addressed the topic 'how we can all actively choose to challenge stereotypes, fight bias, broaden perceptions, improve situations and celebrate women's achievements'.

In line with gender pay gap legislation, we report on data relating to salary, bonus and distribution of pay within Southern Water. For 2019, our report into gender pay differences revealed that – based on the median of all our employees' salaries – our gender pay gap was 2.4% (2018: 7.5%) in favour of men.

We are pleased that we have reduced our pay gap by 5.1% since last year, and that the initiatives we introduced for 2019 are starting to see results. However, we acknowledge that more work needs to be done to continue reducing the gap, including promoting flexible working and our family-friendly policies, encouraging more women into senior positions, and expanding diversity monitoring.

Despite this progress in reducing our hourly gender pay gap, we are disappointed to observe a widening of our bonus gender pay gap. Based on the median of bonuses awarded to employees, our bonus gap was 38.9% (2018: 32.9%). We believe the widening of this gap is due to a higher proportion of men in senior roles than the previous year. Although we have had some success attracting more women into management roles, we have more work to do.

To encourage more women into senior positions, we have introduced a new talent review process at leadership level, which is designed to mitigate unconscious bias. We seek to expand this process to other levels of the company in future. We have also developed a stringent policy around pay movement within the organisation to ensure that decisions are fairly applied.

Our report on gender pay is available at: **southernwater.co.uk/gender-pay-gap**.

Pictured
Our teams work with our supply chain partners to ensure everyone feels safe and supported at work

To encourage our employees to voice any safety concerns, we continue to donate £2 to our company charity for every hazard reported

Health, safety, security and wellbeing

The health, safety, security and wellbeing (HSSW) of our staff, supply chain and the communities where we operate continues to be a priority.

Throughout 2019–20, our performance remained strong in relation to our peers. Although we fell short of our own expectations, achieving 0.32 (2018: 0.19) reportable injuries per 100 full-time employees, missing our target of 0.28, we saw a number of tangible improvements in year, including:

- More structured assurance
- In-depth investigation of near misses and accidents
- Better accountability
- Improved tracking of accidents
- Greater visibility of risks on site
- The impact of the new values, which have placed more emphasis on integrity and led to a better reporting culture.

Major supply partners included in this incident rate are: Siemens, MTS, Cappagh Browne, GSF, MGJV, Galliford Try Southern Water Partnership, PN Daly, BTU, 4D Woolston, CMDP and Clancy Docwra. To address this higher incident rate, efforts were increased across the business to raise awareness of risks, improve processes and ensure every employee is responsible in maintaining and improving performance.

To encourage our employees to voice any safety concerns, we continue to donate £2 to our company charity for every hazard reported. In July 2019, we held our six-monthly Partnership Forum, which focused on best practice in HSSW, and highlighted the importance of working together to ensure everyone feels safe and supported at work. It was attended by our operational employees alongside representatives from our key partners.

Promoting employee wellbeing

While the impact of getting safety wrong can be severe, we recognise health must be taken just as seriously. Our wellbeing programme continues to be enhanced, with mental health awareness training now being provided to all employees, and our community of mental health first aiders increasing. This reinforces our commitment to the Time to Change pledge – signed by our Chief Executive in 2017 – which aims to end the stigma around mental health.

Since being accredited by the Workplace Wellbeing Charter for our commitment to employee health and wellbeing, we have continued to build on feedback from the assessment process. In response, we have developed a Wellbeing Handbook containing advice for employees, and suggestions of ways managers can support the wellbeing of their team members. It contains lifestyle tips ranging from stress management to staying active, and includes guidance from the NHS and the mental health charity, Mind. It also signposts employees to our wider wellbeing schemes and resources, such as our volunteer days, tax-free bike scheme, give-as-you-earn programme and the newly launched Bupa employee assistance programme.

The handbook will be available digitally, and hard copies will be distributed throughout our sites to make sure our wellbeing programme is accessible to all employees.

Our people and our community continued

Our Water First Competent Operator training has been recognised by EU Skills

Developing talent

We are committed to developing our employees. Our emphasis in 2019–20 has been on ensuring our employees can confidently carry out their roles to a high standard. To support this, we have rolled out operations, business skills and management training to drive performance across all areas of our business.

Overall, we delivered an average of 3.6 training days per employee, per year, through a comprehensive range of internal and external courses both online and in a classroom setting, as well as on-the-job training and coaching sessions. We are also pleased that, during the year, 9.7% of our colleagues advanced their career with us, with many taking their first step in management and others progressing in their chosen specialism.

We are particularly proud that our Water First Competent Operator training has been recognised by EU Skills. This training focused on ensuring all our water competent operators are at a consistent level 3 standard. This year, we also launched our Competent Operator/Maintainer programme for wastewater employees.

Over 700 people enrolled in one of our 19 Business Essentials courses, including project management fundamentals, technical report writing, and root cause analysis. In addition to encouraging our colleagues to be more effective in their current roles, these courses also provide an opportunity to build skills that will help them advance their careers.

Our managers play a key role in helping us drive business performance and improvement. To support them, we launched our refreshed Management Development programme, targeted at our frontline and middle managers.

We recognise the importance of inclusivity in attracting, retaining and developing talent, and seek to eliminate bias at every stage. Equality remains a priority throughout our recruitment, retention and development policies and processes. For instance, we are committed to making sure female employees are fairly represented in our talent pipeline and succession plans, and that appropriate development is introduced to enable women to take on senior roles. In turn, this would increase the proportion of women among our most highly paid employees from the 32.8% (2018: 37.9) reported this year.

Communities

As many of our employees live in our region, we are passionate about enriching the communities we share with our customers.

We encourage our people to support charity and community projects, so we offer every employee two paid community volunteer days each year. During 2019–20, 376 of our employees used these days to spend 2,943 hours volunteering (2018–19: 3,708); equivalent to more than 300 working days. Together, we have helped 68 separate charities.

Our charity partner for 2019–20 is Alzheimer's Society, as voted for by our employees. We strive to become a more dementia-friendly organisation and fundraise to support the vital work of Alzheimer's Society. We have made a pledge to raise £100,000 to support people living with dementia and fund research towards finding a cure. Since the start of the partnership we have donated £61,415. Our employees have taken part in sponsored races and sky dives, bake sales and raffles to raise money.

Over 60 employees across our business – including our entire Vulnerability team – have attended the charity's Dementia Friends training, to learn how they can help family members, colleagues and the wider community better understand dementia. In addition, four employees have completed the charity's one-day Dementia Friends Champions training. This qualifies them to train others, so they can help more employees understand what it is like to live with dementia and how they can help. This is allowing us to introduce new ways to support customers and colleagues affected by the disease; for more information read the case study on page 57.

Alongside voting Alzheimer's Society as our company charity, our employees nominated five regional charities to receive a one-off grant of £10,000 for causes including animal welfare, hospice care, homelessness and sustainability.

In addition, we continued to support WaterAid as part of our five-year partnership. In 2019–20, we raised over £67,000 to fund projects in some of the world's poorest communities.

Working with our communities

As a provider of essential services, we understand we have a duty to our customers and stakeholders. As they have no other choice of supplier, we take their interests seriously throughout our decision-making.

Although we are ultimately responsible for making sure our customers' water-related needs are met, we are also keen for customers to understand that everybody has a role to play in providing water for life. To build this understanding, we actively engage members of our community to highlight the link between our work and our customers' lives. Throughout 2019–20, we attended 22 community events across our region and reached approximately 7,500 people.

Our work with communities includes helping people to use water wisely, keep their drains clear and, where possible, save money on their bills. To make these topics engaging, we travelled around the region in our bespoke community vehicle, where we provided practical demonstrations so customers could see water-efficient devices in action. We also handed out items to prevent blockages, including reusable bamboo wipes, and GunkPots for collecting used fat, oil and grease.

We shared water-saving and blockage prevention messages via 51 Waterwise and Sewerwise talks for schools and groups (2018–19: 42).

Unfortunately, we had to cancel our final talks of the year in line with government health advice in the COVID-19 pandemic. However, we are pleased to have spoken to 4,347 attendees – totalling 4.074 hours of learning. We received 100% positive feedback scores for the talks. In addition, we also ran workshops at five other events including Crawley Junior Citizen and Guides open days, at which we engaged a further 3,000 attendees.

As well as helping our customers understand what they can do, we also use this opportunity to learn from them. We frequently ask customers for feedback to help shape our strategy. Throughout 2019–20, we have run several communications campaigns with customers and used their comments to better align our messages and materials to address their priorities. This has been particularly beneficial where we are relying on our customers to support us by changing their behaviour. Our water efficiency campaign in Hampshire and our campaigns to prevent blockages in Havant, Hayling Island and Margate, are great examples of this.

7,500

people were engaged by our community team at events across our region

4,347

people attended our Waterwise and Sewerwise talks for schools and groups

Pictured
We offer talks and practical demonstrations to customers about how to save water and keep our beaches clean

Our people and our community continued

More employees now believe we will do the right thing – a core pillar of our transformation

A great place to work

While our transformation continues, engagement from our workforce is crucial to delivering and maintaining the necessary changes. During 2019–20, employee engagement has been a continued area of focus as we strive to achieve our ambition to be a great company to work for. To lead this, we have appointed Kevin McCullough as a designated independent non-executive director for employee engagement.

We recognise that giving our customers the best possible service relies on our employees carrying out their duties with passion and commitment. Our six-monthly employee engagement survey is at the centre of achieving this. It lets us capture feedback from our employees so we can improve. To achieve the best possible picture of engagement levels, we encouraged employees to respond by us donating £1 to charity for every survey completed.

In early 2020, we completed wave four of the survey, and we received the highest ever volume of responses. Following a jump in overall engagement in the previous survey, our scores flattened this year. The results highlighted that our emphasis on ethical decision-making is gaining traction, as our scores around business ethics show that more employees believe we will do the right thing – a core pillar of our transformation. This is really positive, but we know lasting culture change takes time, and we recognise that we have still not reached the levels we would like to have achieved in terms of employee confidence. Based on insights from the survey, our line managers are working with their teams to address areas for improvement, with support from our team of trained engagement coaches.

Our engagement survey is just one way in which the views of our workforce are considered. We encourage two-way conversations between employees and our leadership team, as this enables our employees' interests to be factored into our decision-making. In addition to the weekly hubs rolled out as part of our Operational Excellence (OE) programme, which allow frontline issues to be rapidly escalated to our leadership team, our OE training sessions have been rolled out to all frontline staff. This training includes techniques for giving and receiving feedback, and provides a framework for constructive conversations to improve performance of people and processes. During our annual ISO 9001 quality management accreditation audit, our BSI auditors commended OE's focus on continuous improvement.

Another way we captured our employees' feedback and encouraged two-way dialogue was through our 'Around Our Sites In 80 Days' roadshow. Members of our Board and Executive Leadership Team travelled to 29 of our sites throughout August and September to meet frontline teams, and to have open and honest conversations with them about the company's transformation.

Meanwhile, we held our second 'Values Week' in April, which focused on succeeding together. Employees were encouraged to express their thanks to teams who have worked with them to achieve shared goals. We asked employees to highlight examples of teamwork and collaboration across our company by posting a thank you message to the teams and people who have helped them succeed on our internal social media platform, Workplace.

We continue to use Workplace to give employees a forum to share news and events throughout the business. Over 75% of our employees have registered and the platform is regularly used to circulate updates and success stories, organise polls and arrange company and social events.

Suppliers

Working with our suppliers

Working collaboratively with our partners is key to the success of our business. From customer support to major construction programmes, our partners are integral to the delivery of our water and wastewater services. We therefore have an ambition to become the 'Customer of Choice' for our supply chain.

In preparation for the next five-year period, we worked collaboratively with our key partners to build upon the relationships established during the last five-year period, address lessons learned and benefit from the deep pool of expertise across our supply chain.

We have jointly developed new and improved ways of working going forward. These include a two-way commitment to achieve joint efficiency targets and embed behavioural change through a range of continuous improvement initiatives. We have already:

- prepared a new Supplier Code of Conduct, soon to be released, to clearly outline how we expect our suppliers to behave, mirroring our values;
- implemented plans to embed behavioural change, benefits realisation and new ways of working (including engaging partners earlier in the project lifecycle, setting up integrated design teams and joint cost-planning and estimating);
- introduced an integrated supply chain group and new supplier relationship management framework to achieve a more consistent contract management, drive greater innovation from the supply chain and facilitate early identification of risk through strong collaborative relationships;
- reduced uncontracted spend and mitigated risks in line with our long-term category spend strategies, driving business alignment and benefits;
- supplemented the supply chain with a new studies and investigations framework and low-complexity delivery route for both our infrastructure and process work types; and
- hosted a supplier collaboration event attended by partners and internal employees to foster collaboration and efficiency as we enter the next five-year period.

Following Ofwat's introduction of C-MeX and D-MeX to measure customer and developer satisfaction, a common approach to service across our internal and external customer interactions will be essential to upholding high levels of satisfaction. The adoption of our water for life brand and company values across our supply chain will help us achieve consistent service.

In response to the impact of COVID-19, we worked closely with our critical supply chain partners to safeguard our essential services to customers. We have conducted a risk assessment across all our critical supply chain partners to understand their ability to maintain continuity of essential goods and services – considering factors such as absence levels and the robustness of their contingency plans.

To protect the health of our employees, customers and partners, we have issued communications to explain key changes to our working practices in accordance with national medical and scientific advice. We also mobilised new communications plans for raising issues, cascading the latest government guidance regarding financial support for suppliers' employees, and facilitating the electronic execution of contracts.

The adoption of our water for life brand and company values across our supply chain will help us achieve consistent service

Pictured
Our supply chain partners are critical in helping us deliver our water and wastewater services

Case studies

Joe Murphy
Head of Health, Safety, Security and Wellbeing

Link to governance

Read more about **our approach to governance** on pages 150 to 153

Read more about **how the Board monitors culture** on pages 162 to 165

Link to strategy

- Promoting gender equality and diversity
- Succeeding together and always improving by having honest conversations about why incidents happen and how we can prevent them in the future

Read more about **our people** on pages 50 to 55

Embracing emotional intelligence in health and safety

I have been a health and safety practitioner for more than 20 years, generally in high-risk enterprises. Principally, my job is to make sure the business is working in a way that meets regulations and policies.

Over the past few years, I have seen a shift in the health and safety industry. There has been a realisation that if people break the rules, they can do so for many reasons. Rather than assuming they are ignorant or uncooperative, we are using emotional intelligence to understand the reasons that something is happening.

In the past, the health and safety industry attracted people with a rule-based outlook. The new approach is less transactional. It involves having conversations to understand the pressures employees are under. As a result, soft skills are increasingly important, which is attracting a wider range of people to the industry.

We have begun to roll out a new approach, which comes from the aviation industry, focused on fairness. When there has been a breach, you look at all the reasons why. Rather than telling people what they are doing wrong and the punishment they will face, we are applying emotional intelligence to understand why people do what they do. Often this helps us uncover the root cause of health and safety incidents, which allows us to improve the way we work.

It does not mean a softening of the approach or a relaxing of the rules. Instead, we ask people to explain why they have breached a policy. If they have a legitimate reason, we can learn from that and improve.

Our Health, Safety, Security and Wellbeing team now has more female managers than male

Steven Laker
Vulnerability
Liaison Officer

Understanding how to support customers affected by dementia

Link to governance

- Read more about **how we monitor our impact on our communities** on pages 162 to 163
- Read more about **stakeholder and employee engagement** on page 164

Link to strategy

Our commitments to customers (AMP6):

- Customers in genuine hardship with improved support

Read more about **support for our customers** on pages 68 to 71

In the Vulnerability team, the support we offer must evolve in line with the challenges our customers face. The South East is a popular retirement area, so we serve lots of elderly customers. As the population grows and people live longer, the number of people being diagnosed with dementia is increasing – one in six people aged over 80 now receive a diagnosis. We felt a responsibility to improve our understanding of this disease and how we can support the growing number of customers affected by it.

Our employees had voted Alzheimer's Society as our company charity, so we decided that was a good starting point. We approached the charity for ideas and the team was invited to attend its Dementia Friends training.

Before the course, we had a basic idea what dementia was. But the session really opened our eyes. We learnt about the different variations, such as Alzheimer's and short-term memory loss. We also discovered that people as young as 30 have been diagnosed. The course also helped us understand the impact the disease can have on family members, who often become unpaid carers to those diagnosed. After the course, we are much more patient and accommodating if we are interacting with someone showing signs of dementia.

Seeing the bigger picture also gave us ideas of how to better support customers who are directly or indirectly affected. For example, a person with dementia may leave taps running, which could lead to higher bills. However, we can alleviate the financial pressure on the household by putting bill caps in place. We are also tailoring the support we can offer though our Priority Services Register. For instance, we can set up a password-protected account for customers with dementia so a trusted carer can manage their affairs.

Alongside Alzheimer's Society, we are working with other dementia charities and carer groups across our region. We have presented to groups to promote the support we can provide, and our team is now receiving direct referrals from these organisations.

We are also encouraging employees across the company to attend Dementia Friends training, especially those who interact directly with our customers – whether on the phone, in their homes or in the community. We want to provide the best support possible for those customers affected by the disease.

One in six people aged over 80 now receive a dementia diagnosis

Our commitments to customers

Our customers were clear about their priorities for our 2015–20 plan and these were captured under six key outcomes

In our five-year business plan 2015–20 we made 26 clear customer promises, alongside additional commitments following Ofwat's review:

Responsive customer service

- Quick and effective resolution of your queries
- Improved service to you and your community
- Improved ranking in our regulator's league table for customer satisfaction
- Direct compensation paid if we let you down

Affordable bills

- Efficiency savings made from 2015–20 to help keep bills as low as possible
- **A 10% reduction (15 litres per person, per day) in average water use by 2020, with better advice on saving water, energy and money**
- Customers in genuine financial hardship provided with improved support
- Customers provided with better information on how we are providing value for money

Better information and advice

- **A 10% reduction (15 litres per person, per day) in average water use by 2020, with better advice on saving water, energy and money**
- Improved advice on how to prevent blocked drains to help reduce blockages
- A 50% reduction in bill queries by 2020
- Customers provided with better information about what we do, why we do it and what it costs
- Help reduce the effect of hard water in homes and businesses

A constant supply of high-quality drinking water

- No restrictions on water use, such as hosepipe bans, unless there are at least two dry winters in a row
- Reduce leakage by 2020
- No increase in the average time you are without water
- Aim for 100% compliance with drinking water quality standards
- No increase in the number of households suffering from persistent water pressure

Removing wastewater effectively

- No increase in the number of blockages in our sewer network
- Significant reduction of 25% in sewer flooding inside your homes and businesses by 2020
- No increase in the number of incidents of sewer flooding affecting outside areas
- Reduction of 5% in complaints about smells from our wastewater treatment works and pumping stations by 2020

Looking after the environment

- No serious pollution incidents affecting local rivers, streams and beaches caused by our operations by 2020
- Aim for 100% compliance by our wastewater treatment works with required standards
- Increase by seven the number of beaches with excellent bathing water quality by 2020
- Increase the proportion of renewable energy we use to 16.5% by 2020
- Reduce the amount of water we take from the environment by 1.4%, despite predicted population growth of 4%

Financial impact of our performance

Several of our business plan 2015–20 performance commitments had financial rewards and penalties associated with them. This means if we failed to meet our commitments to customers, we paid a penalty. And if we beat our targets, we earned a financial reward.

Our performance over the five-year period in reducing per capita consumption has earned us a reward of £6.9 million – the maximum available under Ofwat's price determination rules. However, we incurred a number of penalties in the 2019–20 period in relation to category 3 pollution incidents (£2.2 million), odour complaints (£0.9 million), leakage (£2.7 million), improving bathing waters (£3.6 million) and coliform compliance at water supply works (£0.2 million). In total, these penalties added up to £9.6 million.

Over the 2015–20 period as a whole, our wholesale water and wastewater business incurred penalties of £12.2 million, following previous penalties for maintaining bathing waters (2015–16: £1.5 million), water supply interruptions (2017–18: £0.3 million) and odour complaints (£1.6 million). In 2018–19 we earned a reward of £1 million for delivering four of the seven bathing waters in our Bathing Waters Improvement programme a year early.

The main incentive mechanism associated with our retail business is the Service Incentive Mechanism (SIM), which is based on customer satisfaction and unwanted contacts and complaints. While SIM performance improved in the second half of the five-year period, based on our performance over the whole five years, we incurred a penalty of £33 million.

Further details about the financial impact of our performance can be found in the Annual Performance Report, on pages 47 to 53.

Outlook: 2020–25

We undertook our largest public consultation yet when developing our Water for Life Business Plan for 2020–25, speaking to more than 42,000 stakeholders, customers and partners, to make sure we had a clear idea of their priorities. They told us that they wanted us to focus on securing future resources, as well as being brilliant at the basics, delivering clean safe water, through a reliable network, at an affordable price, with good quality customer service.

Following a challenging price review process, we now have £3.2 billion to invest from 2020–25 on improving our services across the region. In order to deliver what our customers asked for, we will need to work smarter, collaborating on solutions to some of our region's most pressing challenges. Through a range of transformative programmes, we have committed to protecting and improving the local environment and improving our water and wastewater network where we can. We have developed solutions that align to our customers' priorities, driving improvements in customer service, support for those in vulnerable circumstances, water quality, flooding, leakage, pollution and interruptions to supply.

Read more about **our plans for 2020–25** on pages 36 to 39

Read more about **customer service improvements** on page 65

Read more about **our performance** pages 60 to 99

Pictured
In 2018–19 we earned a reward of £1 million for delivering four of the seven bathing waters in our Bathing Waters Improvement programme a year early

Our commitments to customers continued

How we measure our success

The table below shows how we have performed against our business plan commitments in 2019–20.

Responsive customer service

	2019–2020	2018–2019
Customer satisfaction Service Incentive Mechanism (SIM) score	N/A	–
Percentage of contacts resolved first time[1]	✗	✗
Percentage of customers who feel our service meets their individual needs[2]	–	–
Percentage of customers who feel our service meets the needs of their community[2]	–	✓
Number of compensation payments made to customers (Guaranteed Standards Scheme and Customer Charter)	✗	–

Affordable bills

	2019–2020	2018–2019
Customers in genuine hardship with improved support	✓	✓
Percentage of customers who feel our services provide value for money[2]	–	✓

Better information and advice

	2019–2020	2018–2019
Water usage, per capita consumption (litres/head/day)	✓	✓
Number of unwanted billing queries (unwanted from a customer's point of view)	✗	–
Percentage of customers who are aware of the causes of blocked drains[2]	–	✓
Percentage of customers who are aware how their money is used[2]	–	✓
Percentage of customers who are aware of how to deal with hard water[2]	–	–

Key

- ✓ Max/exceeded a performance commitment
- – Missed a performance commitment but still on target to deliver the outcomes we promised over the five years
- ✗ Not met a performance commitment

GSS payments increased as a result of a customer referral error and an increase in supply interruptions. We are working to ensure that all historic missed appointments have been appropriately compensated.

Helping our customers in most need has been a key focus of our COVID-19 response, in particular we have supported over 5,600 customers with a three-month payment break specifically introduced to help those impacted by the virus.

Good per capita consumption performance, provides a springboard for our commitment to reduce consumption to 100 litres per person per day by 2040.

Further information can be found in Appendix 2 of the Annual Performance Report at **southernwater.co.uk/reports.**

A constant supply of high-quality drinking water

	2019–2020	2018–2019
Water quality (Mean Zonal Compliance) (%)	–	–
Number of contacts regarding discolouration per 1,000 population	✓	✓
Number of properties with low water pressure	✓	✓
Customer minutes lost supply >3 hours	✗	✓
Leakage (millions of litres of water per day)	✗	✗
Number of customers affected by temporary use bans	✓	✓
Maintain asset health	–	✓

We continue to drive down leakage from the 2018 'Freeze/Thaw' peak. But we missed our five-year target, and incurred a financial penalty. We will continue to drive leakage down with a commitment to reduce it by 15% by 2025.

Removing wastewater effectively

	2019–2020	2018–2019
Number of blockages per km/year	✓	✓
Number of internal flooding incidents	✗	✓
Number of external flooding incidents	✓	✓
Number of customer complaints regarding odour[4]	✓	✓
Maintain asset health	✓	✓

Flooding incidents increased due to heavy rainfall in February and March. Meanwhile, blockages remained below target, due to our ongoing work to identify root cause in the community.

Looking after the environment

	2019–2020	2018–2019
Wastewater treatment works compliance (%)	–	–
Maintain the number of bathing waters assessed with excellent water quality	✓	✓
Number of serious pollution incidents (category 1 and 2)[3]	✗	✗
Number of less serious pollution incidents (category 3)[3]	✗	✓
Distribution input (Ml/day) (the amount of water put into supply)	✗	✗
Renewable energy usage	–	–

To address our unacceptable pollutions performance, we have established a dedicated team to drive forward the Pollution Reduction Plan that we have agreed with the Environment Agency.

Notes:

1. The method for reporting First Contact Resolution has been based on using a 30-day window and is consistent with the figure reported for the prior year. This is inconsistent with the methodology used to set the Final Determination target, which used a 21-day window. We also note that the Final Determination specified that the measurement would be undertaken by a third party. In fact, the calculation is carried out internally and assured by a third party. We advised Ofwat of this in June 2018.
2. Our annual customer survey reached around 537 customers online or by post during March to April 2020, and is intended to give us a year-on-year customer view on a number of indicators from value for money to awareness of how to prevent blockages.
3. As reported previously, we have identified a number of issues with spill data. The details of the steps taken and that continue to be taken, to improve the robustness of the spill data collection, the data processing systems and the assurance of that data, have been shared with the Environment Agency and Ofwat. As those steps have not yet reached completion, the data supplied would continue to have an error band of up to 10%.
4. Although we met internal targets in terms of odour complaints, we missed our Ofwat commitment, incurring a penalty of £0.9 million. This is because we received 12 complaints in relation to our Portswood and Tonbridge treatment works, where we had invested in odour management improvements and committed to a target of zero complaints in 2019–20.

Our commitments to customers continued

The launch of our Revive customer survey tool was completed in 2019, providing customer feedback following contact

Responsive customer service

In 2019–20 we have worked towards our aims to improve the experience and service we deliver to our customers

Outcomes

	2019–20	2018–19	2017–18	2016–17	2015–16
Customer satisfaction: C-MeX (previously SIM) score (out of 100)	N/A	80	79	78	73
Contacts resolved first time (%)[1]	63	65	67	67	67
Customers who feel our service meets their individual needs (%)[2]	64	64	64	66	66
Customers who feel our service meets the needs of their community (%)[2]	31	35	34	35	33
Compensation payments made to customers (Company Guaranteed Standards Scheme and Customer Charter) (no.)	4,982	2,439	9,374	2,436	3,912

Link to risks

- We may not be able to provide the desired standard of service to our customers if there is inadequate capability in our people, process or systems.
- We are also subject to challenging performance targets from our regulator Ofwat.

Read more on **risk** on pages 116 to 134

The Consumer Council for Water acknowledged our ‘significant strides’ to improve the level of service offered to our customers. However, we recognise that we still have more work to do.

We have identified several areas of improvement, including our digital capability to meet the demands of customers who want to use online services and applications, and their channel of choice. We continue to look for ways to improve our service as we prepare for the introduction of Ofwat’s new customer satisfaction measure (C-MeX).

Pictured
A new customer feedback tool allows us to capture valuable insight from contact

How we measure customer satisfaction

In the past year, the way the water industry measures customer satisfaction was changed to incorporate feedback from customers who had not been in contact with their provider. The previous Service Incentive Mechanism (SIM) measure was replaced, and shadow reporting, or testing, began of the new C-MeX measures, or Customer Measure of Experience, in May 2019. C-MeX will replace SIM from April 2020.

Each company will have its score calculated from responses to two surveys:

- The customer service survey (CSS) – a customer satisfaction survey of a sample of residential customers who have contacted their company, which asks them how satisfied they are with how it has handled their issue.
- The customer experience survey (CES) – a customer satisfaction survey of a randomly selected sample of the company's overall residential customer base, which asks them how satisfied they are.

Both surveys are scored between 0–10 and contribute 50% each to the calculation of the overall C-MeX score for each company. The maximum penalty for Southern Water is 12% of Retail Revenue – £31 million over the five years (in 2017–18 prices).

Southern Water's overall C-MeX score for 2019–20 was 68.85, against an industry average of 76.33. This places us 16th out of 17 companies – a 5.6% deterioration compared to the first quarter of the year. The company's service and experience score are 16th and 15th respectively.

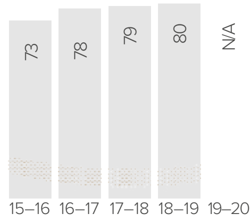
Resolving customer contact faster

Our customers expect to be able to contact us and have their issues dealt with straight away. We set ourselves an ambitious target to resolve 80% of contacts on the first contact; in 2019–20 we achieved 63% (2019: 65%). Following the outsourcing of customer services to our partner, Capita in 2019, we have seen months above 80%, and we are confident that our partnership will continue to drive stronger performance in this area.

The launch of a Revive customer survey tool was completed in December 2019. This will provide customer feedback following customer contact with the call centre, including information about issue resolution. This will be used for both coaching and insight.

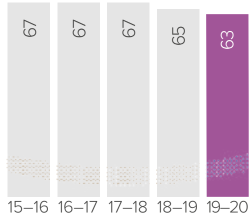
Notes:
1. The method for reporting First Contact Resolution has been based on using a 30-day window and is consistent with the figure reported for the prior year. This is inconsistent with the methodology used to set the Final Determination target which used a 21-day window. We also note that the Final Determination specified that the measurement would be undertaken by a third party. In fact the calculation is carried out internally and assured by a third party. We advised Ofwat of this in June 2018.
2. Our annual customer survey reached around 537 customers online or by post during March to April 2020 and is intended to give us a year-on-year customer view on a number of indicators from value for money to awareness of how to prevent blockages.

Customer satisfaction Service Incentive Mechanism (SIM) Score



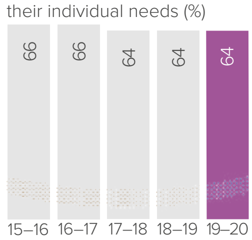
Target: N/A
Achieved: N/A

Contacts resolved first time (%)



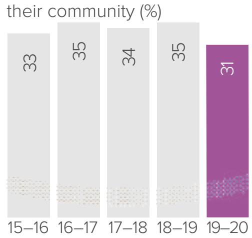
Target: 80%
Achieved: 63%

Customers who feel our service meets the needs of their individual needs (%)



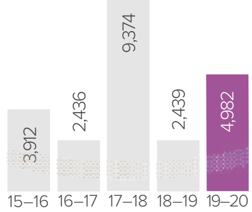
Target: 65%
Achieved: 64%

Customers who feel our service meets the needs of their community (%)



Target: 36%
Achieved: 31%

Number of compensation payments made to customers (Guaranteed Standards Scheme and Customer Charter)



Target: 2,291
Achieved: 4,982

Our commitments to customers continued

Responsive customer service continued

We want to remove the need for customers to complain, by improving our overall experience

Our call centre agent knowledge platform is also under review to ensure the relevant information is available to support effective conversations and increase resolution of customers' issues.

Our complaint volumes in the summer period were in line with our forecast. We saw a downward trend over the summer, but with the highest rainfall on record in February we saw an increase in sewer flooding across our region. While we have seen an increase in wastewater complaints, our billing complaints have declined in the last six months of the financial year and this trend has continued into 2020–21. There were a total of 5,594 complaints responded to in 2019–20 in comparison to 4,544 in 2018–19. We recognise that we have work to do to improve this, and that we need to remove the need for customers to complain by improving our overall experience. A focused team now operates across Customer Service, key internal stakeholders and our partner Capita to transform and simplify our service.

Over the coming year we will be improving the channels available to our customers, making them easier to access, when they need them

Looking after our customers' needs and those of the community

Each year we carry out our own customer satisfaction survey, either completed by customers online or by post. Results indicate that, during 2019–20, 64% (2019: 64%) of customers felt our service met their individual needs, and 31% (2019: 35%) felt that we dealt with the needs of their community. We continue our efforts to improve our performance in this area.

Ensuring guaranteed standards of service

We have made nearly 5,000 individual payments under the Guaranteed Standards Scheme provisions, significantly exceeding our target of 2,291 in 2019–20. These were mostly due to large-scale supply interruptions but also partly due to failures in our process for referring debt to collection agencies.

Following a review of our Customer Charter and the policy, procedures and monitoring in relation to appointments in 2018–19, we discovered that appointments have not been made in full accordance with Guaranteed Standards Scheme provisions. As a result, we are making backdated payments to a number of customers under the same provisions.

Looking ahead

Our transformation plans for 2020–21 include embedding new ways of working across three key areas:

- Improving our self-serve capability for customers. Rebuilding our online portal to make the solution more effortless for our customers and offering self-serve capability that our customers are asking for.
- Helping our customers' use their channel of choice. Understanding our customer demand for different contact channels so we can direct them to the best service experience, while supporting their contact preferences.
- Simplifying our bill. Our customers tell us that needs our bills to be easier to read and understand. We have been working directly with our customers to design a new bill that meet their needs.

Caring for customer information

It is our job to ensure the responsible handling of customers' personal information. We are continuing our work to comply with data protection and cybersecurity legislation: something we take very seriously.

The legislation is particularly relevant for our customer-facing teams and services. This year we have changed the way we use cookies on our website to give customers more control over how we use their information.

Read our full privacy policy at: **southernwater.co.uk/privacy**

Read more about **updates to our website** on page 74

Better serving developers, new appointees, self-lay providers and business retailers

Our Business Channels team (developer and business retail services), continue to progress with changes as part of our improvement programme, which has been designed to give developers, self-lay providers, new appointments and variations, and retailers an improved customer experience.

The team is focused on building a new growth planning capability, analysing five to 25-year housing growth across our region enabling us to better inform our investment decisions.

To foster continuous improvement, the team recently relocated from Otterbourne in Hampshire, to our head office in Durrington, West Sussex. A move that provided us with an opportunity to bring in new people to deliver the step-change in the service that we want to achieve.

By tackling our data quality, our non-household market performance has jumped from 9th to 4th in the industry – the most improved wholesaler in the market. The new R-MeX which goes live in October (delayed from April 2020 due to COVID-19) measures retailer satisfaction. During the pilot of R-MeX in 2019–20 we finished second out of the nine companies that took part.

In addition, we have now had our D-MeX (Developer Measure of Experience) position confirmed as 14th out of 17 for 2019–20.

We started our Customer Action Group in April 2019. This group is made up of developers, self-lay providers, new appointments and variations, councils and consultants, and provides a friendly, critical eye on potential changes we want to implement.

We have been preparing for the industry's water and sewerage codes for adoption, which includes Sustainable Drainage Systems (SuDs), and the new Design and Construction Specification document, which will support our self-lay providers.

We have plans to deliver a step-change in our services. Engaging with customers, we have started working on our new developer portal for customers. We are launching our 'gap site' incentive scheme in the winter of 2020, a delay of a few months due to the impact of COVID-19, which will reward retailers for identifying business properties not registered in the market for charging. The scheme also supports our drive to reduce leakage and improve market data quality.

Outlook

Deliver great service

Customer experience

- C-MeX
- R-MeX and D-MeX

Accurate and affordable bills for all

- Gap sites
- Void/vacant properties

Pictured
A Customer Action Group is helping our Business Channels team improve its services

Read more about **our support for customers** pages 68 to 71

Read more about **help and advice for customers** pages 72 to 77

Case study

Offering our customers online support, when they need it

Donna Howden,
Head of
Customer Service

Link to governance

Read more about **our s172 statement** on pages 162 to 163

On average, 1,500 customers per week have been using our webchat service to get help and support. Our satisfaction score averaged 4.5/5, and 94% of customers told us that they would use our service again.

When baselining our customer service offering we recognised that our opening hours for webchat probably did not support our customers' demand, so we decided to run a trial to increase availability.

Over the month of November 2019 we increased the number of agents supporting this channel to test the demand for the service. We also monitored more closely the hours that customers wanted to talk to us and the times of day that they needed our support.

The trial showed us that the demand for the service was three times greater than the number of conversations we usually had in a typical month. As a result, we have now increased the permanent resource in the team to meet the increasing demands of our customers. We will continue to run trials to measure demand and keep our opening hours under review to make sure we are available when our customers need us, which is of particular importance as we adjust to the impact of COVID-19.

94%
of customers told us that they would use our service again

Read more about **our plans to improve digital services** on page 65

Our commitments to customers continued

Affordable bills

22.6k

customers on our Priority Services Register, and close to...

300k

offered financial assistance

It is important to us, and our customers, to offer financial assistance to those who need it, while also helping them to save water, energy and money

Outcomes

	2019–20	2018–19	2017–18	2016–17	2015–16
Customers in genuine hardship with improved support (no.)	**296,516**	269,926	229,843	194,726	142,040
Customers who feel our services provide value for money (%)[1]	**58**	60	55	57	61
Efficiency savings (£ million)[2]	**160**	160	128	67	56

We want to continue to increase the number of customers on our range of support schemes and tariffs.

We are pleased to report that we have exceeded our target providing tailored financial support to 296,516 (2019: 269,926) customers to date.

Link to risks

- We may not be able to provide the desired standard of service to our customers if there is inadequate capability in our people, process or systems.
- We hold and process personal and payment data about our customers and employees. Failure to properly protect the data we hold could lead to reputational damage and loss of confidence from our customers, as well as significant fines under Data Protection (GDPR) and the Network and Information Systems (NIS) Directive.
- COVID-19: Adverse financial impact due to revenue loss, increased bad debt and additional costs.

Read more on **risk** on pages 116 to 134

We offer a range of payment schemes and tariffs, including:

- *Essentials* – for customers whose household income is less than £16,105, or for those in receipt of pension credit. The criteria for this tariff were changed on 1 April 2019 to align with those offered by our neighbouring water companies in the South, making the application process easier for customers in need of support and any other community agencies they may be working with.
- *WaterSure* – for those who are in receipt of means tested benefits and use a large amount of water either as a result of large families, or because of a particular medical condition.
- *Water Direct* – where bills may be paid from a customer's existing benefit schemes directly to us.
- *NewStart* – for those who owe us money but have not been able to make a payment for a while.

Additional services offered by our Vulnerability team over the past year included:

- Advice about how to access help from specialist support organisations within the community.
- Water-saving home visits, offering customers advice about how to save water, energy and money.
- Training for our Capita Contact Centre and Customer Service teams so they can better

Pictured
Our field team has been working with community partners to expand our Priority Services Register

- serve customers in vulnerable circumstances at their first point of contact.
- Adding customers to our Priority Services Register so that we can tailor our services to their needs.

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

Given the financial impact of the pandemic we thought it would be inappropriate to follow our usual debt collection processes, so we stopped many of our enforcement and collection activities.

We also recognised the work that local community organisations were doing to help those most in need: so far we have donated £20,000 to food banks across our region, and a further £25,000 to community foundations.

Working with our community partners

It is only by further developing our relationships with local authorities, housing associations, debt advice groups and third-sector organisations, like Citizens Advice, that we will reach a better identification and understanding of the needs of our customers in vulnerable circumstances, so we can offer the right support when it is needed.

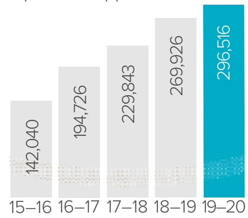
Our dedicated Vulnerability field team has continued to build these partnerships, strengthening links and providing training, which enables representatives of organisations, such as Citizens Advice and National Debtline, to provide direct referrals for assistance to a dedicated office team. We are also working on a Data Sharing Agreement with the Department of Work and Pensions that will allow us to identify customers who may qualify for a discounted water bill.

The team, working with these partners, has also been focused on developing our Priority Services Register (PSR), which allows us to keep track of customers who require additional services, as well as prioritising those customers during an incident. In response to the COVID-19 outbreak, we amended our Priority Services Registration policy to allowed trusted third parties to register customers – helping us to reach more of our customers who need a little extra assistance.

We currently have around 22,570 customers on our PSR, and we are aiming to increase this significantly over the coming years. It is important that we have information about the particular needs of a household, so we can tailor our services accordingly. We will be working closely with our partners to reach out to more of our customers who need this help.

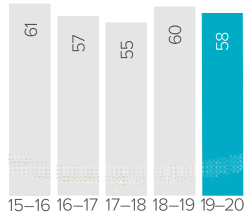
Notes:
1. Our annual customer survey reached around 537 customers online or by post during March to April 2020, and is intended to give us a year-on-year customer view on a number of indicators, from value for money to awareness of how to prevent blockages.
2. This is a cumulative figure over the five-year business plan period 2015–20.

Customers in genuine hardship provided with improved support



Target: 217,100
Achieved: 296,516

Customers who feel we provide value for money (%)



Target: 61%
Achieved: 58%

Our commitments to customers continued

Affordable bills continued

Reducing the burden of bad debt on our customers' bills

By bad debt, we mean the cost of accounting for bills that remain unpaid, and are likely to become uncollectable, which may have an impact on our charges for all our customers.

We have focused on ending the current five-year regulatory period with a more stabilised bad debt position balanced against the costs of servicing debt. Our underlying bad debt for household customers in 2019–20 was £13.6 million (2019: £9.6 million). Clearly, however, the COVID-19 pandemic is now having a significant impact on the economy and our customers. In addition to the underlying charge we have recorded an additional charge of £16 million in the accounts for the current year. This will have an impact on our business plan 2020–25, which aims to further reduce both the levels of bad debt and the associated debt management costs, and this will be more challenging for us as we move into the new financial year.

Providing value for money

Around 58% (2019: 60%) of our customers currently feel we provide value for money. We are disappointed to see a decrease in customer perception here. We know we still have more to do to demonstrate the true value of our services to customers.

During 2019–20, the combined water and wastewater services for an average household was £438, costing less than £1.20 per day.

The same bill in 2020–21 will be £391, costing around £1.07 a day. This is the start of a sustained fall in combined bills; between 2020–25 we estimate that our customer's bills will fall by 18.4% (before adjustment for inflation). By 2025 the average household bill for water and wastewater will be equivalent to £343 a year. Water bills will fall 8% in that time, while wastewater bills will fall 24%.

Read more about **how we are making bills easier to understand** on page 74

Every day we are working to make our processes more efficient so we can pass those cost savings back to our customers

£1.20

daily price of our services in 2019–20

£1.07

daily price of our services for 2020–21

Our charges are set each January based on price limits agreed by our regulator, Ofwat. In addition, we seek assurance from our independent assurers and the Consumer Council for Water before they are finalised, ensuring transparency and independent scrutiny. An explanation of how these charges are set and reviewed is available at: **southernwater.co.uk/swcharges**, clearly signposted from our annual billing leaflet, which is sent out to every customer.

Efficiency through transformation

We also made a commitment to drive efficiency savings to help keep bills affordable for our customers. In the final year of our 2015–20 five-year business plan, we have delivered £160 million of cost reductions (2019: £160 million). This figure has not increased during the year as we have made additional investments to ensure the future resilience of our operations.

To continue to drive efficiency savings, and ensure we are ready to deliver our Water for LIfe Business Plan 2020–25, we are changing the structure and culture of the business. This involves improving engagement with our colleagues and partners, and getting the basics right, so we can innovate and deliver better services for our customers, and a resilient water future for the South East.

The transformation programme has already delivered:

- New and improved processes, systems and data that allow us to work more efficiently and collaboratively
- Better understanding of the issues that drive customer contact
- More collaborative and efficient contracts and relationships with service partners who share our values
- Clarification of roles, accountabilities and business priorities, aligning teams behind them
- Improvements in customer experience across the business
- Closer and more collaborative relationships with our regulators and partners
- Transition from costly, reactive operational processes to a more proactive model
- A more streamlined decision-making process, based on a measurable set of values and an ethical business framework
- A more agile approach to problem-solving and innovation, enabling us to test, review and deliver projects at pace
- A more consistent approach to leadership and management
- More visibility of performance and an increased focus on risk management and compliance.

To support this new way of working, we are focused on playing to our strengths, making sure we have the right skills and capabilities to keep up the pace of transformation. In doing so, we will show our regulators, customers and stakeholders that we have moved to new levels of improved performance and capability.

Outlook

Deliver great service

Support for customers in vulnerable circumstances

- Priority services for customers in vulnerable circumstances
- Customer satisfaction with vulnerability support

Accurate and affordable bills for all

- Effectiveness of financial assistance

Our commitments to customers continued

Better information and advice

126.5

litres per person, per day, was the average water use in our region

28,488

water-saving home visits have been carried out since 2015

It is important that our customers feel informed about our services, how we spend their money, incidents in their area and how they can help us to protect water quality and the environment

Outcomes

	2019–20	2018–19	2017–18	2016–17	2015–16
Water usage, per capita consumption (litres/head/day)	126.5	129.9	128.9	131.3	129.7
Unwanted billing queries (unwanted from a customer's point of view) (no.)	153,870	131,736	181,361	145,962	62,726
Customers who are aware of the causes of blocked drains (%)	81	83	82	79	77
Customers who are aware how their money is used (%)	52	59	56	56	60
Customers who are aware of how to deal with hard water (%)	50	55	55	56	57

Link to risks

- We may not be able to provide the desired standard of service to our customers if there is inadequate capability in our people, process or systems.
- We hold and process personal and payment data about our customers and employees. Failure to properly protect the data we hold could lead to reputational damage and loss of confidence from our customers, as well as significant fines under Data Protection (GDPR) and the Network and Information Systems (NIS) Directive.

Read more on **risk** on pages 116 to 134

Water is vital to the communities we serve, yet its quality and availability can be impacted by our actions or our customers' behaviour. As a result, we have focused on raising awareness and driving behaviour change to help our customers save water and energy, and prevent blockages and flooding, as well as understanding how to address hard water issues in their homes and businesses.

Helping our customers reduce the amount of water they use

We all rely on water for everything we eat and drink, for washing ourselves and our clothes, and to help create the energy we need for heat and light. It is also essential for the products we enjoy, and the rivers, fields, forests and beaches that we all love.

At the same time, we are all facing the challenges of population growth and climate change, which impact how we source and use our water resources both now and in the future. Our customers demonstrate an increasing understanding of these challenges. When we talked to them about our plans, they told us investment in long-term resilience of supplies was a priority.

While we can help to solve these challenges, protecting future resources is a shared responsibility. As a company operating in a water-stressed area, we are committed to helping our customers reduce their water consumption.

We made a commitment to our customers in our business plan 2015–20 to achieve a 10% reduction (15 litres per person, per day) in average water use by 2020. As the five-year period closed, we recorded an average water use of 126.5 litres per person, per day (2019: 129.9 litres). This is an improvement on 2018, when a long, hot summer led to a spike in consumption. It is also well below our target of 133.7 litres, and significantly lower than the UK average, which is still around 144 litres. This establishes an excellent foundation for Target 100 – our long-term commitment to help our customers reduce consumption to below 100 litres per person, per day.

We have achieved this reduction by encouraging customers, partners and communities to adopt water-saving behaviours, products and processes. We have completed more than 28,488 home visits since 2015 to install water-saving and energy-efficient products. In 2019–20 alone, our partner, Aqualogic, completed a total of 7,320 of these home visits (2018–19: 4,863), during which their engineers also talked customers through practical everyday changes they could make in their daily routines to save water in the home and garden.

In addition, the Water Efficiency team has spoken directly to more than 10,400 customers during the year, 76,859 over the five-year period, about the value of water at a series of community roadshows across our region, in classrooms and community centres via our Waterwise education programme. (See more in working with our communities on pages 52 to 53.)

We have continued our work with local authorities to identify customers with high water consumption, and those in vulnerable circumstances, who may benefit from water-saving home visits, products and advice to reduce their monthly bills; for more information read the case study on page 77.

In the summer of 2019, we faced water supply deficit challenges in western Hampshire. After the River Test's flows dropped below a prescribed level, we had to apply for a drought permit to continue taking water from the river for our customers. Although the permit was not implemented as the river levels recovered, our customers' support in reducing their consumption was vital to avoiding the introduction of water use restrictions.

We launched a water efficiency campaign in the area to raise customers' awareness on the shortage and the possibility of restrictions. We used outdoor banners, newspaper adverts and social media advertising to promote saving water and share practical water-saving tips. We also published weekly river flow data on our website to keep our customers informed. Alongside the campaign, we increased our leak-detection activity in the area.

During the August bank holiday (2018 vs 2019) we saw a year-on-year reduction of up to 3.6% in targeted areas verses an overall increase of consumption elsewhere. The combined efforts of our customers and employees avoided the need for water restrictions. In December, we wrote to customers in Hampshire to thank them for saving water in the summer months and preventing water restrictions being necessary. With their help, we kept our commitment to avoid imposing water restrictions on any of our customers over the five-year regulatory period.

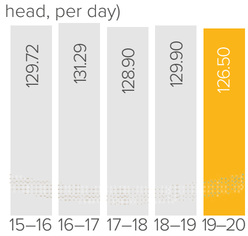
To support behaviour change across our customer base, we piloted some new initiatives in 2019–20, including:

- Hosting a series of informal workshops across our region to gather feedback from stakeholders, including representatives from local authorities
- Commissioning research into the best blend of customer incentives to reduce their usage; this is helping to shape our water efficiency programme for the future
- Considering a new trial with Eastleigh Borough Council, which seeks to incentivise water saving for individual residents across the borough
- Feeding the research and feedback from customers into plans for a behaviour change campaign across our region
- Exploring plans for a major water reuse scheme with two housing developers at Fawley Waterside, Fawley, and Horton Heath, Eastleigh, in Hampshire and the Northern Arc in Sussex
- Working more closely with water retail companies to apply water efficiency in the non-household or commercial market, including completing a water-saving visit to a spa hotel in Winchester, Hampshire
- Running a workshop focused on alleviating the 50% supply and demand deficit we anticipate by the year 2050 based on current usage.

Notes:

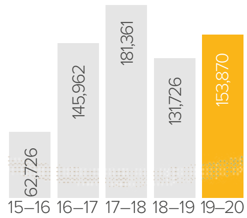
1. The call categorisation for unwanted billing queries was amended during 2016–17.
2. Our annual customer survey reached around 537 customers online or by post during March to April 2020, and is intended to give us a year-on-year customer view on a number of indicators from value for money to awareness of how to prevent blockages.

Water usage, per capita consumption (litres per head, per day)



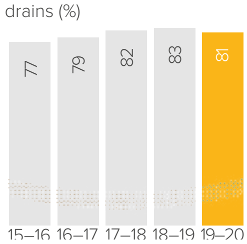
Target: 133.7
Achieved: 126.5

Number of unwanted billing queries (unwanted from a customer's perspective)



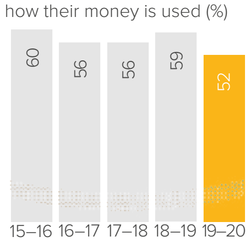
Target: 25,000
Achieved: 153,870

Customers who are aware of the causes of blocked drains (%)



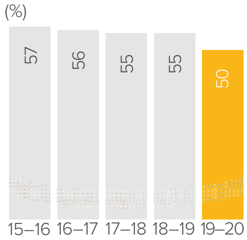
Target: 84%
Achieved: 81%

Customers who are aware of how their money is used (%)



Target: 60%
Achieved: 52%

Customers who are aware of how to deal with hard water (%)

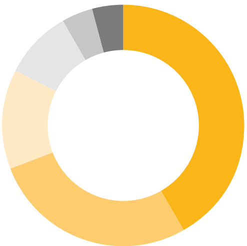


Target: 56%
Achieved: 50%

Our commitments to customers continued

Better information and advice continued

Average household water use per person, per day



We are extremely pleased to reach our target for the year – and for the five-year period. We are also pleased by our customers' growing awareness of the supply challenges in our region and what they can do to help. However, we must continue to help customers and communities to go further, while we work to reduce leakage on our network. For more on leakage, see our constant supply of high-quality water section on pages 78 to 83.

Making our bills easier to understand

The number of unwanted (from the customer's point of view) billing queries we received during 2019–20 continued to be high against our original 2015–20 target, increasing to 153,870 (2019: 131,726) this year.

To reduce the total volume of unwanted contact, we are reviewing our end-to-end billing journey, including our C-MeX and complaint improvement plans. We are also working to improve the way we handle customer contacts with a specific focus on reducing repeated contacts, which will further decrease the overall number.

When our customers cannot understand something on their bill, many of them turn to our website. In the past year we carried out a detailed review of top-performing sites and used best practice insights to refresh **southernwater.co.uk**. We also invited customers to test it and used their feedback to further improve. Our most popular pages are now easier to reach from the home page, and tasks customers can complete for themselves online are more clearly signposted.

Raising awareness about the impact of blockages

Our FOG (fat, oil and grease) and Unflushables team was created in 2015 to help us better understand people's instinctive behaviour around blockages, encouraging them to think more about what they flush down the toilet or pour down the drain, to reduce sewer flooding and water pollution.

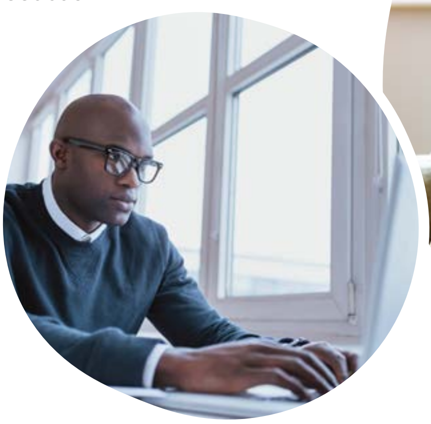
This year, our dedicated team completed its five-year (£1.4 million) blockage reduction programme. Activities during 2019–20 included:

- Attending 120 events to inform and engage domestic customers, including presentations for schools, Women's Institutes, local community groups and most universities in our region
- Lifting manhole covers in high-risk areas and carrying our visual or CCTV surveys – 156 full or partial blockages were identified, and internal flooding at 36 homes was prevented
- Lecturing to master's students at Brighton University and The University of Sussex, combined with field experience
- Representing Southern Water at the European FOG Summit in Amsterdam as speakers and panellists; we were also invited to host the Third European FOG Summit in Brighton in 2021
- Sponsoring the National Poo Museum on the Isle of Wight
- Contributing an article to New Market Times magazine to educate mobile caterers about the consequences of disposing of FOG incorrectly.

To deliver its important messages, the team has used a range of eye-catching and innovative tools in the year to drive engagement and behaviour change. Radio adverts, digital banners and social media adverts have been used to share messages with customers in areas with high instances of blockages. As a result of the team's continued community engagement work, 81% (2019: 83%) of our customers are aware of the causes of blocked drains.

FOG is a very real problem along our coastline, with so many restaurants close to bathing waters and natural habitats, many of which do not have proper grease management solutions.

Pictured
As many customers rely on our website, we constantly refresh it based on their feedback



Fat, oil and grease are a real problem along our coastline, with so many restaurants close to bathing waters and natural habitats

The team visited the headquarters of multi-premises food businesses and supermarket chains, as well as contacting every food trade association operating in the UK. Several associations pledged to help educate their members by circulating fact sheets. The team has also been invited to present at the next conference of the British Takeaway Campaign, which represents 40,000 members nationally.

The team also identified a gap in regulations, awareness and best practices regarding how mobile caterers dispose of kitchen waste. Following a surge in the popularity of street food, it had heard reports of vendors pouring washing up water – rich in FOG and chemicals – into surface water gullies, which lead directly to waterways and the natural environment. A joint investigation with the local Environment Health Officers has resulted in a change to the way these businesses will be assessed during their visits.

Our work has earned the FOG and Unflushables team two awards this year: Drainage and Flood Management Initiative of the Year at the Water Industry Awards for our Unflushables campaign, and the Sustainable Use of Resources Award at the Footprint Awards for improving sustainability in the food service industry.

In addition, two members of the FOG and Unflushables team, Stephen Edwards and Stephen Williams, were shortlisted for The Future of Utilities' Rising Stars Award, which recognises talented individuals who demonstrate a high level of competence in their role, and have a clear passion for the work they are doing.

Making sure our customers know how their money is spent

Our domestic customers cannot choose who supplies their water and wastewater services, so we need to make sure we are clear about our charges and how we spend their money.

Throughout 2019–20, we carried out several activities to build awareness and increase transparency by providing customers with:

- An update against our performance commitments through annual and half-yearly reporting
- A link to our annual performance information on our billing insert, circulated to all our 4.7 million customers
- Advice at community events about how to use water wisely, keep their drains clear and, where possible, save money on their bills. Our Community team attended 22 events in 2019, talking to approximately 7,500 people
- Regular updates on our capital construction schemes, particularly for customers directly affected by our planned improvement work, as well as local media and key stakeholders.

Our commitments to customers continued

Better information and advice continued

We are continuing to enhance our website based on feedback from our customers

Currently, 52% (2019: 60%) of our customers are sure about how their money is spent. This is lower than the previous year – and below our target of 60%. We are continuing to enhance our website based on feedback from our customers, including additional environmental performance reporting, to give our customers greater visibility of our activities and their impact.

Our charges are set in line with controls set by our regulator, Ofwat, and are scrutinised independently by the Consumer Council for Water.

Helping customers deal with hard water

A lot of the water we supply to customers is taken from underground chalk aquifers, which means it contains high levels of calcium carbonate; this makes it quite hard.

Although calcium carbonate does not affect the quality of the drinking water, we know that hard water can affect customers' household appliances; we offer advice at **southernwater.co.uk/how-hard-is-your-water**, which includes a postcode tracker. Our Water Distribution teams also offer water in the home advice leaflets to customers. which contain practical tips and useful contacts for homeowners.

In our annual survey to track customer awareness of our performance against our business plan commitments, 50% (2019: 55%) of customers said they were aware of how to deal with hard water – a decrease since last year and below our target of 56%. While we continue to publish water quality reports for our customers on our website, we know we need to do more to address this issue.

Great places for our customers to get outdoors

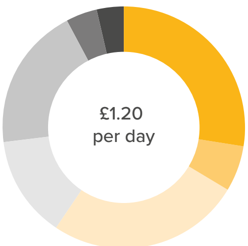
We have four surface reservoirs: Darwell, Powdermill and Weirwood in East Sussex, and Bewl Water on the Kent and Sussex boundary. These all offer outdoor activities such as fishing and sailing.

Bewl Water is our largest reservoir and is the biggest stretch of open water in the South East. Each year it attracts an estimated 98,000 visitors, who take part in windsurfing, sailing, fishing, cycling, walking and boat trips. We have many information boards at the visitor centre highlighting water safety issues, but also displaying interesting facts about the water cycle and the construction of Bewl Water itself – these were updated in 2017.

We have a long-standing partnership with the Hampshire and Isle of Wight Wildlife Trust, which manages our Testwood Lakes site near Southampton. Testwood Lakes has a purpose-built education centre, which hosts environmental activities for thousands of children who visit each year. To enhance this experience, we worked closely with the Hampshire and Isle of Wight Wildlife Trust in 2018 to refresh the centre and the information on display.

Other visitor attractions in our region include the historic steam pumping engines at our water supply works in Brede, East Sussex, which are cared for and displayed by Brede Steam Engine Society.

Breakdown of average daily charge 2019–20



- Day-to-day running costs 33p
- Tax, business rates and licences 7p
- Maintaining our existing assets 31p
- Building new assets 16p
- Interest 23p
- Ofwat/regulatory adjustments 5p
- Profit 5p

Outlook

Deliver great service

Customer experience

- Value for money

Use water wisely

Educate customers about the value of water so they use less, therefore reducing demand

- Per capita consumption (litres per person, per day)
- Water saved from water efficiency visits
- Community engagement
- Schools visited and engagement with children

Fit for the future

Better enable customers to use less water

- Target 100
- Access to daily consumption data

Case study

Ben Earl
Head of Water Efficiency

Working together to protect our customers struggling to pay their bills

Link to governance

Read more about **stakeholder engagement** on page 164

Link to strategy

Our commitments to customers (AMP6):

- Water usage, per capita consumption (litres/head/day)

Read more about **our performance** on pages 58 to 99

Areas of Brighton are among the country's 10% most deprived, so we wanted to help customers in financial hardship to keep their bills down. Saving water is one way to reduce water and energy bills, so we decided to offer them a free water-saving home visit alongside our financial assistance schemes. However, first we had to find out who needed our support.

We approached Brighton and Hove City Council with a proposal to work together, as if people struggle with their water bills, they may also struggle to pay council tax or rent. Together, we launched the Brighton and Hove Affordability and Water Efficiency Project. – sponsored by the Consumer Council for Water.

We matched our data with the Council's occupancy data to identify 1,000 households in social housing that had above average consumption, or whose water and wastewater bills were over 3% of the household income. The Council contacted them and offered them a water-saving home visit, followed by an affordability check.

During the water-saving home visit, an engineer talked to residents about their water use, installed water-efficient devices and shared water-saving tips. As part of the affordability assessment, we talked to residents about their circumstances – including household income and medical conditions – to see if they were eligible for one of our financial assistance schemes.

The project, a UK first, proved effective at reducing customers' bills, and we completed four waves of the project over two and a half years. Based on its success, we have provided recommendations to inform government policy and develop similar partnerships elsewhere in the UK.

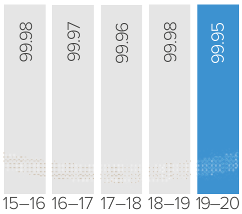
The University of Sussex was commissioned to carry out an independent study into the effectiveness of the project. Residents were interviewed to capture their feedback and assess the impact on their lives. The University produced a detailed report and a 'DIY manual' of water-saving tips: **sussex.ac.uk/sociology/research/research-projects/community-water-partnership.**

1,000 households took part in the project

Our commitments to customers continued

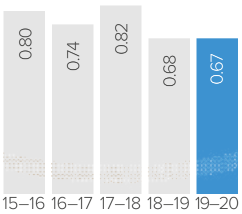
A constant supply of high-quality drinking water

Water quality (Mean Zonal Compliance) (%)



Target: 100
Achieved: 99.95

Number of contacts regarding discolouration (per 1,000 population)



Target: 0.82
Achieved: 0.67

We supply 2.6 million customers with around 542 million litres of drinking water per day

Outcomes

	2019–20	2018–19	2017–18	2016–17	2015–16
Overall drinking water quality index	**99.95**	99.98	99.96	99.97	99.98
Contacts regarding discolouration (no. per 1,000 population)	**0.67**	0.68	0.82	0.74	0.80
Properties with low water pressure (no.)	**203**	209	243	222	288
Customer minutes lost supply > 3hrs	**11**	7	17	7	12
Leakage (million litres of water per day)	**94**	102	89	88	84
Customers affected by temporary use bans (no.)	**0**	0	0	0	0
Asset health	**Unstable**	Stable	Stable	Stable	Stable

Link to risks

- Should operational water treatment processes fail, the water supply become contaminated, or our water distribution network fail: there is a risk that water could be supplied to customers that is unfit for consumption. This could also lead to large numbers of customers' water supply being cut off.
- Managing water events during COVID-19 is more challenging due to additional social distancing and/or the increased number of vulnerable customers that will need additional support.

Read more on **risk** on pages 116 to 134

We work constantly to ensure that water quality remains high, instances of discolouration and low pressure are kept to a minimum, and that when we do need to turn off water supplies, we make alternative sources available while we carry out any repairs to the network.

Customers and stakeholders also expect us to care for the water environment, ensuring we waste as little water through leakage as possible to better protect future supplies. Unfortunately, despite an improvement in leakage levels during 2019–20, we were unable to meet our ambitious target for the year, and the five-year reporting period. We are continuing to invest in improvements in the teams and technology used to detect leaks. We aim to reduce leakage by a further 15% from 2020–25.

We are pleased to have maintained good levels of performance against our other measures for water quality, pressure and discolouration.

Our asset health was reported as unstable to Ofwat. In 2019 we had a total of 13 coliform failures at eight water treatment works (compared with eight detections at three works in 2018). A number of root causes were identified.

We have carried out hazard reviews of all our supply sites and this has resulted in action plans to improve coliform compliance performance. In addition our largest surface water works have specific improvement plans, which are incorporated into Drinking Water Inspectorate (DWI) Notices.

Clean, safe drinking water is a priority

Water supplies are at risk of contamination from organic matter, chemicals, bacteria and even radiological elements like radon. Any such incident would have a far-reaching impact on both our customers and the environment, which is why the DWI, the regulatory body for drinking water quality, sets particular standards for the water we supply.

We are pleased to report that the quality of the water we deliver remains high. We achieved 99.95% (2019: 99.98%) compliance with the DWI's quality measures.

We have also kept recorded instances of discolouration stable in year with 0.67 contacts regarding discolouration per 1,000 customers (2019: 0.68). This is the result of continued focus on our mains cleaning programme, and good working practices across teams to mitigate the risk of discolouration in higher risk areas. A revised discolouration metric will be used as we enter the 2020–25 reporting period.

Minimising properties at risk of experiencing low pressure

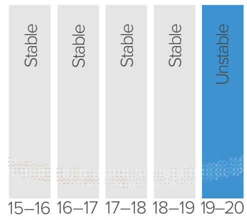
The agreed industry standard for minimum level of pressure is the equivalent of being able to fill a 15-litre bucket from a tap in one minute and 40 seconds. We regularly check water pressure across our network to ensure we meet this standard, and we can proactively identify customers who are experiencing low pressure.

To enable us to have a real-time view of this, we have installed pressure-logging devices in every District Metered Area, which, on average, serve around 1,250 homes and businesses. Areas that dip below required standards are recorded on our Low Pressure Register.

In 2019–20 we recorded 203 properties out of 1.1 million at risk of experiencing low water pressure (2019: 209); below our target of 257.

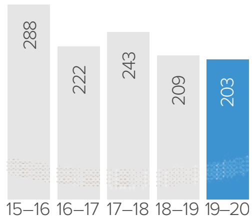
Pictured
The water we supply measures highly against our regulator's quality measures

Maintain asset health



Target: stable
Achieved: unstable

Number of properties with low water pressure



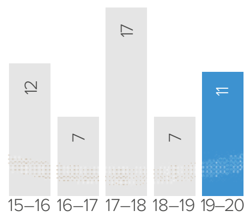
Target: 257
Achieved: 203

Number of customers affected by temporary use bans

There were no temporary use bans from 2015 to 2020

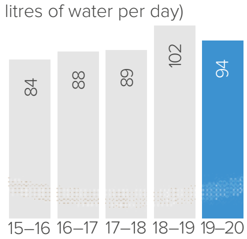
Target: 0
Achieved: 0

Customer minutes lost supply >3hrs



Target: 9
Achieved: 11

Leakage (millions of litres of water per day)



Target: 87
Achieved: 94

Our commitments to customers continued

A constant supply of high-quality drinking water continued

99.95%

compliance achieved against the DWI's quality measures

203

properties at risk of experiencing low water pressure

Pictured
We are very pleased to report that there were no temporary use bans introduced in 2019–20

No temporary use bans were introduced, even though we experienced some very hot weather over the summer period

Reducing time our customers spend without water

To carry out planned repairs to our network or due a major incident, we sometimes must turn off our customers' water supply. Where we can, we will always warn customers about this in advance.

Our performance is measured based on interruptions that last three hours or more. These are added up to give a total time that customers were without water, which we then divide by the number of properties we serve. This gives an average time in minutes of how long we have interrupted customers for. Our performance for 2019–20 was 11 minutes (2019: seven minutes), coming in over our target of nine minutes. This was largely due to a major incident in Wick, Littlehampton, in September 2019, where customers were without water for a prolonged period.

Our water supply teams conducted a thorough review of our risk management processes as the five-year reporting period closed, which resulted in a number of improved mitigation measures, for example, an increase in tankers available during supply interruption incidents to reduce any impact on customers.

Focus on reducing leakage

Leakage from our network is measured by calculating the difference between the amount of water we put into supply and the amount that each customer uses daily. That amount is measured in millions of litres or megalitres (Ml/d) over the course of an average day.

For 2019–20, while we improved our performance from the previous year, we did not meet our leakage target, achieving 94 Ml/d (2019: 101.8 Ml/d). Our target for the five-year period from 2015–20 was to average 87 Ml/d, so we also missed this target, incurring a penalty of £2.7 million. This is largely due to extreme weather incidents, such as the 'Freeze/Thaw', and the long, hot summer of 2018. The impacts of these events caused an increase of around 13 Ml/d in reported base leakage. We are delighted that we have reduced that since 2018, by close to 15% in the most stressed part of our region, which is our committed reduction percentage for the next five-year period.

We have invested additional funds during 2019–20 £3.2 million to temporarily increase the size of our leakage teams, recruiting 30 new leak detection teams – bringing the total number across our region to 190, compared to just 100 in 2018. The plan, over time, is to upskill teams, focusing them on finding the bigger leaks having the most impact on our network. By managing our resources in a more controlled way, we will then be able to reduce the number of teams, while still delivering large reductions in leakage.

We have also continued to install acoustic loggers to detect leaks. Real-time data from these devices is fed into our new leakage reporting system, and helps us to pinpoint leaks and proactively work with customers to repair them quicker. This system enables us to create weekly reports, helping us to better manage reactive events, reservoir levels and abstraction rates.

No temporary use bans for our customers

We are pleased to report that, in the year, no temporary use bans were introduced, including restricting the use of customers' hosepipes, even though we experienced some very hot weather over the summer period.

Although we did not experience a temporary ban, our networks were still at risk of drought during 2019–20. We need to be prepared so we can secure customers' water supplies no matter what the weather brings, so plans are in place for drought in particularly water-stressed areas, such as Hampshire and the Isle of Wight.

Changes made to our abstraction licences by the Environment Agency (EA) in the area, to secure the health of the Rivers Test and Itchen, have significantly reduced the amount of water we can take from them, which puts pressure on existing supplies. As a result, we applied for, and were granted, a drought permit by the EA for abstraction at our Testwood Water Treatment Works, although the permit was not implemented as the river levels recovered.

We plan to invest more than £800 million up to 2027 to make up the deficit, while ensuring water resources continue to be resilient and environmentally sustainable. Our plans, which will require Ofwat and Environment Agency approval, include water reuse, desalination, new pipelines from neighbouring water companies, reducing leakage and improving water efficiency behaviours.

New measures of performance

In order to improve water quality performance across the industry, the DWI has introduced a new risk-based approach. Its new metrics – Compliance Risk Index (CRI) and Event Risk Index (ERI) – have been put in place to highlight risks to individual consumers and are weighted by population, targeting issues at our larger treatment works. These new metrics will apply from 2020 onwards.

We are currently below industry average for both measures. Provisional figures for 2019 to December were: CRI 7.656; ERI 1,433.477; against an industry average of CRI 2.868; ERI 688.694.

In order to address this, significant work is underway at our larger works such as Testwood and Otterbourne, with major rebuilds taking place to 2025.

Because of this, and historic issues regarding our performance reporting, we have been under significant scrutiny from the DWI, and are currently under enforcement. We were the subject of four Final Enforcement Orders; three of which were associated with new asset improvement schemes, and one with improvements in water quality sampling and information management. We have successfully closed three of these orders, but one remains in place – a final asset improvement scheme at Shoreham water supply works.

These investigations can take some time to conclude, and relate to issues from as far back as 2012. To illustrate: the most recent prosecution from the DWI in August 2018, resulted in a fine of £65,000, and relates to an event that took place in 2013 at Cooks Castle on the Isle of Wight, well before new structures and improvement programmes were implemented. In addition, we are subject to two other cases: one from 2014–15, and one due to operational issues in 2018 for which we are awaiting decisions from the DWI.

11

minutes was the average length of time during which customers lost supply

£3.2m

invested in tackling leakage (2019–20)

£800m

planned investment in new water resources for Hampshire until 2030

Our commitments to customers continued

We are working with farmers and landowners to address water quality at source

A constant supply of high-quality drinking water continued

Putting Water First

Water First is a long-term improvement programme, which reaches beyond any five-year planning process, to embed public health protection at the centre of our water services. It is a source-to-tap approach – spanning catchment sources, water treatment, network, customer services and monitoring – underpinned by improvements in people, processes, systems, culture, training, and risk and information management.

Two improvement initiatives delivered as part of Water First in 2019–20 included our mains flushing programme and our site manual review.

Our mains flushing programme completed more than 820 kilometres by the end of March 2020, and focused in on areas where we had received reports of dirty or discoloured water. Customers were contacted in advance to explain the process and we received positive feedback. During the process the teams recorded flow, pressure and turbidity so we could accurately document the improvement and collect data, improving the overall resilience of the network.

As part of a site manual review, 70 bespoke site operating manuals were produced over the year for all our groundwater water supply works. These revised manuals provide a more thorough overview of all aspects of operation.

The manuals have been shared with the DWI, which was very pleased with how comprehensive they were. They are now used across the business from the operators and maintenance teams running the water supply works, to the control centre alarm handlers monitoring the site overnight, and the process scientists optimising site operation, providing consistency across teams. We have now started work on the manuals for the larger, more complex surface water sites, and plan to target water booster stations and reservoirs from October 2020.

Our Catchment First programme is also starting to pick up pace. Our teams work with farmers and landowners to design and deliver solutions that address water quality at source, which deliver positive benefits for all parties.

In the western Rother catchment in West Sussex, we are a partner in an EU-funded Interreg project (Channel Payments for Ecosystem Services) and are working with the Rother Valley Farmers Group and the Arun and Rother Rivers Trust to investigate whether working with farmers to improve the health of their soils can deliver cost-effective water quality improvements, while also supporting the farmer's business.

Read more about **Catchment First** on page 93

We are working with the South Downs National Park Authority to quantify and evaluate the wider benefits that these changes in land management practice can have on biodiversity, carbon sequestration and flood risk management.

In the upper River Beult catchment in Kent we have partnered with Kent Wildlife Trust and local farmers to establish a farmer cluster focused on securing a reliant and healthy water supply for the people and wildlife. The group is exploring regenerative farming techniques, integrated pest management and habitat creation approaches alongside farmland wildlife monitoring.

Other ongoing programmes include:

- Hazard reviews – a risk review process to identify potential water quality hazards on sites and catchments; a process we have now shared with other water companies as best practice
- Reservoir maintenance –a major programme of works to improve the condition of our treated water storage facilities, which includes an in-house Cleaning and Inspection team and a reservoir remedial framework contract. In the year, we completed inspections at 64 of our treated water storage facilities

Outlook

Deliver great service

Clean running water

- Water quality compliance (CRI)
- Event Risk Index (ERI)
- Water supply interruptions
- Drinking water appearance
- Drinking water taste and odour
- Mains repairs
- Unplanned outage
- Properties at risk of receiving low pressure
- Water supply resilience

Use water wisely

Reduce water wastage on our network

- Leakage

Fit for the future

Limit the impact of drought on customers

- Risk of severe restrictions in a drought

Develop new sources of water

- Effluent reuse

Address long-term issues with our network

- Long-term supply demand schemes
- Replace customers' lead pipes

820km

of mains flushing was completed by March 2020

70

new site operator manuals were produced detailing the full operation of our water supply works

Pictured
We work constantly to maintain high quality water and minimise disruptions to supply

Read about **our water efficiency campaigns** pages 72 to 77

Read more about **our water resources** pages 90 to 97

Case studies

Robin Kelly
Catchment Risk Management Officer

A helping hand for regional farmers

Link to governance

Read more about **stakeholder engagement** on page 164

Link to strategy

Our commitments to customers (AMP6):

- Mean zonal (water quality) compliance

Read more about **our performance** on pages 58 to 99

This year we ran a pesticide amnesty with local farmers in Brighton and Worthing. The scheme was run with our contractors, and we have another one planned for the Medway area co-funded by Kent County Council and North Kent Marshes Internal Drainage Board. This has been postponed due to the COVID-19 pandemic.

We wanted to help farmers get rid of stores of unwanted and out-of-date chemicals such as pesticides. Without intervention these chemicals can potentially leak into the soil and end up in surface and ground water, and cause damage to the environment. Removing these chemicals from our water supply is also a more complicated process.

Some 19 farms in the Worthing and Brighton area took part in the schemes in December 2019 and March 2020 – the first of their kind for us – and so far, 675 litres of potentially harmful liquids, and 45 kilograms of granules have been handed over.

The amnesty really helped us to engage with farmers and landowners, and start conversations with them about the vital role they play in ensuring the health of habitats and water supplies.

19
farms took part in the pesticide amnesty

Sonya Knight
Operational Performance and Governance Manager

New water quality training programmes improve capability

Link to governance

Read more about **employee engagement** on page 164

Investing in our people to improve competence and capability is a significant part of our Water First programme with focus in two key areas: Process Scientist training and the Competent Operator programme.

The Process Scientist training has been implemented to further enhance the scientific teams' knowledge of water treatment best practice to ensure all sites adhere to water quality regulations. The training package is bespoke and has been designed internally by our team. The face-to-face training covers technical and regulatory knowledge, systems and enhanced mathematics.

The Competent Operator training programme is made up of 12 modules covering all aspects of on-site processes. The content has been created collaboratively with external training providers and our own subject matter experts. Attendance on the module has been determined by the results of a training needs analysis assessment, ensuring training is directed to those who will benefit most across our water operators and asset maintenance teams.

We have delivered 85 training sessions, which has enabled us to clock up 621 training days. The programme has been well received by the Drinking Water Inspectorate and has been endorsed further, achieving full accreditation from EU Skills.

Our team has developed specific course books, which are distributed to attendees to be used as reference guides on site to enhance their learning. Both training programmes are supported by an online tool to test competence on an ongoing basis, to ensure that all training is embedded and sustainable.

85
Water First training sessions delivered this year

Link to strategy

Our commitments to customers (AMP6):

- Mean zonal (water quality) compliance

Read more about **our performance** on pages 58 to 99

Our commitments to customers continued

Removing wastewater effectively

In early 2020, our region experienced some of the most intense periods of rainfall on record

We committed £3.2 billion to operate, maintain and improve assets between 2015–20. £1.8 billion of this was specifically allocated to improvement and maintenance of wastewater and water services

Outcomes

	2019–20[1]	2018–19	2017–18	2016–17	2015–16
Blockages per km/year (no.)	**0.53**	0.52	0.49	0.55	0.56
Internal flooding incidents (no.)	**453**	389	401	448	492
External flooding incidents (no.)	**9,386**	8,255	7,106	8,009	8,314
Customer complaints regarding odour (no.)	**373**	543	381	326	262
Maintain asset health	**Stable**	Stable	Stable	Stable	Stable

Our investment continued to deliver results for customers in the final year of this business plan period.

In early 2020, our region experienced some of the most intense periods of rainfall on record during storms Ciara and Dennis. Our ability to maintain strong performance despite these weather events demonstrates the improved resilience of our wastewater network, which has allowed us to better protect the environment during these episodes. These improvements are in line with the priorities our customers have expressed in terms of investment in long-term resilience, and protecting and improving the environment. However, following these severe weather events, we are disappointed that our performance suffered in some areas.

In 2019–20, our network remained stable and odour complaints dropped following activity to counter the increase during the extended period of warm, dry weather in the summer of 2018. Although we met internal targets in terms of odour complaints, we missed our Ofwat commitment, incurring a penalty of £0.9 million.

Despite increases since last year, we met our targets for blockages and external flooding incidents. However, following the exceptional weather, a rise in the number of internal flooding incidents since last year exceeded our target. To support our work to limit blockages and flooding, we are working with our customers to understand the causes and consequences of blocked sewers.

Meanwhile, our teams are focused on doing the basics even better and taking a more holistic approach to wastewater management through our Environment+ programme, driving efficiencies and improving training opportunities through Operational Excellence and continuing to explore new technology.

We are in close communication with the Environment Agency to understand its expectations, and we provide regulator updates on our progress. This is establishing greater trust and has enabled us to achieve better environmental outcomes.

Link to risks

- Should operational wastewater treatment processes fail, or our sewers and pumping stations become blocked or fail, our assets may discharge sewage, which is not of the required standard, to the environment. This may cause risks to the environment or public health from sewer flooding.

Read more on **risk** on pages 116 to 134

Pictured
We work in the community to raise awareness about how customers can help keep our sewers flowing

Keeping our network clear of blockages

Around 20,000 sewer blockages occur in our region every year – nearly two-thirds are caused by fat, oil and grease (FOG) and other items flushed down the toilet or discarded in drains. As such, our Field Customer Engagement teams have continued to focus on raising awareness in problem areas as part of our £1.4 million blockage reduction programme for 2015–20, led by our award-winning FOG and Unflushables team – which has trained other organisations in the UK in our approach. To learn more about the work the team does in our communities, see the better information and advice section on pages 72 to 77.

This work to raise awareness and affect behaviour change with our customers meant that we were able to meet our target of restricting blockages on our network to 0.58 per kilometre of sewer, achieving 0.53 (2019: 0.52).

This programme has already made a difference to the performance of our sewers and the behaviour of our customers, so from 2020–25 we will be investing around £2 million to extend it.

Keeping the number of flooding incidents to a minimum

Each flooding incident is hugely distressing for our customers. As such, we take this area of our performance extremely seriously.

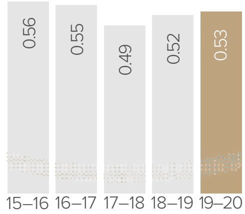
This is why we were disappointed to have not met our target of keeping incidents of internal flooding below 382, reporting 453 incidents in 2019–20 (2019: 389). We are working hard to improve this performance by deploying additional teams in high-blockage areas. Improvements in the technology we use to identify problems with our network is also helping us to be more proactive, fixing issues before our customers are affected.

In terms of the number of external flooding incidents, a total of 9,386 have been reported in 2019–20 (2019: 8,255), which is below our target of 9,694. Factors beyond our control will always put pressure on our sewer network, such as weather events. However, our performance during extreme weather events this year has started to demonstrate our improved resilience.

Over the five-year period, we have carried out flood mitigation work on 574 properties, ranging from fitting anti-flood devices and deploying additional pumps, to removing antiquated Buchan traps. We focused on properties in areas with a history of flooding or on preventing future flooding at properties that had already suffered an incident. We estimate this work has prevented more than 180 flooding incidents over the five-year period. As sewer blockages are the main cause of flooding, we have also assessed manholes across our region to identify those at highest risk. We have prioritised these hotspots in our flooding reduction plans to ensure our activities have the maximum impact on our customers.

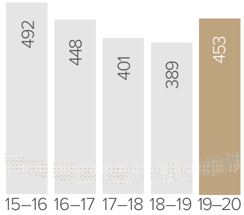
Notes:
1 Although we met internal targets in terms of odour complaints, we missed our Ofwat commitment, incurring a penalty of £0.9 million. This is because we received 12 complaints in relation to our Portswood and Tonbridge treatment works, where we had invested in odour management improvements and committed to a target of zero complaints in 2019–20.

Number of blockages per km



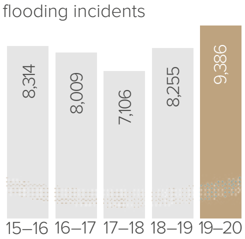
Target: 0.58
Achieved: 0.53

Number of internal flooding incidents



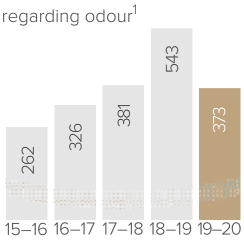
Target: 382
Achieved: 453

Number of external flooding incidents



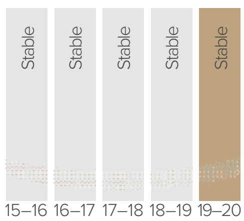
Target: 9,694
Achieved: 9,386

Number of customer complaints regarding odour[1]



Target: 390
Achieved: 373

Maintain asset health



Target: Stable
Achieved: Stable

Our commitments to customers continued

Removing wastewater effectively continued

We are working proactively to reduce pollution and flooding throughout our region

In a flooding incident, our Flooding Prevention teams have daily calls to discuss any appropriate action to prevent repeat incidents. This year, we have enhanced our standard processes to incorporate a more dynamic approach to risk, greater innovation and evidence-based processes that deliver efficient and cost-effective solutions.

Our Zero Flooding project, which began in 2017, is aiming to bring down the number of sewer flooding incidents in 10 towns and cities across our region. It uses several innovative tools, methods and materials to help understand and improve the way our sewers respond to different circumstances. It will also try targeted communications campaigns in different zones to see what works best in terms of changing the behaviour of our customers.

We have established a Pollution and Flooding Resilience team, which is working to proactively define and deliver best practice reduction programmes throughout our region. It also reports on incidents to help us continuously improve and optimise our efforts in this area.

Reducing complaints about odour from our sites

The number of complaints we received about odour from our wastewater treatment sites has dropped this year. The extended period of warm, dry weather during summer in 2018 meant we had an unusually high number of complaints.

In 2019–20, we met our target of keeping odour complaints below 390, receiving 373 (2019: 543) complaints in total. Although we met internal targets in terms of odour complaints, we missed our Ofwat commitment, incurring a penalty of £0.9 million. This is because we received 12 complaints in relation to our Portswood and Tonbridge treatment works, where we had invested in odour management improvements and committed to a target of zero complaints in 2019–20.

We have installed odour plume monitoring technology at several sites, which helps us identify sources of odours (including those generated by other sources) and predict who could be affected and when, so we can better manage risks.

Making sure our sites and networks are working as they should

Underlying risk to our wastewater assets – our sites and network of pipes – increased in 2018–19 due to impact of extreme weather events such as the 'Freeze/Thaw' and the long, hot summer. These underlying risks were managed back down for the start of 2019–20, as a result of site health checks and work at high risk sites.

Building on this foundation, we have continued to invest in improving our assets during 2019–20:

- We have completed our multimillion-pound redevelopment of Woolston wastewater treatment works in Southampton. The redeveloped site is now operational and will reduce odours while ensuring treated wastewater leaving the site meets new, higher environmental standards
- We have completed the £16 million upgrade to our wastewater treatment works at Eastbourne, which serves around 140,000 people. The major refurbishment has improved how the site treats up to 86 million litres of wastewater each day
- We received 26 new phosphorous permits for smaller treatment works to remove greater amounts of phosphorous from the wastewater we treat and return to the environment
- Extended Event Duration Monitoring systems for all storm tanks and outfalls to improve our monitoring and management of discharges
- We are close to completion of a £34.5 million rehabilitation project of century-old Thanet sewers. This was the second phase of a three-phase scheme to overhaul of the area's sewer network, protecting customers' home and the environment for the future.

Outlook

Deliver great service
Reliable wastewater services

- Internal sewer flooding
- External sewer flooding
- Risk of sewer flooding in a storm
- Sewer collapses

Fit for the future
Address long-term issues with our network

- Update Thanet sewers

Read about **our blockage prevention work** on pages 74 to 75

Case study

Kaylass Ramlagan
Wastewater Asset Strategy Manager

Preventing our customers' homes and properties from flooding

Link to governance

Read more about **risks** on pages 116 to 134

Read more about **our s172 statement** on pages 162 to 163

Link to strategy

Our commitments to customers (AMP6):

- Number of internal flooding incidents
- Number of external flooding incidents

Read more about **our performance** on pages 58 to 99

We are wholly committed to reducing sewer flooding in the community and are continually looking into the best ways of doing so.

Sewers may flood for many reasons: the two main causes are hydraulic overload, caused by extreme rainfall, which the sewers are not designed to carry; and blockages, often caused by incorrect materials being disposed of down drains and toilets.

Throughout 2015–20 our flood mitigation (prevention) project, saw us carry out flood prevention work in around 580 properties – something we are very proud of. Measures taken involved the installation of anti-flood devices (AFD), pumped AFD, air brick covers, flood doors, flood boards and others.

Properties were identified either through a planned proactive scheme, where our Engineering and Technical Services team worked together with County Sewerage Engineers to analyse data to identify properties that may be at risk of flooding, or via our Operations team during a reactive response to flooding.

Our overall aim is to reduce the number of repeat flooding incidents and prevent first time flooding, with our success measured this way too. Over the next five-year period we are investing in further improvements to reduce cases of sewer flooding inside and outside of properties, and prevent them happening in future.

Our flood prevention work has protected
580
properties

Our commitments to customers continued

Looking after the environment

541.78

Ml/d of water put into supply

62

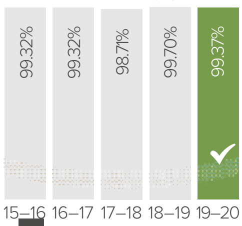
bathing waters in our region rated 'excellent'

Our purpose is to provide water for life to enhance health and wellbeing, protect and improve our environment, and sustain the economy

Outcomes

	2019–20	2018–19	2017–18	2016–17	2015–16
Wastewater treatment works compliance (%)	**99.37**	99.70	99.38	99.32	99.32
Maintain the number of bathing waters assessed with excellent water quality	**62**	62	53	51	43
Serious pollution incidents (category 1 and 2) (no.)[1]	**7**	7	4	3	7
Less serious pollution incidents (category 3) (no.)[1]	**427**	144	131	143	160
Distribution input (Ml/d)	**541.78**	558.75	541.00	532.28	520.64
Renewable energy usage (%)	**16.1**	15.8	17.2	17.0	17.3

Wastewater treatment works compliance (%)



Target: 100
Achieved: 99.37

Over the past year, we collaborated to further improve bathing water quality, built stronger relationships with regional environmental and farming groups, and assisted customers in Hampshire and Kent reduce their water consumption during the hottest bank holiday weekend on record.

In preparation for the hot summer, as well as the limits placed on our abstraction licences, we applied for a drought permit for the Test and Itchen Rivers in Hampshire. Thankfully, due to our efforts to reduce leakage and our customers' commitment to using water wisely, we did not need to use the permit.

This section explains our 2019–20 performance on key environmental metrics, as well as our continued transformation through Environment+. It also includes information on our energy use and greenhouse gas emissions.

Link to risks

- We may fail to supply enough water to our growing population of customers if resources are not sufficient. This can be from available resources becoming scarcer e.g. through climate change, or through protecting local environmental needs which can result in a reduction in the amount of water that can be abstracted for water supply.
- Damage to the environment could lead to a risk to our customers, and consumer confidence, and lead to prosecution and fines by the Environment Agency or the Drinking Water Inspectorate.
- We are currently being prosecuted by the Environment Agency for wastewater permit breaches and legacy issues relating to wastewater sampling compliance. Further detail can be found on page 27 and in our Annual Performance Report.
- If we are unable to improve our resilience to extreme weather events predicted by the onset of climate change: we will find it increasingly difficult to supply sufficient water to meet the growing demands of our customers; our assets could more easily be overwhelmed by storm events; and our coastal sites may become inundated from rising sea levels or at risk of coastal erosion.

Read more on **risk** on pages 116 to 134

Continued focus on compliance

Our wastewater treatment works are essential in ensuring the water we recycle maintains, protects and improves our environment and key habitats. In 2019–20, our performance remained good achieving 99.37% compliance (2018: 99.70%) with the required standards. Although this is a slight reduction from the previous year (2018: 99.70%), it still reflects strong performance in this area.

We continually strive to improve performance, reduce pollutions, and maintain confidence in our reporting by focusing on compliance and the proactive transformation taken in response to historic failings identified by our regulator.

Environment+

Environment+ is our overarching environmental improvement programme, encompassing all aspects of our environmental performance and compliance. Progress made since 2019 includes:

- Completing a best-practice scoping exercise to inform our Flooding Reduction Plan
- Significant progress on our Pollution Reduction Plan (see more on page 92)
- Pollution training across relevant teams
- Preliminary work started in 2019 on the new Drainage and Wastewater Management Plans (DWMPs), following the publication of the national guidance by Water UK. The full programme to 2025 is now progressing for all 11 of our river basin catchment-based DWMPs.

More excellent bathing waters than before

Our Bathing Water Enhancement Programme (BWEP) continues to deliver results, with 62 bathing waters achieving excellent status, using the annual assessment (2018: 62). That is 56 against our target of 54 plus a further six improved by the BWEP – a significant improvement compared to 43 in 2015.

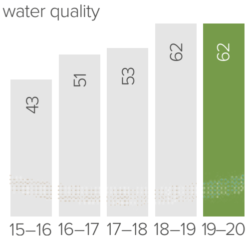
BWEP has been a collaborative effort with our teams working closely with local authorities, environmental groups, regulators and landowners. Collectively, we identified misconnections, shared information and advice, reached customers across our region through our Beauty of the Beach campaign and helped farmers manage their land differently.

During 2015–20 all seven of the bathing waters specified in BWEP achieved excellent status. However, Deal Castle was not classed as excellent in 2019 due to two high samples. We worked with partners in our Bathing Water Management group to investigate potential sources and determined the high samples were not linked to our assets.

Pictured
The water we recycle is key to supporting the environment and key habitats

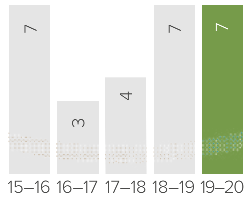
Notes:
1. As reported previously, we have identified a number of issues with spill data. The details of the steps taken and that continue to be taken, to improve the robustness of the spill data collection, the data processing systems and the assurance of that data, have been shared with the Environment Agency and Ofwat. As those steps have not yet reached completion, the data supplied would continue to have an error band of up to 10%.

Maintain the number of bathing waters assessed with excellent water quality



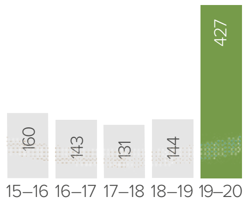
Target: 54
Achieved: 62

Number of serious pollution incidents (category 1 and 2)[1]



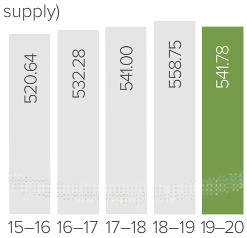
Target: 0
Achieved: 7

Number of less serious pollution incidents (category 3)[1]



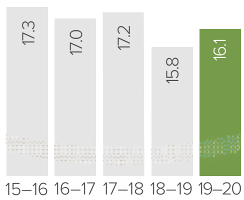
Target: 158
Achieved 427

Distribution input (Ml/d) (the amount of water put into supply)



Target: 526.39
Achieved: 541.78

Renewable energy usage



Target: 16.5%
Achieved: 16.1%

Our commitments to customers continued

86.5%

self-reporting of pollutions – our best ever performance

16.1%

of the energy used to power our operations we generated ourselves

Looking after the environment continued

Our pollutions performance needs to improve

Despite making strong progress elsewhere, we realise our pollutions performance remains unacceptable, with seven serious (category one and two) pollution incidents (2018: 7), and 427 less serious (category three) incidents (2018: 144). This perfrmance is not acceptable to us and we continue to invest in our systems and assets, £54 million in 2019–20, to make improve improvements.

An increase in reported pollution incidents has been driven by increased awareness and reporting improvements. We built on our best-ever self-reporting performance of 83% in 2018, to achieve 86.5% in 2019.

Our root cause analysis found abnormal rainfall has very little bearing on the pollution incidents we have seen from our assets. However, heavy rainfall – particularly after dry periods – has an impact on surface water flooding. There is a higher incidence of blockages where flows have been lower, as fats, oils and grease and wet wipes are not flushed to our wastewater treatment works.

Our analysis found one of the biggest causes of pollutions from our assets is the resilience of the power supplies at our sites, which lead to power outages, and occasionally mean we have to restart our works. We are working with partners across the South East, including energy network providers, to understand if there is a network issue and how this can be resolved.

Our Pollution Reduction Plan (PRP) has around 50 separate actions under eight Critical Success Factors (CSFs). These are:

- Enabling customer behaviours that help meet our pollution incident targets
- Understanding risk and improving resilience
- Trusted and effective monitoring systems
- Fast and effective response
- Trusted analysis and reporting
- Continuous improvement
- Predictive analysis and smart networks
- Customer participation.

We have made strong progress against many of these actions, including:

- Training nearly 700 colleagues to better recognise and understand the causes of pollution
- Auditing 385 of the 400 highest risk sites
- Launching our new ASPIRE spills reporting system
- Testing and improving the resilience of 126 backup generators
- Auto reset set up at 200 pumping stations
- Launching public awareness campaigns on blockages in Havant, Hayling Island and Thanet.

See our pollutions case study on page 45.

Protecting our water resources

The summer of 2019 saw the highest ever temperature recorded in the UK, and was the 12th warmest since 1910. Despite falling from the previous year, the amount of water we put into supply (Distribution Input (DI)) remained high at 541.78 Ml/d (2019: 559 Ml/d).

The 2019 August Bank Holiday weekend was the hottest on record. Despite this, and as a result of our proactive campaigns, the people of Hampshire, the Isle of Wight and Thanet reduced their consumption. Customers in Southampton are now the most water-efficient in our region.

We also published our Water Resources Management Plan (WRMP), which takes a 50-year look ahead, detailing how we will secure a resilient water future by meeting the challenges of environmental protection, climate change and population growth. It includes a balance of long-term behaviour change programmes, improved management of existing sources, halving leakage and securing additional water through water recycling, transfers from neighbouring water companies and the Havant Thicket Reservoir.

The challenge is particularly acute in Hampshire where we face a potential supply shortfall of 190 million litres per day, due to licence changes restricting the amount we can take for public supply from the Test and Itchen rivers. As temperatures rose last year, we were granted a drought permit by the Environment Agency to continue relying on the rivers even after flows dropped below a certain level. Due to our efforts to reduce leakage and our customers' commitment to saving water, the permit was not needed, and the area avoided the first temporary use ban in decades.

Pictured
Customers can save water by catching rain in a water butt for use in the garden

We worked closely with our environmental regulators to ensure the permit could be processed quickly. The permit application includes commitments from us to invest in measures to protect and enhance the rivers' ecosystems and habitats under Natural England's supervision.

Increasing our use of renewable energy

After a brief dip in performance last year, due to maintenance of our Combined Heat and Power fleet, we generated the equivalent of 16.1% of the energy used in our operations in 2019–20 (2018: 15.8%). Of this, 15.4% was from converting biogas generated as a by-product of our wastewater sludge digestion into electricity, and 0.6% was from solar power.

In addition to renewable energy generation, we continue to invest in energy efficiency and improving our existing processes and assets. This year we have invested in improving our internal energy efficiency capability to help identify and implement energy saving opportunities. In addition, we completed a number of site energy audits and surveys as part of fulfilling our obligations under the Energy Savings and Opportunities Scheme. We have invested in improvements in a number of our aeration systems and implemented enhanced monitoring and reporting to drive down energy usage and will expand the number of sites covered in the coming year.

The water sector is responsible for around 1% of the UK's total carbon emissions. We fully support the industry's Public Interest Commitment to achieve net zero emissions by 2030.

Conservation and biodiversity

It is widely recognised that urgent action is required in order to halt the loss of biodiversity as part of efforts to tackle drivers and impacts of climate change. We recognise the importance of a healthy and biodiverse environment as it underpins the essential services that we provide as a water company.

In our business plan 2020–25 we have identified Catchment First as one of our long-term strategic priorities. This places catchments at the centre of our decision-making, and champions investment in nature-based solutions alongside our more traditional engineering options. Investing in the protection, enhancement and recovery of nature will increase its resilience in the face of current and future risks, such as increasing development, population pressures and the impacts of climate change. A more resilient natural environment will mean greater resilience for our communities and economy in the face of these challenges.

There is growing consensus that measures that protect, enhance and restore nature can also deliver services that benefit society, such as cleaner water, reduced flooding, carbon sequestration, improved health and wellbeing, as well as protecting and restoring biodiversity to reverse the declines seen in wildlife across the South East.

Measures that protect, enhance and restore nature can also benefit society

Our commitments to customers continued

Looking after the environment continued

We want more biodiversity to result from our business activities, not less

We are active members of our three Local Nature Partnerships and have been working with partners such as the Wildlife Trusts, Local Authorities, statutory bodies and our neighbouring water companies, to start to understand where our natural capital assets are located, and how we might work together to protect and restore these.

Our region supports areas of national and international importance for wildlife, and Southern Water has a dedicated responsibility towards a number of these sites to protect and enhance the wildlife they support. We have active management plans in place at 10 nationally important sites of special scientific interest (SSSIs), and we have met our obligations to deliver all planned work this year. One of the key successes has been the construction of an otter holt at our Boldre wastewater treatment works.

As part of our capital delivery programme, we ensure that the engineering schemes we design and deliver comply with all relevant environmental legislation. Last year we secured an organisational licence that allows us to fast-track approval for engineering works affecting the habitats of protected species. The licence was renewed this year, which demonstrates the ongoing confidence that Natural England (as an environmental regulator) has that we have the in-house technical expertise and robust business processes in place to protect populations of vulnerable species, such as dormice, badgers and great crested newts. This confidence and trust has strengthened our relationship with Natural England.

Our established Environmental Working group, which brings together key staff from across Southern Water and our delivery partner organisations, has continued to gain strength and improve joint ways of working. The group shares learning and best practice, such as:

- Southern Water's maintenance contractor (GSF) uses battery powered equipment including a leaf blower, hedge cutters and strimmers to reduce environmental/pollution risk
- Cappagh Brown is using Green Rhino Enviro Pads on construction and operational sites, which are more efficient and easier to use than traditional drips trays at capturing diesel leaks and spills

Pictured
We work with our partners to protect our natural capital assets

Read more about **our section 19 undertakings** on pages 27 and 177

- CMDP has installed wildlife 'lasagnes' across its active construction sites; these use mostly discarded bits of materials to construct a habitat to encourage wildlife into the area and support the local populations
- CMDP has been using alternative ground protection measures on its construction sites, which reduce the need to remove top soil. These include mat grids paced directly onto the ground as walkways (used at Portobello), wysebase to create steps and cabin bases, and terram grass protective matting to create parking areas.

Invasive non-native species (INNS) can have a significant impact on local wildlife and our operations. This year we have trained more than 20 technical coordinators to identify key INNS that might be found across our sites in order to implement measures to control them. Species, including plants like floating pennywort and Japanese knotweed, and animals such as zebra mussel and signal crayfish, can damage natural habitats and impact on native wildlife populations. During routine survey work at Bewl reservoir, we identified an INNS new to our region – the demon shrimp.

Nests not nets – a scheme inspired by calls from the RSPB and the Chartered Institute of Ecology and Environmental Management – meant that Southern Water banned the placing of nets over vegetation to prevent birds nesting during engineering and construction works. This positive step for wildlife was widely supported by all our delivery partners.

Looking ahead, we are going to be working with colleagues across our business and our key environmental stakeholders to embed natural capital assessments and biodiversity 'net gain' as part of our overall approach to ensure there is more biodiversity as a result of our business activities, not less.

Greater transparency about our environmental performance

As part of our commitment to Ofwat to make amends to our customers for historic misreporting of wastewater treatment works data, we have increased the amount of information we share about our environmental performance.

We have launched dedicated web pages to provide relevant, timely information on:

- Pollution incidents
- Flow and spill reporting
- Wastewater treatment works final effluent compliance
- Regional bathing water compliance results
- Carbon and greenhouse gas emissions
- River levels.

Some of this information is provided to us by the Environment Agency, so we are working with them to link to relevant information on our website.

Outlook

Protect and improve our environment

Protect our environment

- Pollution incidents
- Treatment works compliance
- Surface water management
- Satisfactory bioresources recycling
- Abstraction incentive mechanism
- River water quality
- Maintain bathing waters at 'excellent'
- Distribution input

Improve our environment

- Improve the number of bathing waters to at least 'good'
- Improve the bathing waters at 'excellent' quality
- Combined Sewer Overflows (CSO) monitoring
- WINEP delivery

Fit for the future

Increase value from environmental initiatives

- Natural capital
- Renewable generation

Read about **our plans for AMP7** on pages 36 to 39

Case studies

Rob Butson
Bathing Water Manager

Link to governance

Read more about **risks** on pages 116 to 134

Read more about our **s172 statement** on pages 162 to 163

Link to strategy

Our commitments to customers (AMP6):

- Maintain the number of bathing waters with excellent water quality
- Number of serious pollution incidents (cat 1 and 2)
- Number of less serious pollution incidents (cat 3)

Managing misconnections to protect our bathing waters

The Southern Water Misconnections team was created and first deployed in January 2019 with an initial remit to identify misconnections at the seven locations of the Bathing Water Enhancement Programme (BWEP).

The team, made up of two technicians per county, with over 100 years of drainage experience, now works across several bathing water locations from the Isle of Wight to Kent.

Providing a vital resource for local authority partners, councils' environmental health officers now work closely with the team to resolve issues, where once there was no such direct communication.

The techniques used by the team include:

- Caging surface water sewers
- Sample tests/ammonia kits
- Visual signs of pollution
- Misconnected pipework
- Using your nose
- Look/see equipment
- Dye testing
- UV torches.

Moving into the next five-year period, the team now has fresh obligations set by the Environment Agency and Ofwat, to improve the water quality at another 31 seaside locations. Action plans have been created for each location with detailed instructions of the area.

Thanks to the success of BWEP, the Misconnections team has been identified as fundamental to understanding the condition of our outfalls, and what is passing through them and into the environment. The team will also be investigating the surface water systems that can have an impact on the quality of the region's shellfish beds. In some cases, the quality of the beds have been deteriorating, and pollution from land may be having a direct impact.

The team has
100
years of drainage experience

Zoë Fothergill
Southern Water Catchment Officer for Worthing

Reducing the impact of nitrates on regional water sources

Link to governance

Read more about **risks** on pages 116 to 134

Read more about our **s172 statement** on pages 162 to 163

Link to strategy

Our commitments to customers (AMP6):

- Water quality compliance

Read more about **our performance** on pages 58 to 99

Our specialist teams have now completed their first year of nitrate reduction measures in drinking water catchments in the Worthing area.

The Catchment team has been working closely with the Arun to Adur Farmers Group (AAFG) to raise awareness of water quality issues, and implement measures designed in collaboration with the group, to reduce nitrate leaching to groundwater.

In the Brighton area, the Catchment team has built on the success of the Chalk Management Partnership (ChaMP) project and is now working directly with farmers in our catchment areas. Nitrate reduction schemes are now in their second year in the wider Brighton area.

Over the 2019–20 growing season, we have incentivised farmers to adopt many land management practices, which will reduce their inputs of nitrogen fertiliser and make their applications more efficient, and therefore reducing the amount of nitrate lost to groundwater through leaching. We have also funded soil testing to help us better understand the nitrate risk and to assist farms with nutrient management planning.

As well as encouraging sustainable farming practices, which benefit the natural environment, it is hoped this approach will address nitrate spikes seen seasonally at some of our sources and, in the longer term, reduce the requirement for costly, engineered nitrate removal solutions.

Key facts:

In the last year, in the Brighton and Worthing Chalk Blocks, Southern Water has funded:

- 446 hectares of over-winter cover crops
- 226 hectares of no input grassland
- 221 hectares of cover crops followed by summer fallow
- 100 hectares of arable reversion to grassland, and hundreds more hectares in other nitrate reduction measures.

Our commitments to customers continued

189

KgCO$_2$e less operational emissions since last year

99.95%

compliance achieved by our sludge reporting

We have committed to achieve net zero carbon emissions by 2030

Looking after the environment continued

We want to reduce the impact our business has on our environment, which is why we are working to reduce the contribution we make to climate change

Reducing our impact

Outcomes

	2019–20	2018–19	2017–18	2016–17	2015–16
Greenhouse gas emissions	**189**	200	228	245	267
KgCO$_2$e per person supplied with treated water[1]	**15**	18	23	25	27
KgCO$_2$e per person supplied with wastewater services[1]	**28**	30	33	35	39

KgCO$_2$e – Kilograms carbon dioxide equivalent

Link to risks

- Combatting climate change is also about mitigating its causes. We have made a Public Interest Commitment (PIC) to becoming a carbon neutral (net zero) company by 2030 (along with other English water companies).
- A failure to deliver this commitment could incur financial and reputational damage and increased scrutiny from our regulators, who have signalled a greater emphasis on climate change in future strategy.
- Failure to effectively monitor and adapt to any changes in our regulatory frameworks (Ofwat, Environment Agency or Drinking Water Inspectorate) may lead to potential non-compliance and financial penalties.

Read more on **risk** on pages 116 to 134

In 2019–20, our carbon emissions (greenhouse gases) reduced; these are produced by our operations in order to provide services to our customers. Our emissions are 189 kilotonnes of CO$_2$e for 2019–20. This is down from 200 kilotonnes in 2018–19. The reduction is principally due to the reducing greenhouse gas content in the power that we buy from the grid.

We also continue to consider the carbon impact of our capital programme, and are looking ahead to how we can use efficient and integrated designs to improve even further in the years ahead.

Using more renewable energy

We have signed up to the Public Interest Commitment net zero carbon by 2030, in collaboration with other water sector companies.

The goal of net zero carbon by 2030 is to reduce and mitigate greenhouse gas emissions and, where this is not possible, find solutions to balance remaining emissions through carbon sequestration through nature-based solutions and offsetting. This target will require a greater uptake of renewables, but also innovation to target process emissions.

We are developing our plans to meet this target by:

- Reducing our emissions through energy efficiency, water efficiency and switching to less polluting technology such as electric vehicles

- Mitigating our emissions by generating more renewable energy. We are aiming to procure greater than 15MW of onsite solar Power Purchase Agreements (PPA) in order to improve our energy performance from both a carbon and financial perspective. Additionally, in line with our business plan to 2025, we are replacing the oldest CHP engines with more efficient assets.
- Developing natural capital approaches to maximise carbon uptake and biodiversity with partners such as local nature partnerships
- Investing in an Innovation team
- Support of water sector research/project steering.

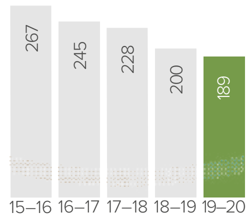
Recycling waste from our treatment sites

During 2019, the Environment Agency (EA) identified discrepancies between the assumptions used by different water companies in England when reporting on sludge. After an investigation, the EA removed the sludge metric from its overall environmental performance assessment. Though the metric was no longer compulsory, companies were asked to continue reporting on it for information purposes. During 2019, we actively participated in working groups organised by the EA to standardise and improve the sludge metric for the future, when the metric will become compulsory again.

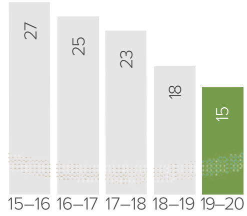
As requested, we submitted our sludge data to the EA in April 2020 for information purposes. The report highlighted compliance of above 99.95%.

The deviation from 100% compliance was due to a minor technical non-conformance with the environmental permitting regulations. The material was compliant with the agricultural regulations throughout the year.

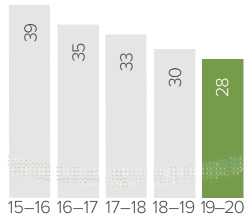
Greenhouse gas emissions ($ktCO_2e$)



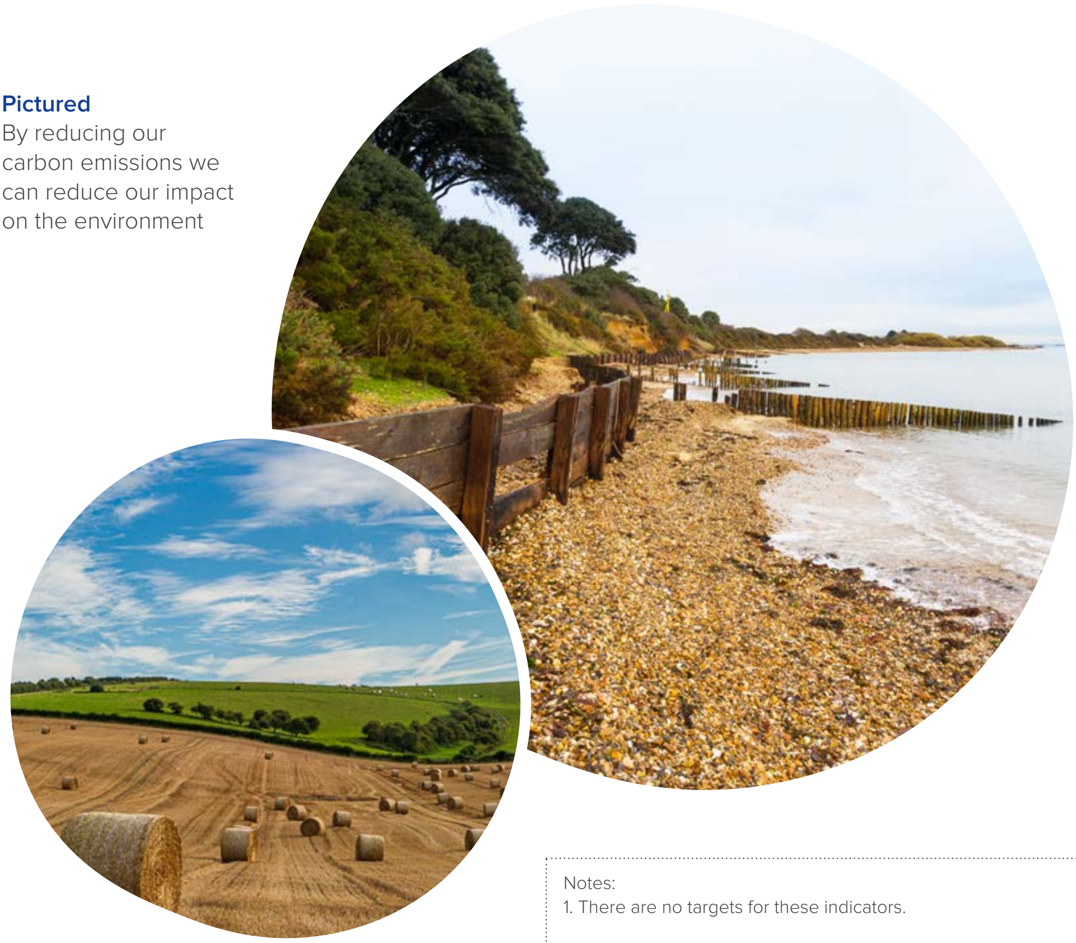
$kgCO_2e$ per person supplied with treated water



$kgCO_2e$ per person supplied with wastewater services



Pictured
By reducing our carbon emissions we can reduce our impact on the environment



Notes:
1. There are no targets for these indicators.

Financial Performance

from Southern Water

Financial performance

Table 1

Income Statement	31 March 2020 £m	31 March 2019 £m
Revenue before regulatory settlement	**878.0**	876.3
Other operating income	**1.4**	1.2
Operating costs before charge for bad and doubtful debts and regulatory settlement	**(373.5)**	(338.6)
Charge for bad and doubtful debts	**(29.6)**	(10.7)
Depreciation and amortisation	**(264.0)**	(271.8)
Operating profit before regulatory settlement	**212.3**	256.4
Regulatory settlement	**–**	(138.5)
Operating profit after regulatory settlement	**212.3**	117.9
Other income	**–**	0.2
Profit on disposal of fixed assets	**0.9**	0.7
Profit before interest and tax	**213.2**	118.8
Net finance costs	**(119.2)**	(155.8)
Fair value gains/(losses) on derivative financial instruments	**339.9**	(216.6)
Profit/(loss) before tax	**433.9**	(253.6)
Tax	**(105.2)**	20.7
Profit/(loss) for the financial year	**328.7**	(232.9)

Accounting policies

The accounting policies of the company are set out in note 1 to the financial statements and include details of the impact of IFRS16 'Leases' which became effective for periods beginning 1 January 2019.

Income statement

Our income statement is summarised in Table 1 above.

Revenue before the regulatory settlement increased to £878.0 million (2019: £876.3 million). This increase largely results from changes to our inflation-linked water and wastewater tariffs. The increase in revenue resulting from the annual change to tariffs was substantially offset by a reduction in consumption, resulting in a small increase to revenues overall. The impact of COVID-19 included within revenues has been estimated as a net reduction in consumption of £0.7 million for the year following the application of the lockdown by the Government in March 2020. An analysis of revenue is provided in note 5 to the financial statements.

2019–20 has been a challenging year as we have been preparing for the delivery of our plan for 2020–25, while addressing historic performance and managing an increased number of operational issues during the year. As a result, operating costs before the charge for bad and doubtful debts and the regulatory settlement increased by £34.9 million to £373.5 million (2019: £338.6 million).

The major movements in our operating costs are described below and presented in Table 2.

In order to prepare for the challenge of the next five-year period, improve our services and reduce our costs, we have undertaken a number of restructuring activities during the year. These have included transferring the majority of our customer services activities to Capita, closing our final salary pension scheme and reshaping a number of teams across the business. As a result, we have incurred a number of one-off restructuring costs, totalling £7.7 million.

Our wastewater operational teams have responded to a number of challenges during the year including:

- A number of significant sewer bursts on our network which resulted in £4.8 million of additional costs, principally tankering and repairs to minimise disruption to our service
- Interventions at a number of sites to mitigate compliance risk, totalling £4.6 million, including the repair of equipment at treatment works, the hire of additional back-up equipment and the provision of additional tankering to reduce the risk of spills to the environment
- Additional tankering and wastewater treatment costs of £4.5 million to deal with high groundwater levels following the storms and wet weather experienced this winter.

On the water supply and distribution network, we have continued additional activity to reduce leakage. We started this last year by increasing the size of our teams and collaborating with our partners, following the impact of the 'Freeze/Thaw' on our network. This resulted in additional costs of £3.2 million in our activity to find and fix leaks during the year.

Table 2

Year-on-year increase/(decrease) in operating costs before charge for bad and doubtful debts and regulatory settlement	£m
Inflation	11.6
Restructuring	7.7
Sewer repairs	4.8
Wastewater compliance	4.6
Wastewater weather related	4.5
Increase in leakage activity	3.2
Provisions	4.0
Environmental provision	(3.3)
Debt collection costs	(1.6)
IFRS16 – operating leases	(2.0)
Pensions	(0.8)
Other	2.2
Movement in operating costs	34.9

As reported in our Annual Performance Report last year, we have been improving the processes for making and recording customer appointments for some functions that undertake tasks at customers' premises. During the course of making these improvements, we identified that a number of historic guaranteed standards of service (GSS) payments for missed appointments may have been due and, therefore, we have made a provision of £3.0 million this year for these historic payments.

In addition, as disclosed on page 27, we have recognised a provision of £1.0 million in relation to the charges presented by the Environment Agency to the court regarding historic wastewater performance. This provision represents a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs. The court has a very broad discretion to assess the level of the fine and the provision is not intended to indicate or predict any particular level. The Board will continue to review the level of provision made as more information becomes available.

Over the past two years, we have made environmental provisions for work to improve the resilience of the Rivers Test and Itchen in Hampshire for periods of severe drought to help protect the rivers' ecology. No significant additions to this provision were required during the year, resulting in a reduction in operating costs of £3.3 million.

Other changes to operating costs in the year were:

- debt management, which fell due to lower litigation costs of £1.6 million
- the removal of operating lease costs, amounting to £2.0 million, from the income statement following the implementation of IFRS16 'Leases' effective from 1 April 2019
- the net change to pension costs from increasing employer stakeholder pension contributions of £1.0 million, which were offset by the one-off cost incurred in the prior year for Guaranteed Minimum Pension Equalisation costs of £1.8 million.

As a result of COVID-19 pandemic on our view of the future collectability of debt outstanding at 31 March 2020, we have recorded a significant additional bad debt charge during the year. Overall, our charge for bad and doubtful debts increased by £18.9 million to £29.6 million (2019: £10.7 million). Of this increase, £16.0 million represents our estimate of the impact of COVID-19 on the collectability of these debts.

Meanwhile, depreciation and amortisation decreased to £264.0 million (2019: £271.8 million) as a result of a number of large, but short-life, assets becoming fully depreciated over the past two years.

As a result, operating profit (before regulatory settlement made in 2018–19) decreased to £212.3 million (2019: £256.4 million), a 17% reduction, one third of which relates to the COVID-19 bad debt charge.

As reported in the Annual Report last year and disclosed on page 27, following its investigation into our historical wastewater treatment works compliance reporting, Ofwat confirmed its intention to impose a penalty under Section 22A of the Water Industry Act. This penalty comprises a fine of £3.0 million together with a reduction to future revenues of £122.9 million at 2017–18 prices, which will be made by way of a rebate to wastewater customers over the period 2020–25. We provided for these in full in the financial statements for 2018–19, resulting in a reduction to operating profit of £138.5 million (at forecast outturn prices) for that year.

The profit on disposal of fixed assets of £0.9 million (2019: £0.7 million) mainly relates to minor property and vehicle disposals and the release of deferred revenue from the historical sale of income rights relating to aerial masts.

Read more about our response to **COVID-19** on page 28

Financial performance continued

Net finance costs decreased by £36.6 million to £119.2 million (2019: £155.8 million). This reduction is largely driven by the refinancing activities undertaken at the end of the prior year which, along with a further redemption in preference shares, have resulted in a reduction in net interest payable of £23.2 million. There was also lower indexation on our index-linked debt of £5.3 million and an increase in the amount of interest capitalised of £9.8 million.

The fair value gain on our derivative financial instruments amounted to £339.9 million (2019: loss £216.6 million). There have been some changes to derivatives in the year, described on page 110, but the primary driver for changes in the valuation is the fluctuation in UK Government bond yields which are used to discount the future cash flows. As Government gilt yields are constantly moving the valuation of our derivative instruments can be volatile. These changes do not represent cash flows.

We have recognised a total tax charge to the income statement of £105.2 million (2019: £20.7 million tax credit). This differs from the charge that may be expected of £82.4 million, based on the profit before tax of £433.9 million and the current period tax rate of 19%, as described in note 10. The difference is primarily due to the company receiving group relief losses surrendered by other companies in the Southern Water group for nil payment, and the announcement made in the Government's Budget Statement in March 2020 that the rate of Corporation Tax would not be reducing to 17% as announced and would remain at 19%. As a result a charge of £40.3 million has been recognised in the income statement for the impact of this change on our deferred tax balance.

The profit after taxation for the year amounted to £328.7 million (2019: £232.9 million loss).

Cash flow statement

Overall, cash and cash equivalents decreased in 2019–20 by £242.7 million (2019: £207.6 million increase). This movement of £450.3 million principally results from the refinancing activities that we undertook during the prior year. Further details of the year-on-year movements are provided in Table 3 below.

Read more about our **capital structure** on pages 109 to 114

Table 3
Cash flow statement – summary

	Years ended 31 March 2020 £m	2019 £m	Movement £m	Explanation
Movement in loan to SWSG	–	682.3	(682.3)	In 2018–19 (FY19) Southern Water Services (SWS) received a repayment of £682.3 million from Southern Water Services Group (SWSG) of an inter-company loan as part of the refinancing exercise.
Net interest related transactions	(175.0)	(152.2)	(22.8)	Following the repayment of the SWSG loan, interest receivable fell this year by £34.2 million. This was offset by one-off charges incurred in the prior year relating to the refinancing exercise and the planned closing of our Cayman Islands company of £8.4 million. Other differences relating to lower interest payments due in the current year following the repayment of loans were offset by the fact that interest payments relating to 2018–19 were made in the current year due to 31 March 2019 falling on a weekend.
Net movement on borrowings	(202.8)	(255.1)	52.3	During the year we made loan, credit facility and preference share repayments totalling £417.8 million (2019: £425.1 million); these were offset by an increase in a credit facility of £215.0 million (2019: £170.0 million).
Payments on restructure of derivative instruments	140.0	(122.5)	262.5	During 2019 we restructured the cash flows associated with an existing financial instrument, which brought forward a cash receipt of £140.0 million at present value. In the prior year we incurred costs of £113.6 million extending the mandatory breaks on our swap agreements, together with the net cost for the early termination of swaps of £8.9 million.
Equity dividends paid	(7.1)	(34.8)	27.7	In FY20 our dividends to SWSG fell by £27.7 million. These dividends are used by SWSG to make interest payments back to SWS on an inter-company loan. As a large portion of the loan was repaid in FY19 the dividend required to enable the interest to be paid also reduced.
Other	2.2	89.9	(87.7)	The net cash movement from operating activities and our capital investment programme. The inflow of cash was lower in FY20 due to an increase in the level of capital expenditure.
	(242.7)	207.6		

Statement of financial position – summary

	31 March 2020 £m	31 March 2019 £m
Non-current assets	**6,721.3**	6,302.1
Current assets (excluding cash)	**278.3**	337.2
Cash and cash equivalents	**129.3**	372.0
Total assets	**7,128.9**	7,011.3
Current liabilities	**(1,017.5)**	(871.0)
Non-current liabilities	**(4,857.9)**	(5,302.6)
Total liabilities	**(5,875.4)**	(6,173.6)
Total net assets	**1,253.5**	837.7
Total equity	**1,253.5**	837.7

At the end of the year to 31 March 2020, we had non-current assets of £6,721.3 million (2019: £6,302.1 million), an increase of £419.2 million from March 2019. This increase results from our ongoing capital investment programme which, after depreciation, increased the value of property plant and equipment and intangible assets by £271.1 million and an increase in the value of our non-current financial derivative assets of £148.1 million.

Current assets decreased to £278.3 million (2019: £337.2 million), principally as a result of the increased provision for bad debt relating to COVID-19 of £16.0 million together with a reduction in the balance on the inter-company debtor with Southern Water Services (Finance) Limited of £54.4 million. This inter-company arrangement is used to pay the interest on our loans. The balance reduced this year as a number of interest payments are made at 31 March and this fell on a weekend in 2019, resulting in a higher than normal debtor balance.

Current liabilities increased to £1,017.5 million (2019: £871.0 million). This is mainly caused by an increase in a credit facility of £160.0 million, loans repayable within the year of £49.5 million, and the transfer from long-term liabilities of £35.6 million of the regulatory settlement provision offset by a reduction in the accrual for interest on bonds by £107.4 million, which were paid on 31 March in the current year.

At 31 March 2020, non-current liabilities totalled £4,857.9 million (2019: £5,302.6 million). This decrease of £444.7 million was principally the result of the following:

- A reduction in borrowings of £386.1 million following the re-classification of a £349.5 million loan as short-term, the repayment of preference shares of £50.1 million offset by indexation
- An increase in lease liabilities of £27.4 million following the implementation of IFRS 16 'Leases'
- An decrease in the derivative financial instrument liability of £51.8 million
- An increase in the deferred tax liability of £121.0 million in part driven by the announcement that the corporation tax rate would not decrease to 17% from 1 April 2020 together with current year results
- A reduction in retirement benefit obligations of £125.9 million, following the closure of the scheme to future accrual, a lump sum deficit payment of £17.3 million and the movement in market conditions at 31 March 2020.
- The transfer of £35.6 million of the regulatory settlement provision to short-term liabilities.

Overall, net assets increased from £837.7 million to £1,253.5 million.

Dividend policy

Our dividend policy is formulated to ensure a fair balance of reward between customers and investors. To deliver on our vision for the successful delivery of our business plan for 2020–25, all stakeholders must share in success: customers benefiting through enhanced service and lower bills, and shareholders earning a fair return on the near £2 billion of equity invested.

When proposing payment of a dividend, the directors of Southern Water Services Limited, acting independently in accordance with their directors' duties and in accordance with the company's licence, will apply the following principles:

1. Determination of a base level of dividend, based on an equity return consistent with our most recent Final Determination and our actual level of gearing. This recognises our management of economic risks and capital employed.
2. In assessing any adjustment to the base level of dividend, we will take into account all aspects of

Financial performance continued

our performance. This would reflect our overall financial performance as compared to the final business plan as agreed by Ofwat and would explicitly consider a qualitative assessment of customer service levels and how customers share in our successes.

3. We will consider our financial resilience ahead of any dividend decision and whether any financial outperformance should be re-invested to benefit customers. This consideration will include taking into account the interests of our employees, other stakeholders, and our pension schemes.

   Our dividend policy is intended to support the financial resilience and investment grade credit ratings of the business and ensure continued access to diversified sources of finance. As part of step three, we carry out an assessment of:

   a. headroom under debt covenants

   b. the impact on the company's credit rating

   c. the liquidity position and ability to fulfil licence conditions

   d. key areas of business risk.

4. We will be transparent in the payment of dividends and will clearly justify the payment in relation to the factors outlined above.

5. We will publish our dividend policy annually (as part of the Annual Report) and highlight any changes.

The Board has resolved that the company will not pay any dividends until it is clear that to do so would not be detrimental to the company's financial position. These tests are not applied to the interim dividends of £7.1 million paid in 2019–20 to Southern Water Services Group (SWSG) as this dividend payment is instantly offset by a corresponding interest receipt from SWSG and is therefore immediately repaid to the company in a 'dividend loop' (see page 114) resulting in no net cash flow for the company.

Having undertaken its assessment for 2019–20, the Board has decided not to declare an ordinary share dividend for 2019–20 (2019: nil). The potential level of base dividend was calculated as £70.4 million. This potential level of base dividend is calculated as per step one of our dividend policy. In discussing this potential base dividend and taking into account the remainder of our dividend policy, it was decided that we would not make an ordinary dividend payment at this time.

In 2019–20 the Board approved repayments of preference share capital totalling £50.1 million and preference share dividend payments of £9.0 million (2019: £5.9 million), which are disclosed as interest in the financial statements, of which £5.0 million related to an accrual made at 31 March 2019. A further £2.4 million has been accrued at 31 March 2020.

Taxation strategy

We have a low risk approach to our management of tax. The foundation of our tax strategy is to comply fully with tax legislation, focus upon maintaining a strong tax compliance culture, and manage our tax affairs in the best interests of our customers and stakeholders. The very nature of our business means we take a long-term view on all the activities we undertake and, as a result, we also ensure our tax strategy is sustainable.

Our tax strategy is reviewed regularly and we regard this publication as complying with our duty under paragraph 16(2) of Finance Act 2016 in the current financial year of 31 March 2020.

Our tax policy

Our tax policy is consistent with the overall values and corporate strategy of the company and considers financial risk, reputational risk, and social responsibilities. Our approach to tax planning is to align to business decisions made in the best interests of customers and stakeholders, rather than use tax planning to drive or determine business decisions. Our focus is therefore on compliance and our tax planning is always aligned with our commercial and economic activity.

Our approach to tax management is to be fully compliant with tax laws, rules, regulations and reporting requirements in all operations. This extends to following both the letter of the law as well as the spirit of the law. A culture of doing the right thing is embedded in our core values and our approach to tax embodies this by ensuring we pay the right amount of tax, in the right place, at the right time. We also use the expertise of professional tax advisers to ensure we maintain best practice in our approach to compliance and in circumstances when additional advice is deemed appropriate.

We are open and transparent and we do not use tax avoidance schemes or take an aggressive stance on our interpretation of tax legislation when tax planning.

Our management of tax risk

As stated above in our tax policy, we adopt a conservative approach to tax risk. Our tax management focus is on compliance, systems and governance and our tax planning is always aligned with our commercial and economic activity. All companies within the Southern Water group are subject to UK tax and all companies are UK tax resident, irrespective of their place of incorporation, ensuring that each company is subject to UK tax.

Tax risk primarily emanates from the evolution and complexity of the Southern Water business, along with the ever-changing regulatory and legislative environment. We manage this risk by having an experienced Tax team dedicated to tax compliance and the identification of tax risks in our business.

Our Tax team works with the wider business to ensure there are sufficient processes and controls in place and determine what level of risk is acceptable. We also have a support network of industry tax experts who provide specialist tax services, check what we are doing and provide advice and guidance on new tax compliance challenges. Our Internal Audit team also carries out assurance on the control environment relating to the transactional processes underpinning our payments to the Exchequer and our collection of taxes on behalf of the Exchequer.

Our relationship with Her Majesty's Revenue & Customs (HMRC)

A key factor in our management of our tax affairs is our relationship with HMRC.

We meet all statutory and legislative requirements and we manage our tax affairs in an open and transparent way. This extends to us sharing information with HMRC which goes beyond the normal filing of statutory returns, such as the sharing of internal audit findings so that we can be open and transparent in our approach to managing tax risk. HMRC shares our view of our low risk approach to the management of our tax affairs with an HMRC assessment of us as a 'low-risk' company.

Maintaining public trust

As previously stated, we are committed to complying fully with tax legislation, maintaining a strong culture of compliance and having open and constructive relationships with tax authorities.

We apply Government and fiscal authority tax incentives and exemptions, where they exist. For example, the UK tax system recognises the benefit to the economy of investment in infrastructure and environmental protection through the availability of capital allowances which reduce the corporation tax Southern Water pays. Any benefits of this are passed to our customers.

Southern Water and all Southern Water group companies pay taxes in the UK and have never used offshore companies to avoid tax or levies. We have a Cayman Islands registered subsidiary company which was set up to issue debt in the UK (see page 113 for more information). Its Cayman Island registration does not have any impact on the tax due by the group. However, we know that this company has contributed to misconceptions about our business practices, which is why we are working towards closing it. We hope to complete this process shortly.

Understanding our taxable profits and our corporation tax

Our taxable profits are generally different to our accounting profits for the following reasons:

- Capital allowances and depreciation – we have a large capital expenditure programme and this is deducted against taxable profits as capital allowances. Capital allowances are applied at different rates than the depreciation charged against profits in the financial statements. As a result, there is a timing difference between deductions made against our taxable profits and those made against our accounting profits. Due to the scale of our capital expenditure programme and the level of capital allowances utilised, our taxable profits are significantly reduced.
- The treatment of interest costs – we borrow money to finance our capital expenditure programme. The interest associated with this borrowing is recognised as both an accounting and tax expense, reducing profit and the amount of tax we pay. However, there are differences between the amounts of interest recognised for accounting profits and for taxable profits. Examples are that movements on the fair value of our financial derivatives are not recognised in our taxable profits and interest that is capitalised in our financial statements is deducted in calculating our taxable profits.
- Group relief – Southern Water is part of the Greensands Holdings group of companies as set out on page 111. All of these companies are taxable as UK companies and profits or losses of the companies within the group can be set off against one another in the financial year.
- Changes to future tax rates – the financial statements carry the temporary differences between our taxable profits and our accounting profits as a deferred tax balance on the statement of financial position. Changes to the future rate of corporation tax revise the carrying value of these differences.

Our tax charge is reduced by our large capital expenditure programme and the interest we are charged on borrowings. The benefit of this is passed to our customers through reduced bills. There is no corporation tax allowance within our customer bills for the regulatory period from April 2015 to March 2020.

Details of our tax charge for the current financial year are disclosed in note 10 to the financial statements and the current year charge to the income statement is also explained further on page 229.

Financial performance continued

Our other tax contributions

Our other contributions to the Exchequer amounted to £71.9 million. These are explained below:

- Business rates of £27.5 million paid to local authorities (2019: £27.2 million) and payments to the Environment Agency of £8.3 million (2019: £9.0 million) for abstraction licences and discharge consents, which reduce profits chargeable to corporation tax.
- Employment taxes of £36.1 million (2019: £33.6 million) paid to the Exchequer under PAYE (Pay As You Earn) and National Insurance contributions.

Payments have also been made to other group companies of £1.7 million for tax losses surrendered to the company. These were paid to SWSG, allowing SWSG to make interest payments back to Southern Water. Overall, Southern Water pays 2.4 pence in the pound for losses surrendered from group companies. As a result of capital allowances and interest charges, no corporation tax was paid by the company to HMRC in 2019–20.

Financial KPIs

Within our financial debt structure is a comprehensive set of covenanted financial ratios. Of these, there are two key ratios, namely the ratio of net debt to Regulatory Capital Value (RCV) and the ratio of adjusted net cash income to net interest cost.

The net debt to RCV ratio is calculated as short and long-term senior borrowings, less cash and short-term deposits to the RCV (all values taken from our Regulatory Accounts). The RCV is set by Ofwat at each five-year periodic review and reflects our initial market value plus subsequent capital investment and inflation. The RCV is adjusted at each periodic review for relevant changes to the level of expenditure or performance during the five-year period.

Senior adjusted cash interest cover (measured as the ratio of net cash inflow from operating activities less RCV depreciation to senior debt interest) is targeted to be maintained above 1.1 times to meet covenanted levels.

Following the announcement by Ofwat of the outcome of its investigation into our wastewater performance in September 2019, and our acceptance of the Final Determination in February 2020, the credit rating agencies each reviewed their assessment of the credit ratings for Southern Water. The credit ratings are shown in the table above and the outlooks of Standard and Poor's and Fitch is Negative Outlook, Moody's is Stable.

Note:

A further credit rating downgrade by one or more Rating Agencies could result in a Trigger Event under our Common Terms Agreement (defined below) which in turn would require creditor consents to the raising of new debt and restrictions on the payment of dividends.

A further credit rating downgrade by Moody's would lead to a restriction on the payment of dividends under the terms of our Licence.

A Trigger Event would occur if any two of the credit ratings fall to BBB (Standard & Poor's), BBB (Fitch) or Baa2 (Moody's) or below.

A cash lock-up under our Licence of Appointment would occur where the credit rating outlook assigned the lowest investment grade credit rating has been changed from stable or positive to negative.

A Default would occur if any two of the credit ratings are less than the minimum rating required for the status of investment grade.

Net debt/RCV	%
2016–17 performance	77
2017–18 performance	77
2018–19 performance	66
2019–20 performance	67
Covenanted lock-up level (to 2017–18)	<85
Covenanted lock-up level (from 2018–19)	<75

Adjusted cash interest cover	Times
2016–17 performance	1.9
2017–18 performance	1.8
2018–19 performance	1.5
2019–20 performance	1.7
Minimum target trigger level (to 2017–18)	1.1
Minimum target trigger level (from 2018–19)	1.3

The covenanted lock-up level/trigger level refers to debt covenants where payment of dividends by Southern Water are not permitted. These are structural buffers to protect against a default covenant e.g. the covenanted default net debt to RCV level is at 95%.

Credit rating as at signing date of accounts

Standard & Poor's	Fitch	Moody's
Class A debt:	Class A debt:	Class A debt:
BBB+	**BBB+**	**Baa3**

Capital structure

Why Southern Water raises finance

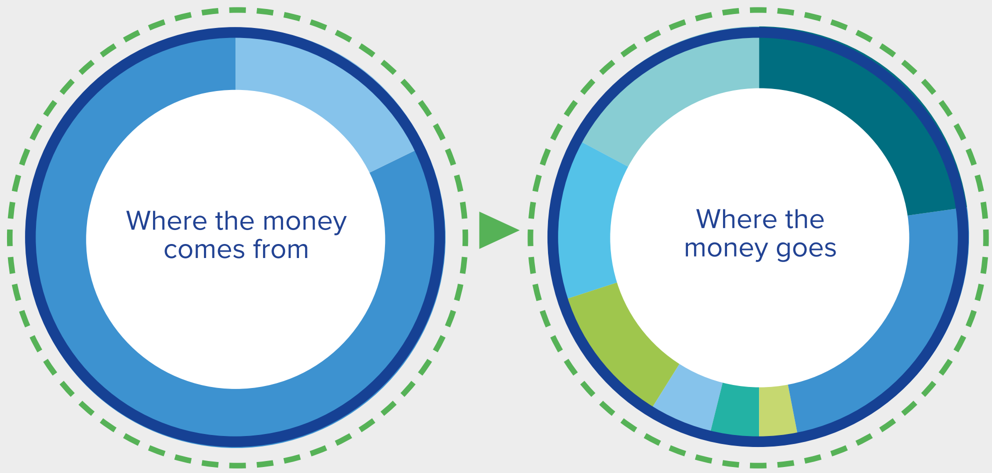
Significant capital investment has been a feature of our business since privatisation in 1989. We have invested in both maintaining our existing asset base and constructing new assets in order to improve the environmental quality of wastewater, improve the quality of drinking water and accommodate population growth in our area of operation.

As an example, before privatisation, 350,000 cubic metres of wastewater per day was discharged into our coastal waters untreated, but the completion of our £300 million Cleaner Seas for Sussex scheme in 2013 marked the conclusion of a programme of capital investment to fully treat wastewater of the coastal towns and cities from Kent to Hampshire and the Isle of Wight. A further example is a current £93 million construction project at Woolston which will improve the quality of effluent discharged into the River Itchen and reduce odours.

We raise finance to pay for the construction of new assets and to repay loans taken out in previous years. In addition, we are partly financed by shareholder equity, sufficient in size to absorb financial risk and to contribute to the financing of the construction of new assets.

The level of customer bills is calculated to cover our operating expenditure, our annual financing costs (including any equity return to our shareholders) and the amount required to invest in and maintain our assets, such as water pipes, sewers, pumping stations and treatment works.

The charts below illustrate the sources and uses of expected cash flows for the business plan 2015–20, and demonstrate our requirement to raise finance to fund our capital investment programme. The data is based upon the regulatory price determination for 2015–20, which sets out both our performance obligations and the limits on customer bills for this five-year price period.



Key

- New finance 18%
- Customers 82%

Key

- Maintaining our assets 23%
- Day-to-day running costs 24%
- Profit 3%
- Ofwat/regulator adjustments 4%
- Tax, rates and licences 5%
- Building new assets 11%
- Maturing debt 13%
- Interest on debt 17%

Where the money goes

Day-to-day running costs include wages, power, chemicals, materials and bad debt* costs.

* Bad debt = the cost of providing for unpaid customer charges.

Maintaining our existing assets includes our pipe network, treatment works and capitalised employee costs.

Interest on debt is interest on money we have borrowed to finance improvements to the business over the long term.

Building new assets contributes to projects to enhance treatment standards and cater for growth.

Profit is the residual return earned on shareholders' investment in the business.

Tax, rates and licences include corporate taxes, business rates on buildings, wastewater treatment and water supply works and Environment Agency licences.

Ofwat/regulator adjustments applied by Ofwat for the period 2010–15, relating to customer satisfaction, cost-savings and revenue collection.

Capital structure continued

GSH ownership

UBS Asset Management
Shareholding advised by UBS Asset Management, a large-scale global asset manager, offering investment capabilities across all major traditional and alternative asset classes

IIF Int'l SW UK ParentCo Ltd
A constituent entity of the Infrastructure Investments Fund, a fund advised by JP Morgan Asset Management (JPMAM), a large-scale global asset manager advising institutional investors.

Whitehelm Capital
Shareholding managed by Whitehelm Capital on behalf of Motor Trades Association of Australia and Prime superannuation funds

Hermes Infrastructure funds
Hermes Infrastructure is part of Federal Hermes International and is a specialist infrastructure manager operating a diversified, well-established, UK-focused shared investment platform. With £4.1 billion of assets under management, Hermes Infrastructure is one of the UK's largest direct investors

Other
Minor shareholdings held by infrastructure investment companies

How we are structured

Southern Water Services Limited (SWS) is a privately owned company and is the principal subsidiary of Greensands Holdings Limited (GSH). All companies in the group are UK tax resident and liable for tax in the UK.

Ownership

GSH is owned by a consortium of long-term investors representing infrastructure investment funds, pension funds and private equity and no single shareholder has majority control.

Key

- Institutional investors advised by UBS Asset Management 21.92%
- Institutional investors advised by JPMAM 39.83%
- Shareholding managed by Whitehelm Capital 7.75%
- Hermes Infrastructure funds 21%
- Other 9.5%

GSH Board

The GSH Board comprises five directors. Three of those members, including the Chairman, are appointed by institutional investors advised by JP Morgan Asset Management; one director is appointed by shareholders represented by UBS Asset Management; and one is appointed by shareholders represented by Hermes. Another shareholder is entitled to appoint an observer to attend and take part, but not vote, at GSH Board meetings. No members of the Southern Water Board sit on the Board of GSH.

The purpose of GSH is to act as a single-purpose entity as the ultimate holding company for Southern Water and the other companies within the group. The GSH Board complements and supports the aims of Southern Water for its long-term success. While certain matters are reserved to the GSH Board and/or shareholders, they do not impact the day-to-day operations of Southern Water and nor do they materially affect Southern Water's ability to function as an company in providing an essential public service.

Group structure

In September 2007, the Greensands group of companies was established for the purpose of the acquisition of 100% of the share capital of Southern Water Capital Limited, the then ultimate parent company of Southern Water, from the Royal Bank of Scotland (investing £1.9 billion of equity and debt to finance the acquisition).

During 2018–19 additional Greensands financing companies were added to the group structure as part of a financing plan to improve financial resilience of Southern Water ahead of the five-year price review period starting April 2020.

Financing in 2019–20

A Sustainable Financing Framework was put in place at Southern Water during 2019–20 which aligns our long-term strategy with our social and environmental commitments. An independent Second Party Opinion is also provided by DNV-GL to ensure alignment with the relevant bond/loan principles and guidelines.

The framework also sets out a robust process for project evaluation, project selection, the management of proceeds and reporting.

The majority of our assets and expenditure on projects, and programmes of work, fall within the eligible green categories and the eligible social categories taken from the Green Bond Principles and the Social Bond Principles.

We issued our inaugural financing under the Sustainable Financing Framework in May 2020 with a dual tranche public bond amounting to £825 million.

During 2019 Southern Water also restructured the cash flows associated with an existing financial instrument, which brought forward a cash receipt of £140.0 million at present value.

Financing in 2018–19

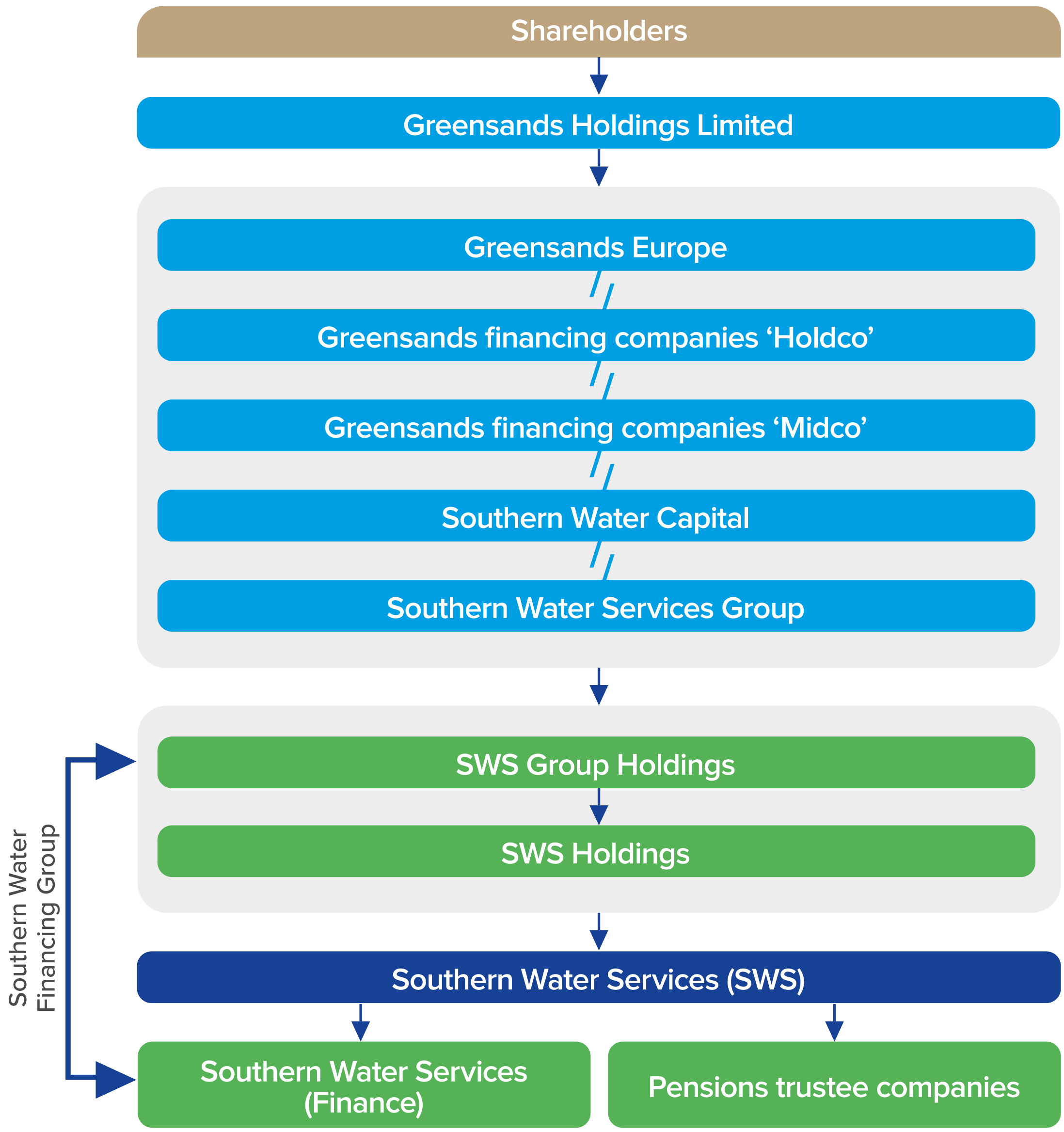
The financing during 2018–19 which included the incorporation of additional Greensands financing companies:

- £450 million new borrowings raised by new Greensands financing companies formed as a 'Midco' financing structure
- £250 million new borrowing raised by existing Greensands financing companies ('Holdco' financing structure)
- £700 million of new finance was invested into Southern Water, net of £12 million costs, by a repayment of inter-company liabilities totalling £687.3 million
- These proceeds were used by Southern Water to repay £400 million of outstanding Class B debt, provide £150 million towards repayment of the £300 million Class A bond repaid 1 April 2019, £113.6 million was used toward reducing the interest cost of our inflation linked derivatives for the period 2021 to 2031, and the remaining £37.0 million was used to pay costs associated with repaying the Class B debt and terminating a derivative associated with the Class B debt.

The Greensands financing companies also maintain liquidity facilities which can provide a short-term source of finance.

The holding company structure for Southern Water is shown in the diagram below, and this is followed by an explanation on the next page of the principal companies in the structure.

Southern Water ownership structure summary



Capital structure continued

Further details can be found in the GSH Annual Report and Financial Statements which are published at **southernwater.co.uk/our-story/our-governance/our-ownership**

Greensands Holdings (GSH)

The ultimate parent company within the group. GSH was established in 2007 for the acquisition of the Southern Water Capital group from RBS by the shareholders. The company is Jersey registered, but it is UK tax resident and, as such, is liable for tax in the UK. The company was incorporated in Jersey because Jersey law allows greater choice than the UK about the way distributions can be made to shareholders. GSH holds 100% of the share capital of Greensands Europe and has no direct holdings in any other entities.

Greensands Europe (GSE)

A subsidiary of GSH incorporated in England and Wales and resident for tax in the UK. GSE was established to issue bonds as part of the financing for the acquisition of the Southern Water Capital group in 2007. GSE has issued debt, Eurobonds, which are held by our shareholders in proportion to their respective shareholdings. This bond debt meets the eligibility requirements of the 'quoted Eurobond exemption' for tax purposes. The Eurobonds are listed on the International Stock Exchange in the Channel Islands which is a recognised stock exchange for the purposes of the quoted Eurobond exemption by HMRC. The bonds were issued on this stock exchange for ease of administration, as they are issued to the shareholders of the group and are not traded.

Greensands financing companies 'Holdco'

A number of companies, all incorporated in England and Wales and resident for tax in the UK, were established to provide additional external financing for the acquisition of the Southern Water Capital group in 2007. A further £250 million of additional finance was secured during 2019, the proceeds of which were invested into SWS. The security granted to the lenders of this financing is limited to the share capital of Greensands Holdings Limited. There are no debt guarantees in place between the Greensands financing companies and the Southern Water Financing Group, with the result that SWS is fully protected, and fully isolated, from a default at any Greensands company.

Greensands financing companies 'Midco'

The Greensands Midco group of financing companies was incorporated in 2018 as part of a financial restructuring exercise to improve the financial resilience of Southern Water. The objective of the restructuring was to reduce the total leverage within the Southern Water Financing Group and to reduce interest payments at Southern Water to help manage financial covenants. The debt issued by Midco companies is senior to that issued by the Greensands Holdco group of financing companies.

Southern Water Services Group (SWSG)

The immediate parent company of the securitised group which acts as a holding company for this group, following the financial restructuring in 2003. SWSG is incorporated in England and Wales and resident in the UK for tax.

Southern Water Capital (SWC)

The previous holding company for the Southern Water group, established as part of the sale of Southern Water by ScottishPower in 2002. SWC is incorporated in England and Wales and resident in the UK for tax. It does not trade and holds preference shares in SWS, from which it receives dividends.

Southern Water Services Group (SWSG)

The immediate parent company of the securitised group which acts as a holding company for this group, following the financial restructuring in 2003. SWSG is incorporated in England and Wales and resident in the UK for tax.

Southern Water Financing Group

Southern Water established a financing structure, known as a Whole Business Securitisation (WBS) in 2003, following its sale by ScottishPower. The WBS sets strict rules which demonstrate to investors that Southern Water is a safe and reliable business in which to invest. This structure helps to reduce our financing costs and improves access to long-term and secure sources of finance. Reducing financing costs ultimately benefits customers in the form of lower bills.

In 2018–19 SWS repaid its £400 million of outstanding Class B debt, and entered in to a deed that no further Class B debt will be issued for so long as MidCo debt is outstanding. The £400 million of outstanding Class B debt was repaid out of £700 million of new finance invested into SWS (net of £12 million costs).

The WBS works by creating a ring-fence around the Southern Water business in the form of a financing group. The financing group, whose immediate parent is SWSG, provides security to finance providers in the form of a charge over the share capital of SWS Group Holdings (SWSGH). No security is provided over our individual regulated operating assets. This structure ensures that, in the event that either Southern Water or SWSF was to default on its debt obligations, Southern Water would continue to operate as usual. Debt providers are not permitted to either break up or interrupt the business and can therefore only look to a new owner of the financing group to recover their debt in the unlikely event of serious default.

The WBS also sets out arrangements for the ongoing management of the debt issuance programme as well as a number of operating arrangements in order to minimise our financial risk and adhere to good industry practice.

One of the WBS arrangements is a limit on the indebtedness of Southern Water and SWSF. This includes precautionary 'early warning' limits which prevent the payment of dividends if a limit is breached. We seek to ensure that we operate with sufficient financial headroom against these limits and have not breached a limit at any time since the implementation of the financing framework in 2003.

SWS Group Holdings

An intermediate holding company, forming part of the securitised group. The company is incorporated in England and Wales and resident for tax in the UK.

SWS Holdings

The immediate holding company for Southern Water, forming part of the securitised group. The company is incorporated in England and Wales and resident for tax in the UK.

Southern Water Services

This is the only operating company within the group, providing water and wastewater services to customers across Kent, Sussex, Hampshire and the Isle of Wight. Southern Water is incorporated in England and Wales and resident for tax in the UK. It is the company that this Annual Report and Financial Statements relates to.

Southern Water Services (Finance) (SWSF)

Our financing subsidiary, SWSF, was established for the express purpose of raising debt finance on our behalf under the securitisation in 2003.

Due to administrative reasons applicable at the time of the WBS, it was necessary for SWSF to be registered in the Cayman Islands in order to raise debt listed on bond markets. This original requirement for it to be registered in the Cayman Islands is no longer necessary and we are in the process of closing this company.

SWSF is wholly and exclusively resident for tax in the UK and files tax returns only with HMRC. This means that any profit or loss made by this company is subject only to UK tax.

How we finance the business

In note 20 to the financial statements, we provide an analysis of our outstanding debt at 31 March 2020 and 31 March 2019. Our loans comprise: sterling bonds, issued by our financing subsidiary SWSF, and listed on the UK Stock Exchange; other loans, including loans from US insurance companies; bank loans; and a loan from the European Investment Bank.

The regulatory framework under which revenues and the RCV are indexed exposes us to inflation risk. This risk is managed through the use of inflation-linked loans and derivatives within the overall debt portfolio. We do not intend to access future inflation-linked debt through the use of derivatives, but will instead seek such debt from natural sources, such as public and private bond markets. As a consequence, we expect the proportion of the RCV and debt that is currently linked to inflation through the use of derivatives will decrease over time. We are not restricted to issuing only sterling debt, but will ensure any other currency loans are fully hedged back to sterling. We also hedge our exposure to interest rate volatility by ensuring that at least 85% of our outstanding debt liabilities (in respect of Class A and Class B debt) is either inflation-linked or fixed rate for the current five-year regulatory period and at least 70% in the next period (on a rolling basis).

We also consider refinancing risk by ensuring that loan maturities are not concentrated in any single year or regulatory period. When issuing new loans, we test that refinancing obligations are less than 20% of RCV in any two consecutive years and 40% of RCV within any five-year regulatory period. The maturity profile of loans extends to March 2056, which ensures we comfortably meet this test. Although not formally required, we ensure that inflation-linked swap accretion payments are included within our maturity analysis.

We ensure that sufficient liquidity (cash and committed bank facilities) is in place to fund the business for at least the next 12 months (including loan and inflation-linked swap accretion maturities), which is an important consideration given that we have negative cash flow generation in the majority of years as a result of our continuing capital investment programme.

As a result of our prudent liquidity policy, we can at times have large cash balances. We reduce the risk of losing cash on deposit, from bank or fund failure, by setting maximum limits on cash deposits and minimum credit ratings for each bank or fund. Banks must have, as a minimum, a credit rating of P1 (Moody's), A1 (Standard & Poor's) or F1 (Fitch). Funds must have the most secure rating of AAA rated.

In addition to our loans, as analysed in note 20, we have in issue a loan with SWSG which was put in place as part of the refinancing in 2003 (note 14). The original value of this loan was £812.3 million and, as part of the financial restructuring undertaken during 2018–19, £682.3 million was repaid, reducing the balance to £130.0 million.

Capital structure continued

We received £8.8 million interest on this loan from SWSG during 2019–20. In order to enable SWSG to make this payment, it received dividend and tax payments from us. For the year ended 31 March 2020, the dividend was £7.1 million and the tax payment, in respect of the taxable losses incurred by SWSG, amounted to £1.7 million. This loan provides no tax benefit to either us or the Greensands group, with the tax payment we make to SWSG simply negating any tax effect of this loan. This is illustrated in figure 1 of the diagram below.

The Greensands companies also have their own loans:

- A UK-listed bond which was repaid in April 2019
- Loans issued by Southern Water (Greensands) Financing Plc (SWGF), represented in the diagram below as part of the 'Holdco' financing companies
- Loans issued by Greensands Finance Limited and Greensands Financing Plc, represented in the diagram below as part of the 'Midco' financing companies
- Eurobonds issued by Greensands Europe.

The Greensands financing companies also maintain liquidity facilities (£100 million at Greensands Midco financing companies and £40 million at Greensands Holdco financing companies) which can provide a source of finance to pay interest on loans.

The Greensands financing companies comprise:

Holdco:
Greensands UK Limited (GSUK)
Greensands Junior Finance Limited (GSJF)
Southern Water (Greensands) Financing Plc (SWGF)
Greensands Senior Finance Limited (GSSF)
Greensands Investments Limited (GSI)

Midco:
Greensands Finance Holdings Limited (GSFH)
Greensands Finance Limited (GSF Ltd)
Greensands Financing Plc (GSF plc)

Interest and dividend payments 2019–20

Fig. 1

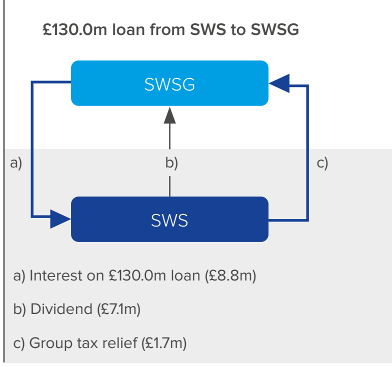
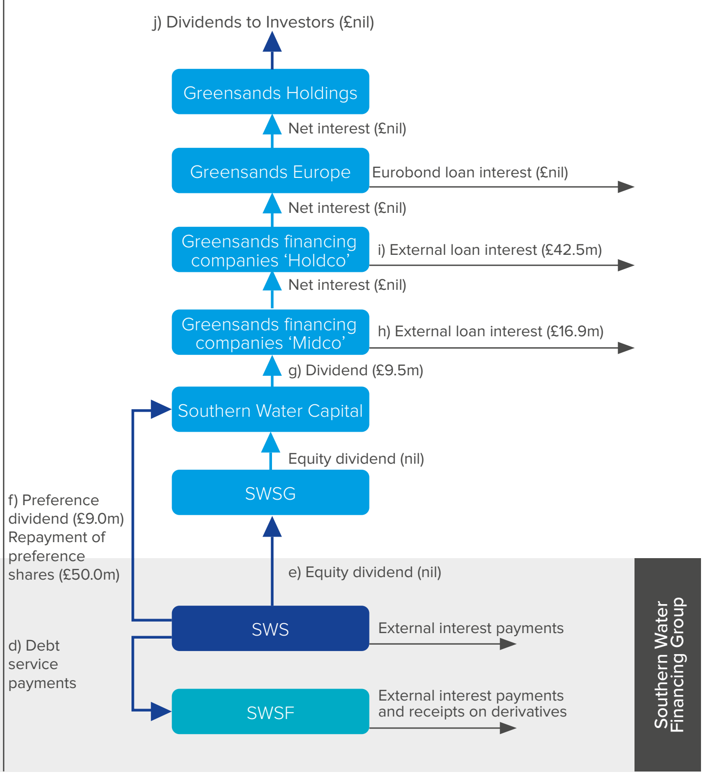


Fig. 2



In summary, SWS has paid £9.0m to internal companies. Greensands companies have paid external loan interest payments of £59.4m. No interest or dividends have been paid to investors.

Notes:

a. Interest received by SWS on the £130.0m loan from SWS to SWSG amounted to £8.8m.
b. Dividends paid by SWS to SWSG to facilitate the interest payment on the £130.0m loan.
c. Payment of group tax relief by SWS for the taxable losses at SWSG.
d. Interest payments from SWS to SWSF on the loans taken out by SWSF on behalf of SWS. This is then used by SWSF to pay the interest on these external loans.
e. There were no ordinary dividends during the year.
f. Dividend payments on the preference shares issued by SWS and repayment of preference share capital.
g. Dividend paid by SWC to GSF Ltd to facilitate interest payments on external loans.
h. External interest paid by GSF Ltd and GSF Plc, funded from interest receivable and cash held at 'Midco'.
i. External interest paid by SWGF, funded from interest receivable and cash held at 'Holdco'.
j. Dividends paid to investors.


Southern Water
Southern Water
Southern Water

Risks

Risk management is a core component of our wider governance and internal control framework, which provides the overarching structure through which the company is managed to achieve its objectives

The most significant risks facing us are referred to as 'principal risks'. The principal risks are the greatest risks to the company's business objectives, both those inherent to the nature of its operations and company-specific circumstances. We therefore consider principal risks to be those with the capacity to have the greatest impact on our business.

As part of delivering better outcomes for our customers and regulators, and becoming a more resilient organisation, we continue our efficiency and transformation programme. We are also working to materially improve processes and systems to ensure we are continually developing the way we carry out our business. In the past, we have fallen short of meeting standards required by our regulators and ourselves. We want to ensure that the mistakes of the past are not revisted.

Through the comprehensive and ongoing transformation process, the business is committed to delivering the level of service our customers – and all of our stakeholders – expect and deserve. The degree of transformation in itself brings with it both some risk and significant opportunity, which will be closely monitored and reflected in the relevant principal risks reported in this and future reports.

The Board is deeply committed to its role of embedding risk management at every level of the organisation. As part of our transformation, we have recognised the need to improve our approach to risk and resilience management.

Last year, the Board created a specific Risk Committee, whose report is on pages 179 to 180. We also formed a new Risk and Compliance Directorate and implemented a risk and resilience enhancement programme. Our risk management methodologies are still evolving and our next stage of improvements in risk and resilience management is in progress. In 2019–20, we submitted our plans to Ofwat to improve our resilience. The plan involved a comprehensive review of the key areas in our organisation responsible for our resilience, alongside subsequent recommendations for improvement.

The plan was initiated in September 2019 and will continue until the end of 2021. The improvement plan spans the key resilience areas of enterprise risk management, incident management and asset investment strategy. The aim is to embed an approach to enterprise risk management that allows us to deliver a more resilient service for our customers and stakeholders.

The Board continues to review the company's principal risks from a strategic perspective, while itself – and through the Risk Committee – supporting the embedding of the risk framework.

Changes to principal risks

Throughout the year, we make an assessment of how the regulatory and physical environment has changed, and what impact it has had on our principal risks. This year, we have made the following changes to the principal risks from 2018–19. The 2019–20 principal risks are set out on pages 120 to 134:

Principal risk in 2018–19	Principal risk in 2019–20		Rationale for change
Political and regulatory reform, and Price Review (PR19)	Regulatory and corporate affairs	We have implemented a new risk structure in Southern Water that better aligns to our values and encapsulates the risks in the company.	The nature of this risk remains significant, encapsulating a similar scope, with the descriptor being updated to better reflect the risk area. The risks associated with the price review have translated into plan delivery following completion of Ofwat's price review process.
Resilience to drought **Resilience to flooding**	Climate change		The new structure has replaced 'resilience to flooding' and 'resilience to drought' with a principal risk for climate change (covering our mitigation and adaptation efforts). This includes the work we are performing in both these areas. We are also defining an associated climate change risk register to consolidate our approach to climate change.
New risks in 2019–20	Resources		Having reviewed our principal risks, we identified a gap relating to HR, power, supply chain and chemicals. We have therefore introduced a new principal risk to cover these key areas and the associated risks that align to them.
	COVID-19		The COVID -19 pandemic has had a major impact on the way we conduct our business and has presented significant challenges to our ability to provide our essential services to customers, our ability to meet regulatory targets and expectations and the financial viability of the business. Risks affected the whole organisation and, therefore, a new principal risk has been created with new business continuity, risk management and governance systems now in place.
Bad debt	(Declassified as 'principal risk'.) Moved within customer services		As part of the review of our risk structure, we realigned bad debt within the scope of the customer services principal risk, rather than as a standalone principal risk. This aligns more closely to our approach to bad debt which is a key part of our approach to supporting vulnerable customers via payment support options. Obviously COVID-19, which is covered by its own principal risk, will increase the risk of bad debt.

Risks continued

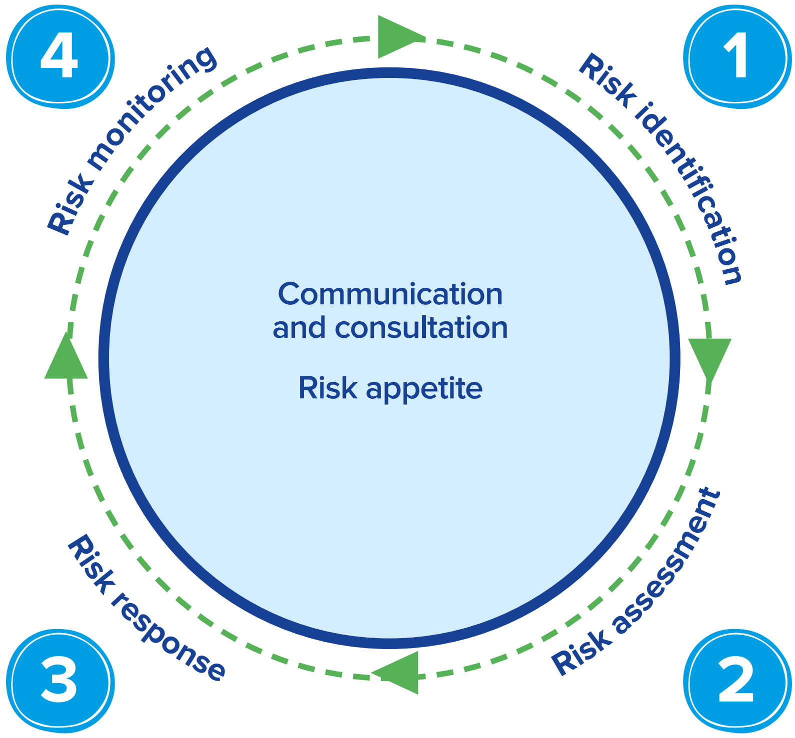
Our Board is responsible for determining the nature and extent of the principal risks it is willing to take in order to achieve the strategic objectives of the company.

Our strategy for risk management is that all principal risks are identified, assessed and managed within acceptable tolerance levels. To achieve this, the Board and senior management seek to promote a culture that encourages a routine consideration of principal risks in decision-making and supports the integration of risk management within our critical processes and ways of working.

Corporate risk management is monitored by a dedicated Risk Committee on behalf of our Board, although the Board retains ultimate responsibility for risk management.

The duties of the Risk Committee include reviewing our current risk exposure against the overall corporate risk appetite, tolerance and strategy, along with advising the Board on the current risk exposures of the company and future risk strategy. As previously noted, these duties were transferred from the Audit and Risk Review Committee to the new Risk Committee in February 2019. Throughout the last year, the new Risk Committee has worked to further improve our corporate risk management and enable more in-depth risk oversight and challenge. See pages 179 to 180 for more detail.

The purpose of our approach to risk management is to support better decisions through an improved understanding of risk.



The objectives of our risk management strategy relating to principal risks are to:

1. identify and understand all the principal risks that we face
2. select and proactively adopt strategies and plans to address, including seeking opportunities from, those risks that deliver the right returns, and understand their potential impact on the company
3. take action to mitigate our exposure to the principal risks, ensuring our resources are effectively and efficiently prioritised and used
4. use the analysis of our principal risks to inform our strategy and to monitor and report the risks we are taking against our desired strategic objectives.

Every employee is responsible for helping us to effectively manage our exposure to these risks and for making us a more resilient organisation that is able to successfully respond to our constantly changing environment.

We seek to ensure controls are in place so we can reduce the likelihood of risks occurring or take action to minimise their impact. To do this, risks are managed through a central database where they are ranked and assigned to senior managers who are responsible for implementing mitigation plans. Risks are reviewed each month and those considered most critical are escalated to our Executive Leadership Team, the Board and the Risk Committee. Any new risks added to the database with a high score are passed to an Executive Leadership Team member and the Chief Executive Officer for immediate review. We are actively strengthening our control framework to ensure failures of the past are not repeated. Our resilience transformation project is strengthening our risk management control framework, how it impacts our risks and how we respond to new risks.

Risk appetite

The amount of risk the Board is willing to take to achieve our strategic objectives is referred to as the risk appetite. We have developed a risk appetite for each of our principal risks, which underpins our governance and reporting framework and is reviewed regularly by the Board.

We have recognised that some of the challenges arising from COVID-19 and a challenging Final Determination have added additional risk to the company. Nor do we think that the determination reflected the preferences of our customers for long-term environmental and system resilience.

Like most organisations, we are tolerating a level of risk which is outside our current risk appetite, which may result in more focus driven to nearer-term issues than longer-term resilience. The Board and the Risk Committee are actively engaged in looking at longer-term strategic risks, as well as reviewing its risk appetites.

We operate a complex infrastructure of water and wastewater assets – from pipelines to processing sites – over a broad geographical area and we recognise that extreme weather conditions and failure of our assets can have a negative impact on our customers. As a result, we have clearly-defined operating processes, procedures and control frameworks, including incident management, to mitigate our compliance and operating risks. In doing so, we acknowledge that we also have to prepare for the unexpected and when unanticipated risk emerges, we must deal with it accordingly. Our approach to risk management is also aligned to our approach to compliance, where we have been implementing a 'three lines of defence' model of compliance.

Our aim is to employ risk management principles, transparent decision-making and effective communication to prioritise risk. We aim to minimise our exposure to compliance, operational and regulatory risk, while accepting and encouraging more risk in pursuit of our mission and objectives. Our acceptance of risks is subject to ensuring that potential benefits and risks are fully understood before developments are authorised, and that sensible measures to mitigate risk are established.

This means we will not seek to intervene in all situations. Instead, our approach is based on judgment and the circumstances of each potential intervention and an assessment of its impact. We prioritise our actions in terms of risk, cost and perceived benefits in a consistent and transparent way, choosing the appropriate course of action.

Principal risks and uncertainties

Operational
Industry risk
Water

Outcomes affected:

Looking after the environment

A constant supply of high-quality drinking water

Risk change in the year

Risk high due to anticipated challenges in supplying water resources in our western region, in accordance with new regulatory limits. In addition we have been set increasingly challenging targets in the next business plan period, with respect to leakage, interruptions to Supply and Compliance Risk Index (CRI) and Event Risk Index (ERI).

Description

We must ensure we can supply enough good quality drinking water to cater for a growing population of more than 2.6 million people across Kent, Sussex, Hampshire and the Isle of Wight.

Risk: Should operational water treatment processes fail, the water supply become contaminated, or our water distribution network fail:

- there is a risk that water could be supplied to customers that is unfit for consumption, and would require a widespread notice in order to protect public health
- large numbers of customers could find their water supply becomes cut off
- harmful chemicals could be released to the environment.

Risk: We may fail to supply enough water to our growing population of customers if resources are not sufficient. This can be from available resources becoming scarcer, e.g. through climate change, or through protecting local environmental needs which can result in a reduction in the amount of water that can be abstracted for water supply.

This could lead to a risk to our customers, and consumer confidence, and lead to prosecution and fines by the Environment Agency or the Drinking Water Inspectorate (DWI).

Cross reference:

Read more about **a constant supply of high-quality drinking water** on pages 78 to 85

Read more about **looking after the environment** on pages 90 to 99

Read more about **ODIs** on pages 58 to 61

Mitigating activities

(Controls in place/work we have done)

- Drinking Water Safety Plans to evaluate risks with our drinking water quality across the entire supply system
- A programme of HazRev source-to-tap reviews
- A Catchment Risk Management team formed to understand and manage catchment risks to drinking water quality
- Trained our employees to the industry and EU skills standard to allow them to perform their roles well
- Emergency plans to continue water supply during an interruption.

We invested over £150 million on our works during 2015–20:

- Improvement schemes at Testwood, Burham and Otterbourne
- General resilience improvement schemes, such as: the ability to run to waste, UV disinfection replacement and borehole headworks upgrades
- Nitrate management improvement
- Advanced filters at water treatment works in high risk areas (e.g. Hastings), to improve the taste and smell of water
- Upgrading wells, service reservoirs, flushing mains, and cleaning service reservoirs
- Leakage reduction plan
- Taget 100 programme
- Outage reduction programme
- Updated our 50-year Water Resources Management plan.

(Work we intend to do in this business plan period 2020–25)

- Water First programme to improve processes and performance
- A culture transformation programme to develop a behavioural competency framework for our employees
- Prioritised maintenance of critical assets and technology
- Ambitious plans to drive a 15% reduction in leakage by 2025 and 50% reduction by 2050 helping our customers reduce consumption to 100 litres per person, per day
- Plans to develop new water resources in our western area to ensure sufficient supplies.

Operational
Industry risk
Customer

Outcomes affected:

Responsive customer service

Better information and advice

Risk change in the year

Description

Providing an excellent customer experience is a key objective for us. We recognise the importance of prioritising our customers, and that accomplishing our strategic goals is contingent on providing the level of service expected by our customers and our regulators.

Risk: We may not be able to provide the desired standard of service to our customers if there is inadequate capability in our people, process or systems. Our targets all aim to make the experience of dealing with Southern Water simple and easy. We are also focused on improving our performance relative to our peers within the Ofwat mechanism which has performance-based rewards and penalties, for which we may incur financial penalties if we do not continuously improve our customer service performance, relative to our peers and our own targets.

The scale of the challenge is significant if the business plan period 2020–25 execution plan is to be delivered;

- The spend on Customer Service in 2015–20 is £95m more than the allocation in the Final Determination (FD) for 2020–25, the scale of improvement required to deliver the FD is therefore significant.
- In 2015–20 the customer experience metric was SIM, for the final year Southern Water finished 16th of 17 companies in the comparative table.

Cross reference:

Read more about **our commitments to customers** on pages 58 to 99

Read more about **better information and advice** on pages 72 to 77

Read more about **ODIs** on pages 58 to 61

Mitigating activities

(Controls in place/work we have done)

- New single outsourced partner appointed to improve the customer journey
- Active engagement with our customers and stakeholders to strengthen our links with local organisations such as councils and community groups
- Baselined our end-to-end customer journeys to identify areas where we can improve the customer experience
- We have agreed investment to support the transformation of the process and technology that underpin our customer service
- Year one: Programme is looking at strengthening customer self-service options
- Year one: Limitations with our SAP billing solution will not be overcome with a replacement moved to 2025–30. The main investment in billing will be in changes to the bill presentation
- Year one: Development of a tailored debt strategy with supporting investment in the debt management tool Tallyman.

(Work we intend to do in this business plan period 2020–25)

- Delivery of the customer rebates that have been agreed with Ofwat and the GSS compliance projects
- Seek to deliver the consolidation of the operational and billing CRMs and the new platform data migration enabling a single view of the customer, full contact history management, improved automation, and an integrated self-service portal and significantly enhanced communication capability through an integrated campaign management tool
- It is highly likely that constraints on investment in 2020–25 will result in CRM consolidation being moved to the next business plan period 2025–30.

Principal risks and uncertainties

Operational
Industry risk:
Wastewater

Outcomes affected:

Removing wastewater effectively

Looking after the environment

Risk change in the year

Due to increasingly challenging targets in the business plan period 2020–25, a number of which were not funded in the price review.

Description

Our region benefits from a high-quality environment, both inland and coastal. We are fortunate to have some extremely rare habitats, as well as some of the best quality river fishing and coastline in the UK. Reliable wastewater services are essential to maintain public health and protect the environment.

Risk: Should operational wastewater treatment processes fail, or our sewers and pumping stations become blocked or fail, our assets may discharge sewage, which is not of the required standard, to the environment. This may cause risks to the environment or public health from pollution and/or sewer flooding. There is also the potential to cause damage to the environment or distress to customers. This could lead to prosecution and fines by the Environment Agency and a reduction in stakeholder and customer confidence.

Cross reference:

Read more about **removing wastewater effectively** on pages 86 to 89

Read more about **looking after the environment** on pages 90 to 99

Mitigating activities

(Controls in place/work we have done)

- We monitor function and performance of our assets on a continuous basis through a central control room
- Data analytics and reporting team proactively monitor asset performance
- We also monitor when our combined sewer overflows are used, to proactively identify infrastructure under stress
- Monitor long-term asset risk and deterioration to target investment
- Complete planned and proactive maintenance to drive reliability
- Have tested deployable contingency plans when incidents occur.

In 2019–20 we invested in our wastewater treatment works and pumping stations to reduce risks at critical sites and in our sewer networks.

We have also implemented an upgrade to our Asset Life cycle Process to ensure risk and value are considered at each step of the investment cycle to provide best value for money to our customers.

(Work we intend to do in this business plan period 2020–25)

- A transformation programme – Environment + to embed change in standards, processes and training to drive a compliance and improve environmental performance
- Pollution reduction plan
- Customer awareness/education programmes on avoiding blocked drains, targeted at catchments with blockage hotspots
- A culture transformation programme to develop a behavioural competency framework for our employees.

Financial

Southern Water specific risk:
Financial

Outcomes affected:

Having a firm financial footing

Looking after our assets

Risk change in the year

Operational and delivery risk has increased risk in the business plan period 2020–25.

Description

Risk: A reduction in our credit rating or a significant increase in interest rates, could put our ability to finance our capital investment programme, or refinance our existing debt maturities, at risk in the future. Maintenance of specified credit ratings is required as a condition of our regulatory licence and our borrowing covenants.

Risk: A failure to maintain certain credit ratings could lead to an increase in interest cost and reduced availability of finance. We only enter into treasury transactions to manage inherent risk and support prudent funding, not to speculate.

During the year each of the rating agencies downgraded the credit ratings of Southern Water as a result of concern regarding perceived challenges facing the company in its delivery of its business plan 2020–25, its relatively weak operational and financial performance and the announcement by Ofwat of the outcome of its investigation into its wastewater performance.

Our current credit ratings are provided on page 108.

Cross reference:

Read more about **financial performance** on pages 102 to 108

Mitigating activities

(Controls in place/work we have done)

- We maintain sufficient cash reserves and liquidity facilities to finance our operations for at least 12 months
- We take each of the main credit agency ratios, relevant for our ratings, into account when setting the plan (1-yr, 5-yr)
- We ensure the aggregate nominal value of debt maturities does not exceed 40% of RCV in any single regulatory period (and 20% of RCV in any 24 months)
- Successful completion of a capital restructure resulted in Southern Water leverage reducing to less than 70% and a reduction to interest costs for the period 2020 to 2030
- Current borrowings are 'fixed rates' or 'index-linked' and we have no exposure to interest rate rises on our current borrowings
- We ensure sufficient funds are available for our operational and capital investment programme.

(Work we intend to do in this business plan period 2020–25)

- We established a Sustainable ESG Framework during the year and in May 2020 issued our first dual tranche sustainable bond.

Principal risks and uncertainties continued

Corporate
Southern Water specific risk:
Compliance

Outcomes affected:

Responsive customer service

Looking after the environment

A constant supply of high-quality drinking water

Having a firm financial footing

Removing wastewater effectively

Risk change in the year

The risk remains stable as a result of closure of some high-profile compliance issues with both Ofwat and the Drinking Water Inspectorate, but with some continuing issues still to be resolved with the Environment Agency.

Description

We are a highly regulated business with three main regulators: Ofwat, the Drinking Water Inspectorate (DWI) and the Environment Agency (EA) and high standards of compliance are expected.

Risk: Inadequate culture, structure, capability, governance and assurance could result in failure to meet these high standards consistently. The consequences can be regulatory enforcement, fines, legal action and, in the worst case, the loss of our appointment as a water and wastewater company. As with all companies we are also required to comply with corporate legislation (for example Competition Law and the Bribery Act).

As reported last year, this risk remains high as a result of regulatory compliance issues, which have been raised by our regulators. We continue to be the subject of intense regulatory scrutiny, and this was reflected in the recent Ofwat investigations into our reporting and operation of our wastewater treatment works, and the associated Section 19 undertakings and customer rebates that we have committed to carry out over the coming five years. We have recognised that we need to improve our culture, capability and performance in this area and improvement programmes are in place. We have one DWI enforcement order in place, which is referred to in the Risk and Compliance section of our Annual Performance Report 2019–20, available at **southernwater.co.uk/our-reports**.

We are being prosecuted by the EA for wastewater permit breaches, we have pleaded guilty to charges in court and we are assisting the EA with its investigations into legacy issues relating to wastewater sampling compliance. Further detail on these and the recent Ofwat investigation can be found on page 27 and in our Annual Performance Report.

Cross reference:

- Read about **our commitments to customers** on pages 58 to 99
- Read about **a constant supply of high-quality drinking water** on pages 78 to 85
- Read about **removing wastewater effectively** on pages 86 to 89
- Read about **looking after the environment** on pages 90 to 99
- Read more about **ODIs** on pages 58 to 61
- Further information on our improvement programmes can be found in our Final Assurance Plan 2019, which is available at **southernwater.co.uk/our-reports**.

Mitigating activities

(Controls in place/work we have done)

- A compliance framework, and internal monitoring and assurance
- Dedicated Risk and Compliance function
- Subject matter experts and compliance related training
- Annual reporting is externally verified by financial and technical auditors to provide assurance on our compliance
- Internal assurance capabilities and process improvements for reporting to our regulators, in particular: Ofwat, the Environment Agency and the Drinking Water Inspectorate
- Reinforced the 'three lines of defence' framework for our reporting governance and assurance activity
- Internal controls and processes to mitigate the risk of supplying incorrect or inaccurate regulatory information
- Awareness training is provided throughout our company for non-technical compliance issues, (such as the Bribery Act and Competition Law)
- Compliance with company procedures is reviewed through self-assessment every six months
- Completed a DWI enforcement order relating to improving the reliability and accuracy of our reporting
- We have agreed an extensive package of Section 19 undertakings with Ofwat as part of our response to the conclusion of the Ofwat investigations into misreporting of our wastewater treatment compliance performance. The undertakings encompass a wide range of activity including payments to customers, technical reviews of our Wastewater Treatment Works, compliance process improvements, improvements to our culture, new work to provide more transparency on our environmental performance and improvements to our board governance processes
- Code of ethics has been refreshed and all staff have been provided training
- We continue to promote our company values to employees.

(Work we intend to do in this business plan period 2020–25)

- A programme to support the embedment of our Values and Code of Ethics. We are developing a behavioural competency framework for our employees over three years (started in 2018–19)
- Continue improvements in training, investment, internal business processes and controls via our transformation programmes to improve compliance and performance
- Embed and mature our regulatory and ethical business framework.

Corporate

Industry and Southern Water specific risk:
Climate change

Outcomes affected:

Looking after the environment

A constant supply of high-quality drinking water

Risk change in the year

Risk increased due to more stringent revised abstraction licences in Hampshire which limits our ability to access water in Hampshire and makes us more vulnerable to weather events.

Description

The impacts of climate change will continue to increase our related risks of water resources, drought, flooding, and extreme weather events. We supply drinking water to a growing population of more than 2.6 million in areas already classified as under 'severe water stress' in the South East. Therefore it is critical we are able to continue to ensure access to adequate water resources for our customers. Additionally, changing rainfall patterns, more frequent and intense storms and rising sea levels, could all lead to an increased risk of flooding if volumes overwhelm our assets.

Risk: If we are unable to improve our resilience to the extreme weather events predicted by the physical impacts of climate change:

- we will find it increasingly difficult to supply sufficient water to meet the growing demands of our customers though scarcity of water resources, or contamination by saline intrusion of existing water reserves;
- the assets on our sites, or our sewer system network, could more easily be overwhelmed by storm events, leading to flooding or pollution in our region; and
- our coastal sites may become inundated from rising sea levels or at risk of coastal erosion.

Combatting climate change is also about mitigating the causes of climate change. In terms of Southern Water's efforts to join in with the global response to climate change, we have made a Public Interest Commitment (PIC) to becoming a Carbon neutral (net zero) company by 2030 (as part of the English water companies).

Risk: A failure to deliver this promise could lead to problems meeting our net zero carbon obligations and could lead to significant reputational damage and increased scrutiny or financial penalities from our regulators, who have signalled a greater emphasis on climate change in their future strategy.

Cross reference:

Read more about **ODIs** on pages 58 to 61

Read more about **a constant supply of high-quality drinking water** on pages 78 to 85

Read more about **looking after the environment** on pages 90 to 99

Mitigating activities

(Controls in place/work we have done)

- Drought Plan containing measures to conserve water, operate our sources and secure additional resources (via drought permits/orders)
- A 50 year Water Resources Management Plan, to provide resilience under different drought severities and a range of climate change scenarios
- Investment in new infrastructure including the Havant Thicket Reservoir
- The RAPID process will lead to new investment in the Western Area
- Part of national research via UKWIR (UK Water Industry Research) on the drainage project on the national headroom capacity and flood risk.

We have invested over £40 million on our water network during 2015–20 including:

- Replacing over 70km of water mains
- Installation of the Hardham winter transfer
- National Environment Programme (NEP) water resources schemes, working to ensure our sources of supply are environmentally sustainable.

We have also invested over £400 million on our wastewater service during 2015–20 including:

- Maintenance on 39,500km of sewers and 3,321 wastewater pumping stations
- Replacing/refurbishing 100km of sewers
- Investing £268 million to reduce the number of blockages in our sewer network
- Assessed Southern Water's current carbon performance position and options to achieve carbon zero by 2030.

Principal risks and uncertainties continued

Corporate
Southern Water specific risk:
Climate change continued

(Work we intend to do in this business plan period 2020–25)

Additionally:

- Develop long-term asset strategies taking into account latest climate forecasts
- Campaigns to increase customer awareness about water availability, including our industry leading Target 100 water efficiency programme
- Plans to reduce our leakage rates by 15% by 2025 and 50% by 2050
- Our outage reduction plan
- An investment planning process to identify and develop schemes to meet demands for water over the next 25 years
- Schemes to enhance our natural catchments to improve the water quality and ecology which will increase resilience to a changing climate
- Planned schemes to maintain secure supplies which will increase resilience to more extreme climatic events, for example water recycling plants and new pipelines between supply areas
- Regional and national initiatives to identify potential strategic water resources for the South East, including desalination, water recycling and new pipelines from neighbouring water companies
- Developing drainage and wastewater management plans
- Building an extensive onwards customer behavioural programme to reduce blockages further
- We are procuring solar PPAs to help achieve our target of 24% of our energy consumption from renewables generated on ours sites
- We are planning CHP engine replacement on *circa* half of our CHP portfolio, to improve efficiency and reliability
- Plans to improve our energy efficiency via asset replacement (spend to save) and plans to increase our sub-metering
- Plans to start our Electric Vehicle (EV) journey during the 2020 to 2025 period.
- Our net zero carbon commitment.

Corporate

Southern Water specific risk:
Delivery of capital investment

Outcomes affected:

- Responsive customer service
- Looking after the environment
- A constant supply of high-quality drinking water
- Having a firm financial footing
- Removing wastewater effectively

Risk change in the year

The scale of the requirements of the capital investment delivery programme combined with a tight financial settlement in the period 2020 to 2025 has increased risk in this area.

Description

We have implemented a capital investment programme of £1.8 billion between 2015 and 2020, and we have a planned investment programme of £2.1 billion between 2020 and 2025. We have plans in place to ensure we will deliver this and we are working hard to ensure our focus is maintained to complete all works on time.

Risk: If we are unable to deliver significant parts of the programme on schedule, our ability to provide an excellent service to our customers could be compromised. Any failure to deliver would also prevent us from fulfilling the promises that we have made in our business plan with regard to performance measured by our outcome delivery incentive measures, along with commitments to our regulators.

Cross reference:

Read more about **a constant supply of high-quality drinking water** on pages 78 to 85

Read more about **removing wastewater effectively** on pages 86 to 89

Read more about **looking after the environment** on pages 90 to 99

Mitigating activities

(Controls in place/work we have done)

We have brought significant investment capability in house (over the course of the current capital investment programme) including:

- An embedded in-house engineering and capital delivery function
- An established long-term delivery partner supply chain
- Improved investment and governance process
- Enhanced management information procedures ensure the delivery of the business plan is given the greatest level of focus within the company
- Working closely with our regulators and other interested parties to resolve issues as they arise
- We have introduced a process to ensure risk and value are considered at each step of the investment cycle to provide best value for money to our customers.

(Work we intend to do in this business plan period 2020–25)

- We are enhancing and continuously developing our asset planning systems, processes and capabilities; and
- Maturing our integrated technical decision-making processes.

Principal risks and uncertainties continued

Corporate
Souther Water specific risk:
Information technology

Outcomes affected:

- Responsive customer service
- Looking after our assets
- A constant supply of high-quality drinking water
- Better information and advice
- Removing wastewater effectively
- Having a firm financial footing

Risk change in the year

The risk in this area has reduced as we continue to make improvements to our IT infrastructure.

Description

We provide water and wastewater services to customers across our regional infrastructure, considered to be critical national infrastructure.

Risk: If we do not maintain the resilience of our operational and enterprise IT systems, their failure could have a significant impact on our business reputation, ability to operate, and the resilience of our operational assets.

Additionally, we hold and process personal and payment data about our customers and employees so it is important that we treat this information with respect and in accordance with the requirements of information governance.

Risk: Failure to properly protect the data we hold could lead to reputational damage and loss of confidence from our customers, as well as significant fines under Data Protection (GDPR) and the Network and Information Systems (NIS) Directive. Our main objective is to be able to manage these risks and issues holistically across the organisation (information governance incorporates physical security as part of its scope).

We have been rebuilding our IT capability. This transformation has been ongoing for the past three years and has featured in-sourcing of our IT capability, and has seen an improvement in our IT estate.

During the year we completed transitioning our outsourced services back in house. This has improved our control of our IT services, and correspondingly, an improved IT environment.

Cross reference:

Read more about **our commitments to customers** on pages 58 to 99

Read more about **ODIs** on pages 58 to 61

Mitigating activities

(Controls in place/work we have done)

- Refresh and update of IT security and Information
- Governance (IG) policies, standards
- Improvements in the ongoing monitoring and incident management of our IT infrastructure to identify risks and threats
- Continued investment in cyber threat mitigation strategies in response to the ever-changing risk landscape
- Regular testing to re-assess our security measures during the year
- Security and data protection training (mandatory for all our staff) and associated 'Red Team' exercises
- IT has Insourced our IT and security management during 2019 which has significantly improved our knowledge of the IT estate, and our ability to respond to incidents
- Commissioning of new data centre and disaster recovery environments to improve our business continuity and security posture
- Put in place an Information Governance Council with responsibilities for the oversight and governance of our GDPR and NIS compliance
- Undertaken the NIS Directive Compliance response and associated roadmap to deliver changes in SWS
- Undertaken the GDPR Phase 2 Programme to mitigate outstanding IG activities identified in GDPR Phase 1.

(Work we intend to do in this business plan period 2020–25)

- Continued investment and improvement activities in security in 2020–25
- Redesign of our networks incorporating security measures
- Improving application resilience by transitioning to the new data centre/disaster recovery
- Re-assess IT risks as part of continuing focus on tightened resources in order to highlight emerging corporate risks, impacts and costs.

Corporate

Southern Water specific risk:

Resources

Outcomes affected:

- Responsive customer service
- Looking after our assets
- A constant supply of high-quality drinking water
- Better information and advice
- Removing wastewater effectively
- Having a firm financial footing

Risk change in the year

Risk remains stable in this area.

Description

The nature of our business model includes the use of long-term contracts for the provision of critical goods, services and works, as well as some outsourced activities. Some of our most critical resources include the supply of chemicals, fuel and spare parts to ensure continuity of service, as well as the energy required to power our operational equipment on a continuous basis, at a commercially viable price.

Risk: There is a risk that a failure to have the required external market capability and capacity, would lead to Southern Water being unable to deliver its committed obligations, required efficiencies in our business plan, and a return for our shareholders. In particular, if we are unable to source the requisite quantity of chemicals, our treatment processes will be inadequate, leading to poor quality drinking water, pollution of our environment or interruption of our services to our customers.

Risk: There is a risk that a failure to have an effective resilient energy model in place will lead power interruption at our sites and subsequent operational interruption, and cost inefficiencies.

Our employees are one of our most valuable assets.

Risk: Should we be unable to attract, develop or retain the best employees, we will be unable to deliver our strategic or investment objectives and the performance of the company will suffer.

All the above resources are intrinsic to our ongoing ability to provide our customers with resilient services, while also meeting the expectations of our regulators.

Cross reference:

Read more about **our commitments to customers** on pages 58 to 99

Read more about **ODIs** on pages 58 to 61

Mitigating activities

(Controls in place/work we have done)

- Our contracts are awarded following rigorous qualifying selection and evaluation criteria as part of our tendering activities. These ensure the successful supplier has the sufficient capabilities and capacity to ethically and efficiently provide the required deliverables, according to the desired level of quality and in a timely fashion
- We have category managers and sourcing specialists to: help facilitate interactions between the business and the supply market, establish the selection and evaluation criteria to award contracts and help facilitate effective commercial arrangements with supply chain partners. Contract Managers are appointed within Business Functions to monitor performance, supported by dedicated Contract and Supplier Managers to protect value
- Each business function has developed continuity plans in the event that the provision of critical resources from our suppliers becomes interrupted, either through identification of alternative suppliers or stockpiling of necessary resources (e.g. chemicals) supported by our dedicated Contract and Supplier Managers
- We have developed a Supplier Relationship Management framework covering governance, 'metrics that matter', 'voice of the supplier' and 'customer of choice' principles to drive the right collaborative behaviours with our key supply chain partners, including plans for continuous improvement efficiencies
- We have regularly tested back up generators at our sites to ensure power to them does not become interrupted and affect our services to customers
- We closely monitor our internal employment trends, and benchmark against the wider industry to detect unusual movements and react accordingly
- We routinely assess our employees' satisfaction through annual engagement surveys, and develop action plans to help identify and improve our company in key areas that may cause dissatisfaction.

Principal risks and uncertainties continued

Corporate

Southern Water specific risk:

Resources continued

(Work we intend to do in this business plan period 2020–25)

- Define and implement Value Management Units (VMUs) to drive business value, demand management, spend control and cost category leadership
- Drive a strategic approach to sourcing and category management activity focusing on value management business
- Develop and implement cost category strategies aligned with business objectives
- In partnership with the business and supply chain partners, embed new commercial model and ways of working to ensure supply chain efficiencies are realised
- Create a new centralised Contract and Supplier Management capability
- Develop detailed procedures, processes, tools and templates and roll-out of Contract Management Centre of Excellence ready for use by Contract Managers in the business
- Embed Supplier Relationship Management framework to provide an enabler for the underpinning behaviours to deliver required outcomes
- Create a means to better harvest and deliver supplier Continuous Improvement
- Where viable, we are developing our own on-site generation capabilities to reduce the dependency on national grid. This is linked to our renewable energy target to achieve 24% self-generation by 2022–23.

Corporate

Southern Water specific risk:
Health, Safety and Wellbeing

Outcomes affected:

Having great people

Working in Partnership

Risk change in the year

We have seen an increase in reported instances this year, however, this reflects improvements in our reporting of incidents which is giving us a much more accurate view of our level of risk.

Description

The health, safety and wellbeing of our employees and the public while we provide our services is of the highest priority. The nature of our work requires that our employees and contractors undertake activities or use equipment which, if uncontrolled, have the potential to cause significant harm.

Risk: Failure to comply with our Health and Safety Management System and associated procedures could result in death, serious injury or adverse health effects. We could be liable for prosecution under the Health and Safety at Work and Corporate Manslaughter Acts, civil claims and employers' liability and professional liability. In addition, our own employees have liability in this area. Finally, emotional and physical wellbeing is an important part of caring about our employees and the company recognises that wellbeing has a major impact on all aspects of our work.

Cross reference:

Read about **our people** on pages 50 to 55

Read more about **ODIs** on pages 58 to 61

Mitigating activities

(Controls in place/work we have done)

- A clearly defined strategy, safety protocols and standards are set
- Health safety and wellbeing performance and compliance is monitored and reported monthly to the Board and to the tri-annual Risk Committee
- The Executive Leadership Team and Operational Leadership Team monitors health and safety performance monthly
- Our processes and procedures are continuously reviewed and changed in line with legislation and industry best practice
- Employees receive suitable health safety and wellbeing training, including mental health awareness training
- We monitor the performance of our suppliers and delivery partners to ensure they meet our standards and expectations for health safety and wellbeing
- Near misses are reported, investigated and tracked
- Access to a copy of the corporate policy statement and health safety and wellbeing processes and procedures for all employees
- Comprehensive health safety and wellbeing processes and procedures help prevent injury and occupational ill health to our employees and contractors.

(Work we intend to do in this business plan period 2020–25)

- Committed to the 'Time to Change' programme to raise awareness and understanding of mental health issues, and established a wellbeing and mental health road map.

Principal risks and uncertainties continued

Corporate
Industry risk:
Regulatory and corporate affairs

Outcomes affected:

- Responsive customer service
- Looking after the environment
- A constant supply of high-quality drinking water
- Better information and advice
- Removing wastewater effectively
- Affordable bills
- Have a firm financial footing
- Looking after our assets

Risk change in the year

Risk maintained following Ofwat's Final Determination and potential changes in future regulatory environment and future price reviews.

Description
During recent years, there has been a significant focus on the water industry at a political and regulatory level. This has included a greater use of market mechanisms to promote innovation and efficiency, and the introduction of competition (with the potential to extend retail competition to all residential customers), as well as recent debates in Government over ownership. The recent Final Determination for 2020–25 highlighted the challenges of meeting customer expectations.

Risk: Failure to effectively monitor and adapt to any changes in our regulatory frameworks (Ofwat, Environment Agency or Drinking Water Inspectorate) may lead to potential unforecasted increases in administrative costs, reduced revenue, and ultimately non-compliance. The resilience of the entire sector is growing as an issue and is reflected in the latest policy from the National Infrastructure Commission.

Risk: Changes in the political landscape (e.g. Brexit) may cause costly consequential impacts on the water sector to which we will have to adapt.

Risk: Our current business plan and approved pricing structure runs until 2025. The Final Determination imposes stringent financial constraints, performance incentives and targets, making longer-term resilience more challenging.

Cross reference:
Read more about **ODIs** on pages 58 to 61

Mitigating activities
Controls in place/work we have done)

- Integrated Business Planning process has developed our execution plan to implement delivery of our objectives in the period 2020–25
- We will respond to all Ofwat's consultations that will impact upon our business
- We also provide information to the Government, regulators, customers and the public as appropriate to help them to make informed decisions
- We are well advanced with our Brexit planning and have worked with the wider industry and Government to ensure an integrated approach
- We closely monitor developments in the requirements from all of our regulators, *inter alia*, Ofwat, The Drinking Water Inspectorate and the Environment Agency
- We maintain close dialogue with Government, Ofwat and other regulators on key issues.

(Work we intend to do in this business plan period 2020–25)

- Work with our customers to understand their perception of our delivery, and future ambitions
- Continue to engage constructively with all of our regulators in regards to the water scarcity challenges we face in the South East of England (including the joint development of Havant Thicket Winter Storage Reservoir with Portsmouth Water)
- Monitor carefully the appeals to the Competition and Markets Authority by four companies in the sector against their final determinations
- Work with our regulators on how we better understand and address our customers' needs to enable successful outcomes on resilience in the next price review period 2025–30.

Corporate
Southern Water specific risk:
Transformation

Outcomes affected:

- Responsive customer service
- Looking after the environment
- A constant supply of high-quality drinking water
- Better information and advice
- Removing wastewater effectively
- Affordable bills
- Have a firm financial footing
- Looking after our assets

Risk change in the year

Risk increasing due to scale of changes required for the 2020–25 period, our year one financial constraints and COVID-19 pandemic.

Description

Through a comprehensive and ongoing transformation programme, the business is completely committed to delivering the level of service our customers, and all of our stakeholders, expect and deserve. The degree of transformation in itself brings with it both risks and significant opportunities, which we will closely monitor.

Risk: The business has identified a significant volume of change required to transform the business over the 2020–25 period while maintaining focus on delivery of performance objectives and deliver shareholder value. There is a risk that these business changes will not lead to delivery of efficiencies, improve our general performance, and support our incentive performance.

However, due to financial constraints, and the impacts caused by the COVID-19 pandemic, our ability to conclude and sustain the volume of change could be impacted due to further restraints in capacity or capability to effectively coordinate the required changes, which might result in the possible failure to deliver some customer promises, including financial targets and incentives.

Cross reference:

Read more about **how we are achieving our strategy** on page 24

Read more about **our values** on page 49

Mitigating activities

(Controls in place/work we have done)

- Programme of efficiencies to improve our approach to risk and resilience management
- Extensive review of our current processes in 2019–20 to identify key improvement areas and develop enterprise risk management
- Programme to address both the organisational capability needs and to improve our resilience baseline understanding of financial, corporate and operational activities
- All initiatives are developed using standard processes and business cases, ranked in order of priority, resources and wider business impact
- Transformation portfolio, office, and governance forums established
- Scope includes initiatives in the transformation portfolio and portfolio dashboard, risk registers, benefit monitoring framework, resources, capacity and capability to mitigate the risk
- External partner support to provide capacity and capability where required
- We have a prioritised and comprehensive change training programme in place to support sustainability of major change activities. Prioritisation managed through business-wide impact assessments
- Execution plan developed for 2020 to 2025 and endorsed by the Board in April 2020.

(Work we intend to do in this business plan period 2020–25)

- **Review our major transformational activities in line with year one financial constraints**
- **Continue to prioritise programmes to reduce our underlying internal costs and the costs of delivering service improvements**
- **Continue to develop programmes to improve our water and waste treatment operational processes and performance (Water First and Environment+).**

Principal risks and uncertainties continued

Corporate
Southern Water specific risk:
COVID-19

Outcomes affected:

- Having great people
- Working in Partnership
- A constant supply of high-quality drinking water
- Having a firm financial footing
- Responsive customer service
- Better information and advice
- Removing wastewater effectively
- Looking after the environment
- Looking after our assets

Risk change in the year

Coming on top of a very tight Final Determination, the COVID-19 pandemic has impacted the way we carry out our business and has presented significant challenges to our finances, our ability to provide our essential services to customers and meet regulatory targets and expectations. In addition, the risk has led to us transforming the way we do our business with increased remote working and additional processes to enable safe working for field team working.

Description

The COVID-19 event has put unprecedented pressure on the overall operation of the organisation. This has impacted all areas. However we have moved quickly to ensure we maintain service levels to our customers and are ensuring that our employees and contractors are able to carry out their work safely. We have provided payment breaks to support customers during challenging financial circumstances. The move to home working for a large section of our staff has impacted the way we work. If uncontrolled, COVID-19 would have potential to cause significant harm to ability to carry out our essential services and put our colleagues at risk of COVID-19.

Risk: Failure to manage this risk could lead to the realisation of a number of issues including:

- Colleagues could be at risk of COVID-19, anxiety or other health and wellbeing issues
- Our supply chain could not meet our needs, with the consequential impact upon our services
- Operational failures due to resource gaps, chemical supplies/ parts restrictions and customer demand increases /behaviour change could impact our essential services to customers of water supply, wastewater collection and customer contact
- Managing concurrent events (e.g. asset failure, heat wave, property flooding) during COVID-19 will be more challenging due to additional social distancing and/or the increased number of vulnerable customers that will need additional support
- Operational performance or regulatory duty issues linked to COVID-19 could result in challenges associated with PR19 regulatory penalties (ODIs) or other regulatory action such as enforcement or prosecution
- Adverse financial impact due to revenue loss, increased bad debt and additional COVID-19 costs.

Cross reference:

This is a business-wide risk and impacts all areas of the business.

Mitigating activities

Controls in place/work we have done)

- Pandemic readiness commenced in January 2020, with a dedicated COVID-19 management team in place
- Structured governance is in place to manage with Board and Executive leadership team engagement and oversight
- A structured Business Continuity approach prioritised essential services. We engage with colleagues and representatives, providing regular updates, guidance, and new ways of working
- We have risk assessed new ways of working and published our company risk assessment
- We have provided additional IT infrastructure, hardware and other equipment to support remote working
- Additional finance has been raised to stabilise the financial viability of the business in response to falling income
- Supporting customers with payment breaks
- Working with retailers and Ofwat as to support falling income challenges in the non household retail market
- Our investment plans have been reviewed to understand phasing due to COVID-19 delay and/or to mitigate the financial risks
- Engaged our supply chain to monitor and mitigate risk
- Regular dialogue with regulators to update on our response
- We are also engaged with Water UK and other industry fora to ensure appropriate messages are communicated to regulator and government and sector support is utilised where appropriate.

(Work we intend to do in this business plan period 2020–25)

- We will transition to medium risk management of the consequences of COVID-19, while retaining readiness for local outbreaks or a second wave
- We are reviewing how we operate and look to benefit from opportunities that arise as we adopt new ways of working.

Viability statement

In accordance with Provision 31 of the UK Code and Ofwat's Information Notice IN 19/07, the Board has assessed the prospects of the company over a longer period than the 12 months required by the 'Going Concern' provision. The Board has selected to conduct this review to March 2030 for the following reasons:

i. The company benefits from a rolling 25-year operating licence which it is assumed will not be revoked.

ii. The period to 2025 is reasonably certain given SWS has accepted the commitments and customer promises in the Final Determination for 2020–25 and the SWS Board has agreed an execution plan to 2025.

iii. Principal risks have been identified which are pertinent to the period to 2025, so we are able to carry out informed sensitivity scenarios for this period.

iv. A high-level plan was produced for the period from 2025–30 as part of the business plan submission to Ofwat. The main purpose of this plan was to provide an indication of future customer bills and provides a reasonable basis for assessment, albeit the Board recognise that the period from 2025–30 is uncertain given the likelihood of further evolution of the regulatory framework and the potential impact from, as yet, unknown factors which may affect the shape of the plan.

v. We considered the long-term financing needs of the business, including the maturity profile of existing debt, which extends to 2056, the predictability of revenues for at least the next five years, and the restructuring activity we have carried out in order to support long-term financial viability.

vi. Additional protection is afforded between price controls by Ofwat's primary legal duty to ensure that water and wastewater companies can finance their functions.

vii. Under the Water Act 2014 Ofwat has a further primary duty to ensure that water and wastewater companies have the long-term resilience to meet the needs of customers

In assessing the viability of Southern Water over the period to March 2030, the directors have taken into account current performance, planned performance improvements and the financial and operational impacts of the principal risks (documented in the Strategic Report on pages 120 to 134) in severe but plausible and reasonable scenarios. These include the impacts of:

- incidents – for example, severe weather, cyber security or a major operational event, resulting in additional operating costs and/or remedial capital investment
- COVID-19
- exceptional items – for example, regulatory fines or legal claims based on historical instances in the sector
- potential Outcome Delivery Incentive (ODI) penalties associated with our current business plan performance commitments
- the activities of any other group companies from which Southern Water is independent
- the potential impact from higher or lower inflation on forecast cash flows, the capital structure, and regulatory inputs
- the funding position of the defined benefit pension scheme (we have recently agreed a funding plan for the scheme and this is included within our business plan assumptions).

The principal risks have been monetised with reference to our risk weighting of likelihood and financial impact.

We have tested these scenarios separately and in combination against our business planning period to 2030. We have also considered measures to mitigate financial risk. An example of scenarios tested is summarised on page 136.

Read more about **our plans for 2025** on pages 36 to 39

Scenario tested	Principal risks	Mitigating actions
The possible impact from COVID-19 followed by a period of lower economic activity and higher unemployment. The scenario includes an assessment of short-term revenue and liquidity risk plus a longer term impact on household bad debts.	COVID-19	We benefit from regulatory protections regarding the timing of revenue cash flows linked to consumption so are protected, over a longer period, from the short-term loss of revenues. Ofwat, the economic regulator, is supportive of our re-prioritisation to ensure continuity of front line services during the lockdown so we can expect to also recover additional costs relating to COVID-19. Residual cost to be mitigated by a separately identified risk contingency within the delivery plan. Discuss impact on debt covenants with lenders and seek a temporary waiver if necessary.
Combined water, wastewater, and customer risks, ranging from unplanned costs associated with extreme weather events, the impact from an expected failure in our network or a key asset, unexpected costs not included within our delivery plan, and operational failure leading to a material increase in penalties.	Water, wastewater, customer and climate change	Cost to be mitigated by a separately identified risk contingency within the delivery plan. Identify and implement further sustainable cost savings and review discretionary expenditure. Review the possibility to raise further finance in order to invest in mitigation improvement.
Combined other risks such as regulatory fines or legal claims, an unexpected failure of key IT equipment or IT infrastructure, a data breach, the loss of a key operational site or workplace, the loss of key staff, a failure to procure essential equipment, or financial penalty from a failure to keep abreast or comply with regulations and standards.	Compliance, information technology, resources, health, safety, and wellbeing	Cost to be mitigated by a separately identified risk contingency within the delivery plan. Identify and implement further sustainable cost savings and review discretionary expenditure. Review the possibility to raise further finance in order to invest in mitigation improvement.
A combined scenario testing the financial impact on forecast cash flows, capital structure, and regulatory inputs, from higher or lower inflation applied to the base delivery plan plus all of the principal risks identified in this table.	COVID-19, water, wastewater, customer, and climate change, compliance, information technology, resources, health, safety, and wellbeing, and sensitivity to changes in inflation	SWS is reasonably well placed to manage inflation risk given that revenues and the regulatory capital value are directly linked to inflation and costs are indirectly linked to inflation. SWS also has in place inflation linked debt and derivatives to ensure a significant proportion of its debt is also directly linked to the movement in inflation. Cost to be mitigated by the separate risk contingency included within the delivery plan. Identify and implement further sustainable cost savings and review discretionary expenditure. Review the possibility to raise further finance in order to invest in mitigation improvement.

The combined scenarios have a potentially more severe impact given that they are the summation of individual risk scenarios and the mitigation extends to an increase in leverage of Southern Water given that one of the mitigation actions is to review the possibility to raise further finance.

There is limited financial flexibility within the current credit ratings for Southern Water given two credit ratings are on negative outlook (see Financial KPI's page 108) and significant long-term effects from COVID-19 could impact on protective covenant ratios either of which could lead to a Trigger Event. A Trigger Event would occur if either of the negative outlooks are acted upon, and a dividend restriction under our Licence of Appointment would occur where a negative credit rating outlook is assigned to the lowest investment grade credit rating. A Trigger Event would require creditor consents to the raising of new debt and restrictions on the payment of dividends.

Credit ratings are also affected by operational performance, the regulatory environment, and relative performance against water company peers. An Environment Agency prosecution relating to wastewater permit compliance between 2010 and 2015 (inclusive) is ongoing (see page 27). It is not yet possible to determine a reliable estimate for a level of fine or to assess the reputational impact. The viability assessment has, however, considered a wide range of financial risk, including the other combined risk scenario which includes the risk of regulatory fines and penalties.

Southern Water is not, however, forecast to breach its debt covenant ratios and credit rating agency financial metrics are in line with an investment grade credit rating. All financial metrics recover by 2030.

The other companies in the wider Greensands group are in place to support the overall financing of the group. None of these companies trade. In assessing the viability of Southern Water the Board has taken into consideration the activities of the other group companies, as described on pages 112 to 113, and the overall group structure.

The directors have concluded that the viability of Southern Water is not compromised by the individual or combined scenarios over the assessment period. When arriving at this conclusion, the directors anticipate the ability to efficiently raise new finance and a stable and supportive regulatory environment.

In making their assessment, the directors have assumed capital markets will be available to provide funding for the significant ongoing capital investment programme as well as for the refinancing of debt, credit facilities and financial derivative maturities when they fall due.

Based on this assessment, the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period to March 2030.

In arriving at their opinion, the directors have taken into account the following:

- The certainty of wholesale and household retail price controls to March 2025 provided by the 2019 Final Determination by Ofwat
- The financial strength of the company at the balance sheet date and the fact that it has arranged £330 million of five-year committed bank facilities as back-up liquidity (maturing in 2024)
- The Sustainable Financing Framework put in place in 2019–20 and the successful bond issue in May 2020 totalling £825 million
- The company's annual budget and business plan projections, including stress testing reflecting plausible but severe combinations of the principal risks of the business
- The company's formal risk and governance arrangements which are monitored by the Risk Committee, Audit Committee and Board
- The company's ability to manage the timing of capital programmes and associated expenditure
- The company's track record in being able to raise new forms of finance in most market conditions.

The results of the review were considered by the Audit Committee in June 2020 as part of the process of recommending the accounts for approval. In addition, to support the Board in its assessment, third-party assurance was obtained over the supporting calculations and sensitivities applied to the financial projections for the 'viability statement'.

The Strategic Report, including the directors' Section 172(1) statement on pages 162 to 163, was approved by the Board of Directors on 10 July 2020 and signed on its behalf by Richard Manning, General Counsel and Company Secretary

Richard Manning
General Counsel & Company Secretary

10 July 2020

WATER for LIFE

Governance Report

from
Southern Water®

Chairman's overview

A company's purpose, values and culture must be embedded within the DNA of the organisation and those who work for it and must inform how and why every act is carried out within that organisation

As we face challenges from the settlement with Ofwat and EA prosecution to the Final Determination, and, more recently, the COVID-19 pandemic, more than ever, it is crucial to uphold the highest standards of governance

Introduction

This has been a year of significant change for the Board of Southern Water. I warmly thank Paul Sheffield for acting as Chairman between 1 April, when Bill Tame retired, until my arrival in August 2019. Not only did Paul provide firm leadership, but his support of me in my new role was invaluable. I am delighted that he continues to do so as the company's senior independent non-executive director as the Board and I support the continued transformation of the business and grapple with the COVID-19 issues that confront us all.

The Board has also welcomed two new independent non-executive directors: Kevin McCullough and Malcolm Cooper, both of whom provide significant experience and expertise identified as being required to improve the Board's overall effectiveness. In addition, the Board agreed to make the appointment of Sebastiaan Boelen as Chief Financial Officer permanent. Furthermore, Marykay Fuller was appointed to the Board as a representative of Greensands Holdings Limited in June 2020. Marykay brings extensive experience in organisational transformation and has a background in finance and consulting.

Outside of the boardroom, this year has seen the coming into force of a number of important requirements in terms of corporate governance, including:

- The major update of the UK Corporate Governance Code in July 2018 with which Southern Water seeks to comply inasmuch as is applicable for an unlisted company;
- The Companies (Miscellaneous Reporting) Regulations 2018, which includes the 'section 172(1) statement'; and
- The Board leadership, transparency and governance principles and guiding provisions published by Ofwat.

The Board's agenda has also been both full and varied with much focus being devoted to the continuation of the process started in 2018 to submit and finalise the company's business plan for 2020–25. Throughout the period from the submission of the company's initial plan to receipt of Ofwat's Initial Assessment, Draft and Final Determinations, the Board has been highly engaged in, and has made all key decisions with respect to, the company's plans for 2020–25, particularly as they have a significant impact on the its operational and financial resilience.

Following receipt of Ofwat's Final Determination in December 2019, the Board, taking into the account the views of its legal and financial advisers, as well as the company's investors, agreed to accept it. This was a difficult decision given our view that the Final Determination was not sufficiently reflective of our customers' express wishes for long-term resilience and because of the significant financial constraints imposed on the company. On balance, nevertheless, the Board considered it a better use of time, resources and energy to deliver an improved service for Southern Water's customers than to challenge Ofwat's decision through the Competition and Markets Authority (CMA). The Final Determination leaves the company with steep hills to climb and we will be watching the progress of the four appeals to the CMA with interest as they re-determine a number of issues that made our decision to accept so challenging.

The Board's agenda has also been focused on the regulatory settlement with Ofwat and the prosecution of the company by the Environment Agency; further details can be found on page 27.

2
new independent non-executive directors

Dec 19
Ofwat's Final Determination was received

Read more about **our plans to 2025** on pages 36 to 39

Read more about **our Board members** on pages 146 to 149

The Board has been heavily involved in the cultural change programme being rolled out throughout the business, including a new purpose and values and a Code of Ethics, all designed to ensure that behaviours change for good.

The Board has continued to support management in its efforts to transform the operations of the business, and has devoted much time to monitoring and reviewing the company's transformation in areas such as its core operations, new contractual arrangements with our delivery partners, the outsourcing of certain customer functions to Capita and the changes required to the company's IT platforms and solutions. The Board is clear that the company must transform its ways of working and cost efficiency to be able to deliver a resilient water future against the backdrop of Ofwat's toughest ever regulatory settlement.

As is to be expected, and as reported elsewhere in this document, the Board's attention toward the latter part of the financial year and beyond has been focused on the COVID-19 pandemic and the consequent and potential impact on Southern Water, the water sector and the UK as a whole. The Executive team invoked emergency protocols that were adapted to government advice hour-by-hour and the Board delegated the authority necessary to ensure that our key workers could continue to provide our essential services and to give assistance to all our customers, whatever their circumstances. The Board has received regular updates on the latest position within both the company and the wider sector and has supported management's efforts to ensure that the working environment is as safe as practicable for our workforce, including introduction of home-working and social distancing measures.

Business integrity

I was aware, when I joined Southern Water, that the organisation was in the process of addressing, and correcting, a number of significant issues from its past, which have so visibly affected the company and our employees. I joined also knowing the absolute commitment of the Board and the company's leadership to rebuild around a strong ethical code, with systems, processes and support to enable people to always do the right thing for our customers and for one another.

It is of the utmost importance, demonstrated by the prominence afforded to it by the UK Corporate Governance Code, that the Board takes a lead on setting the purpose, values and culture of an organisation and continues to monitor culture; indeed, we have given undertakings to Ofwat to

Read more about **our approach to governance** on pages 150 to 153

Read more about **our COVID-19 response** on page 28

Pictured
Members of the Board regularly spend time with teams from across the business

Chairman's overview continued

3
Southern Water values are its fundamental building blocks

2030
the company's viability statement takes a long-term view

do so, in addition to meeting the UK Corporate Governance Code requirements in this area. A company's purpose, values and culture must be embedded within the DNA of the organisation and those who work for it and it must inform how and why every act is carried out.

To this end, we launched our new purpose, values and culture in 2019 to reflect our role in society in delivering an essential service and to emphasise and embed the importance of doing the right thing, succeeding together and always improving. These might sound like simple and obvious propositions, but they are the fundamental building blocks of a successful organisation.

In addition, following significant engagement with experts in the field, including the Institute for Business Ethics, the company has launched a new Code of Ethics, which sets out Southern Water's expectations for those who work for it. This includes an 'ethical decision-making tool', which should be used for all decisions within the organisation. The Board has fully endorsed the Code of Ethics and has taken part in a workshop hosted by the Institute of Business Ethics.

We must ensure that the culture of the organisation is one founded on the principles of ethics and integrity, so that we can deliver the best outcomes for our customers, local communities, the environment and our workforce.

Section 172(1)

All companies and their operations affect the lives and wellbeing of a number of stakeholders over and above their shareholders. As such, it is appropriate that directors should consider the impact of their decisions on sectors beyond the 'traditional' shareholder perspective, including on the company's employees, its customers, local communities and, of course, the environment. As a provider of essential public services, the supply of drinking water and treatment of wastewater, Southern Water has always paid significant attention to the impact of its operations on its customers and the environment as well as on the communities the company operates in. The need has been reinforced by a regulatory framework, which requires companies in the sector to address customer and environmental concerns in particular.

However, Southern Water's operations also have a direct impact on its workforce and those who work for our partner organisations, as well as those we have commercial arrangements with, either as customers or suppliers.

The nature of our business also requires the Board and management to consider the long term in its decision-making. The five-year business planning cycle may be considered as long term for other sectors, but is not within our sector in the context of a 25-year instrument of appointment to provide water and wastewater services. Our longer-term view by the Southern Water Board can be seen in the viability statement on page 135, which has required the Board to consider the company's ability to operate to 2030 – almost 10 years. Moreover, the requirement, as also emphasised in our vision, to provide a resilient water future also makes consideration of long term investment necessary.

The introduction of the requirement for directors to explain how they take into account the factors listed in section 172(1) of the Companies Act 2006 is a welcome opportunity for boards to take a step back and consider exactly how they take into account the views of and impact on stakeholders and the environment, as well as, more fundamentally perhaps, how the board informs itself about the interests of those stakeholders, and who they are.

The Board of Southern Water has considered the new reporting requirement to produce a section 172(1) statement in the context of the mechanics of the statement and of how Southern Water, as a whole, can better consider the interests of those affected by its operations. In addition, to how Southern Water's strategy, purpose, values and culture takes into account these interests and how the company considers the potential impact on these stakeholders and the environment when determining its approach to risk.

I am confident that the Board has always acted within the boundaries and intentions set out in section 172(1) and we will continue to look at ways to fully embed them.

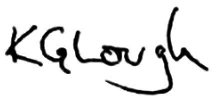
Ofwat Principles

This is the first year that the company has been required to report against the Board leadership, transparency and governance principles issued by Ofwat (the ‘Ofwat Principles’). Meeting the objectives of the principles is also a requirement under Southern Water’s licence. The principles make an important contribution to setting consistent expectations for the governance of the sector and the Board was pleased to note that Southern Water’s 2018–19 annual report was highlighted as being an example of best practice in some areas in Ofwat’s intitial assessment in 2019. However, it was noted that disclosures in respect of its Board evaluation required improvement. We have taken steps to improve these disclosures on pages 168 to 172.

The Board believes that it has met the objectives of the Ofwat Principles and, on pages 152 to 153, we set out a summary of our compliance with the Ofwat Principles, together with relevant cross-references.

Conclusion

It has again been a busy, yet challenging, year for the Board of Southern Water, with a number of changes in the composition and a number of significant issues in the operational, financial and regulatory spheres to deal with. I do believe that the Board has risen to these challenges, together with management, led by Ian McAulay, our CEO, and guided by our values and principles. We have taken the steps needed to ensure future improvements in the company’s performance, to change our culture and to work towards delivering a resilient water future for the South East. My ambition for the coming year is to develop strategic debate inside the company and with our regulators, to ensure that we continue to do the right things for our customers and our region, as we emerge from a pandemic that has affected much that we take for granted.



Keith Lough
Chairman

10 July 2020

Pictured
Directors should consider the impact of their decisions on customers and communities and the environment

Read about **our environmental performance** on pages 90 to 99

Read more about **our people and our communities** on pages 50 to 55

Board of directors

The Board

As at 31 March 2020, the Board comprised: the Chairman, Chief Executive Officer, Chief Financial Officer, six independent non-executive directors (one of whom is the senior independent non-executive director) and one shareholder-nominated non-executive director. They are supported by the General Counsel and Company Secretary. Marykay Fuller joined the Board as a shareholder-nominated non-executive director on 15 June 2020.

More information on the background and experience of the Board members and a description of their roles can be found on pages 146 to 149.

Members of the Board and Company Secretary at 31 March 2020 are pictured above.

Top row left to right:

Keith Lough
Chairman

Ian McAulay
Chief Executive Officer

Sebastiaan Boelen
Chief Financial Officer

Paul Sheffield
Senior independent non-executive director

Rosemary Boot
Independent non-executive director

Bottom row left to right:

Malcolm Cooper
Independent non-executive director

Dame Gillian Guy DBE
Independent non-executive director

Kevin McCullough
Independent non-executive director

Mike Putnam
Independent non-executive director

Sara Sulaiman
Non-executive director

Richard Manning
General Counsel and Company Secretary

Moving towards creating a resilient water future for our customers

Balance and experience of our Board

In order to be able to deliver for our customers and the communities we serve, the Board requires a diverse range of skills and experience. The table below shows the current Board members in terms of their primary skills and experience and how these contribute to ensuring a more resilient water future.

Ensuring Southern Water contributes to a more resilient water future	Board skills/experience required	Board members
Succeeding together	Customer, capital programmes, operations, financing, transformation	Keith Lough, Ian McAulay, Sebastiaan Boelen, Rosemary Boot, Malcolm Cooper, Gillian Guy, Kevin McCullough, Mike Putnam, Paul Sheffield, Sara Sulaiman, Marykay Fuller
Doing the right thing	Customer, environment, governance, regulation	Keith Lough, Ian McAulay, Rosemary Boot, Malcolm Cooper, Gillian Guy, Mike Putnam, Sara Sulaiman
Always improving	Customer, capital programmes, operations, transformation, utilities sector	Keith Lough, Ian McAulay, Sebastiaan Boelen, Rosemary Boot, Gillian Guy, Kevin McCullough, Mike Putnam, Paul Sheffield, Marykay Fuller

Pictured
Board members are taken around Goddards Green Wastewater Treatment works

Board of directors continued

Key: A Audit Committee RI Risk Committee N Nomination Committee RE Remuneration Committee ● Committee Chair

Keith Lough
Chairman

Executive: No
Independent: On Appointment
Committee Membership N

Date of appointment
01/08/2019

Experience
Keith has extensive experience in the natural resources and energy sectors in both finance and leadership roles, including as finance director for British Energy plc between 2001 and 2004 during a period of major restructuring.

In addition, Keith served as non-executive chairman of Gulf Keystone Petroleum plc following a successful debt restructuring. Immediately prior to his appointment to the Board of Southern Water, Keith was a non-executive member of the Gas and Electricity Markets Authority (Ofgem), where he was chairman of the Audit and Risk Assurance Committee, having served on the board since 2012.

Keith holds an MA in economics and MSc in finance and is a Fellow of the Association of Chartered Certified Accountants.

External appointments
Keith holds non-executive directorships in a number of oil and gas companies, including at Hunting plc as senior independent director, Cairn Energy plc and Rockhopper Exploration plc.

Ian McAulay
Chief Executive Officer

Executive: Yes
Independent: No
Committee Membership

Date of appointment
01/02/2017

Experience
Ian joined Southern Water as Chief Executive Officer in January 2017 and was appointed to the Board from 1 February. He is a member of the Executive Committee and the Executive Leadership Team.

Ian has more than 30 years of global water and environmental experience, operating in both publicly quoted FTSE100/250 companies and privately-held enterprises. He has managed utility, construction and consulting businesses in the UK, Belgium, India and the USA, and has enhanced his experience with professional executive education, most notably at Harvard Business School.

In his previous role, he served as an executive director of the Pennon Group plc and chief executive of its subsidiary company, Viridor.

In a non-executive capacity, he served as a member of Greater Manchester Authorities Low Carbon Hub Board and the Scottish Government's 2020 Climate Change Board. He has also provided expert input into government review groups and industry partnerships.

Ian holds an honours degree in Civil and Environmental Engineering and is a Chartered Member of the ICE, CIWEM.

External appointments
Ian currently chairs the Greater Brighton Infrastructure Panel.

Sebastiaan Boelen
Chief Financial Officer

Executive: Yes
Independent: No
Committee Membership

Date of appointment
14/12/2018

Experience
Sebastiaan started his career with 10 years in the Royal Navy, followed by management consulting (McKinsey; C&L – now PwC) and senior finance roles in telecoms (infrastructure), consumer goods, business services and financial services, for listed and private equity portfolio companies.

He also worked with Electricity North West and has been CFO and Board member of Southern Water since December 2018. He is a member of the Executive Committee and the Executive Leadership Team.

Sebastiaan has worked and lived in the Netherlands, France, Switzerland, Belgium, Luxembourg and the UK.

External appointments
None.

Key: A Audit Committee RI Risk Committee N Nomination Committee RE Remuneration Committee ● Committee Chair

Paul Sheffield
Senior independent non-executive director

Non-executive: Yes
Independent: Yes
Committee Membership N RE

Date of appointment
01/06/2014

Experience
Paul joined the Board in June 2014 and was appointed as senior independent non-executive director in July 2015. Between 1 April and 31 July 2019, Paul served as acting Chairman while he led the search for a new Chairman.

In his executive career, he spent over 32 years with Kier Group plc – the construction, services and property group. Graduating as a Civil Engineer in 1983, Paul spent 15 years working on major capital projects around the world before taking responsibility for a number of business units within the group. Paul was on the board for 10 years and served as chief executive officer between 2010 and 2014. Between 2014 and 2017, he headed up the construction operations for the European and Middle Eastern businesses for Laing O'Rouke Services, delivering some of the biggest capital projects such as Crossrail, Hinkley Point C Nuclear Power Station and major capital projects in the water industry.

Through his various roles in business leadership, Paul has gained significant experience of strategy, productivity innovation and efficiency and the vital role that ethics plays in determining the long-term success of an organisation.

External appointments
Paul is a member of the Supervisory Board of BAM Group in the Netherlands. He is also a Fellow and President of the Institution of Civil Engineers.

Rosemary Boot
Independent non-executive director

Non-executive: Yes
Independent: Yes
Committee Membership A RE

Date of appointment
01/03/2015

Experience
Rosemary joined the Board in March 2015. She served initially as interim and subsequently as Chairman of the company's Audit and Risk Review Committee between March 2017 and September 2018. Following the departure of the then Audit Committee Chair, Rosemary served as interim Chair between February and December 2019.

Rosemary was the chief financial officer of Future Cities Catapult, one of a network of technology and innovation centres established by the UK government. She also worked at Circle Housing Group and was involved in setting up the government-owned Low Carbon Contracts Company and Electricity Settlements Company.

From 2001 to 2011, Rosemary was group finance director of the Carbon Trust, the independent company set up in 2001 to work with business and the public sector to accelerate the move to a sustainable, low carbon economy. Prior to that, she worked for 16 years as an investment banker, primarily advising large listed UK companies on mergers and acquisitions.

External appointments
Rosemary is senior independent director of Impact Healthcare REIT plc. She is a non-executive director of Urban&Civic plc. She is also a trustee of Green Alliance, and a founder and director of Chapter Zero Limited.

Mike Putnam
Independent non-executive director

Non-executive: Yes
Independent: Yes
Committee Membership A RI

Date of appointment
26/09/2017

Experience
Mike has over 25 years' experience leading and managing multiple businesses across development and construction. He is known for his values-based approach to leadership. He has since transitioned to a plural career with a portfolio of non-executive directorships.

Mike was president and CEO of Skanska UK between 2009 and 2017, responsible for a business with circa £1.8 billion revenues and 6,000 employees. Prior to this he was executive vice president and main board director from 2001, as well as working across the group as a non-executive director on some of the international boards. Throughout his career he has been closely involved with the successful delivery of many high-profile projects and programmes.

Mike is a member of the Construction Leadership Council. He has also been chair of the Green Construction Board; a member of the CBI Construction Council; and a non-executive director of the Association of Consulting Engineers

Mike is a Chartered Engineer and a Fellow of both the Institution of Civil Engineers and Royal Institution of Chartered Surveyors.

External appointments
Mike currently serves on the boards of Network Rail, Arcadis NV and Bazalgette (Tideway) Tunnel Ltd.

Board of directors continued

Key: A Audit Committee RI Risk Committee N Nomination Committee RE Remuneration Committee ● Committee Chair

Dame Gillian Guy DBE
Independent non-executive director

Non-executive: Yes
Independent: Yes
Committee Membership RE RI

Date of appointment
12/11/2018

Experience
Gillian joined the Board in November 2018.

Gillian served as a non-executive board member and chair of the Audit Committee of the National Audit Office and as a non-judicial member of the Sentencing Council for England and Wales. Gillian was awarded a CBE in the New Year's Honours List in 2015 and was awarded a Damehood in the 2020 New Year's Honours List for services to public and voluntary sectors.

Gillian is a lawyer and spent 11 years as chief executive officer of the London Borough of Ealing before becoming chief executive officer of Victim Support.

External appointments
Since July 2010, Gillian has been chief executive officer of the independent charity Citizens Advice. She is also currently chair of the UK Finance Consumer Advisory Group and a member of the Banking Standards Board.

Kevin McCullough
Independent non-executive director

Non-executive: Yes
Independent: Yes
Committee Membership RI

Date of appointment
18/07/2019

Experience
Kevin joined the Board in July 2019 and was appointed as the non-executive director with the remit for communicating the views of the workforce to the Board in February 2020.

Kevin has over 35 years of experience in the utility sector. He has developed a strong reputation for delivering results in the most arduous of business environments, having held significant executive positions with RWE Innogy & npower, Horizon Nuclear Power and UK Coal Production Ltd.

He has been responsible for the development and construction of some of the UK's largest power plants, including large-scale offshore wind and high-efficiency combined cycle gas turbine. Kevin's career has seen him take key roles interfacing with, and in some cases advising, government directly, on all aspects of UK energy generation.

As chairman of Horizon Nuclear Power, he helped nuture the opportunity for new nuclear capability in the UK.

Kevin is a Chartered Engineer and a Fellow of both the Institute of Mechanical Engineers and the Energy Institute.

External appointments
Kevin is currently the CEO of Calon Energy Ltd, responsible for the management of one of the country's highest efficiency combined cycle gas turbine generation businesses.

Malcolm Cooper
Independent non-executive director

Non-executive: Yes
Independent: Yes
Committee Membership A RI

Date of appointment
23/12/2019

Experience
Malcolm joined the Board in December 2019 and was appointed as Chair of the Audit Committee.

Malcolm has extensive experience in the regulated utility sector, having worked for around 30 years at National Grid plc, British Gas plc and other companies. He was a member of the board of both National Grid Gas plc and National Grid Electricity Transmission plc.

Malcolm was previously a non-executive director of St William. He is also a past president of the Association of Corporate Treasurers and was a member of the Listing Authority Advisory Panel of the FCA.

Malcolm has a degree in Pure Mathematics and is both a Fellow of the Association of Chartered Certified Accountants and the Association of Corporate Treasurers.

External appointments
Malcolm is a non-executive director at Morgan Sindall plc and at MORhomes plc where he is senior independent director and new issues committee chair. He was also a non-executive director at CLS Holdings plc, where he was senior independent director and Audit Committee chair. He is a member of the Audit Committee of Local Pensions Partnership Ltd.

Key: A Audit Committee RI Risk Committee N Nomination Committee RE Remuneration Committee Committee Chair

Sara Sulaiman
Non-executive director

Non-executive: Yes
Independent: No
Committee Membership N A RE

Date of appointment
26/09/2017

Experience
Appointed in September 2017, Sara is an executive director at JP Morgan Asset Management.

Before joining JP Morgan, Sara was an investment director at Arle Capital Partners, a London-based mid-market private equity firm. Prior to that she worked on corporate finance transactions both within Simmons & Company International, a specialist energy investment bank, and KPMG's Global Infrastructure and Projects Group (within the Energy & Natural Resources team).

Sara started her career in industry working as a finance analyst in Petroleum Development Oman and Shell Chemicals in London.

Sara holds a Bachelor of Arts in Economics from Yale University, an MPhil in Economics from the University of Cambridge and is an Associate of the Chartered Institute of Management Accountants.

External appointments
Sara currently serves as a non-executive director on the holding companies of Nortegas, a Spanish gas distribution business and North Sea Midstream Partners, a gas transport and processing business in the UK.

Marykay Fuller
Non-executive Director

Non-executive: Yes
Independent: No
Committee Membership

Date of appointment
15/06/2020

Experience
Marykay joined the Board in June 2020 as a shareholder representative non-executive director for Greensands Holdings Limited.

Marykay's executive career was in finance and consulting with significant experience in organisational transformation in both the public and private sectors across a variety of industries, including infrastructure, transportation, energy and construction.

Marykay previously served on the board of British American Business and retired from KPMG LLP in 2016 as a senior advisory partner.

External appointments
Marykay is currently a director of the UK Civil Aviation Authority (CAA) where she sits on the audit committee and the management advisory board for the CAA's subsidiary, CAA International.

She is the chair of the Air Travel Trust and a director of GCP Asset Backed Income Fund Ltd where she is a member of the audit and remuneration committees as well as chair of the management engagement committee.

She also serves on the Alumni Advisory Board of Carnegie Mellon University Heinz College in the USA.

Richard Manning
General Counsel and Company Secretary

Secretary to all committees

Date of appointment
24/07/2018

Experience
Richard joined Southern Water in July 2018 as General Counsel and Company Secretary and now has overall responsibility for leading the Risk and Compliance directorate alongside his legal and governance roles. He is a member of the Executive Committee and the Executive Leadership Team.

He has held similar roles in a number of listed and private companies including GCap Media plc, JJB Sports plc and Waterstones, and brings a wide experience of legal and governance matters.

Richard holds a law degree and an MBA and is a qualified solicitor.

External appointments
None.

Our approach to governance

Ofwat Principles

In 2019 Ofwat published its Board leadership, transparency and governance principles, which represented a major update of the principles published in 2014 and incorporate many of the principles and provisions of the UK Corporate Governance Code published by the Financial Reporting Council (FRC). Accordingly, Southern Water seeks to apply both the Ofwat Principles and the relevant principles and provisions of the UK Corporate Governance Code in terms of its corporate governance.

The Ofwat Principles are based around four objectives, each supported by a number of provisions that aim to assist companies in demonstrating their application of the Ofwat Principles.

In July 2019, the licences of water and wastewater companies were amended to require them to comply with the objectives set out in the Ofwat Principles as set out below.

Find more information at **ofwat.gov.uk**

1. Competence and independence

Boards 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.

Read more on pages 154 to 161

2. Purpose, values and culture

The regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

Read more on pages 162 to 165

3. Effectiveness

The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.

Read more on pages 168 to 172

4. Transparency and accountability

The board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.

Read more on pages 174 to 180


WATER
for LIFE

Our approach to governance continued

A summary of Southern Water's application of the Ofwat Principles is provided below:

Objective/provision	Compliant?	Page(s)
The regulated company board established the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.	Yes	162
i. The board develops and promotes the company's purpose in consultation with a wide range of stakeholders and reflecting its role as a provider of an essential public service.	Yes	162, 164
ii. The board makes sure that the company's strategy, values and culture are consistent with its purpose.	Yes	162, 164
iii. The board monitors and assesses values and culture to satisfy itself that behaviour throughout the business is aligned with the company's purpose. Where it finds misalignment it takes corrective action.	Yes	164-165
iv. Companies' annual reporting explains the board's activities and any corrective action taken. It also includes an annual statement from the board focusing on how the company has set its aspirations and performed for all those it serves.	Yes	140-143, 162
The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.	Yes	144-149, 154-156, 158 161, 168-172
i. The regulated company sets out any matters that are reserved for shareholders or parent companies (where applicable); and explains how these are consistent with the board of the regulated company having full responsibility for all aspects of the regulated company's business, including the freedom to set, and accountability for, all aspects of the company's strategy.	Yes	110, 154-155
ii. Board committees, including but not limited to Audit, Remuneration and Nomination Committees, report into the board of the regulated company, with final decisions made at the level of the regulated company.	Yes	156-157
iii. The board of the regulated company is fully focused on the activities of the regulated company; takes action to identify and manage conflicts of interest, including those resulting from significant shareholdings; and ensures that the influence of third parties does not compromise or override independent judgment.	Yes	154-156, 161, 171 to 172
The board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.	Yes	154, 174-178
Regulated companies publish the following information in a form and level of detail that is accessible and clear for customers and stakeholders:		
i. An explanation of group structure;	Yes	109-113
ii. An explanation of dividend policies and dividends paid, and how these take account of delivery for customers and other obligations (including to employees);	Yes	105-106, 114
iii. An explanation of the principal risks to the future success of the business, and how these risks have been considered and addressed;	Yes	116-134
iv. The annual report includes details of board and committee membership, number of times met, attendance at each meeting and where relevant, the outcome of votes cast; and	Yes	146-149, 158, 168, 174, 184
v. An explanation of the company's executive pay policy and how the criteria for awarding short and long-term performance-related elements are substantially linked to stretching delivery for customers and are rigorously applied. Where directors' responsibilities are substantially focused on the regulated company and they receive remuneration for these responsibilities from elsewhere in the group, policies relating to this pay are fully disclosed at the regulated company level.	Yes	182-199

Objective/provision	Compliant?	Page(s)
Boards 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.	Yes	158-161
i. Boards and board committees have the appropriate balance of skills, experience, independence and knowledge of the company. Boards identify what customer and stakeholder expertise is needed in the boardroom and how this need is addressed.	Yes	145, 158-161, 169-172
ii. Independent non-executive directors are the largest single group on the board.	Yes	154, 159-160, 161
iii. The chair is independent of managers and investors on appointment and demonstrates objective judgment throughout their tenure. There is an explicit division of responsibilities between running the board and executive responsibility for running the business.	Yes	159
iv. There is an annual evaluation of the performance of the board. This considers the balance of skills, experience, independence and knowledge, its diversity, how stakeholder needs are addressed and how the overarching objectives are met. The approach is reported in the annual report and any weaknesses are acted on and explained.	Yes	168-169
v. There is a formal, rigorous and transparent procedure for new appointments which is led by the Nomination Committee and supports the overarching objective.	Yes[1]	170-171
vi. To ensure there is a clear understanding of the responsibilities attached to being a non-executive director in this sector, companies arrange for the proposed, final candidate for new non-executive appointments to the regulated company board to meet Ofwat ahead of a formal appointment being made.	Yes	170
vii. There is a majority of independent members on the Audit, Nomination and Remuneration Committees and the Audit and Remuneration Committees are independently led.	Yes[2]	168, 174, 184

[1] Southern Water has established a Nomination Committee, which, in the ordinary course of business, would lead the process for new appointments. However, during 2019–20, due to the significant changes in the Board, the Board as a whole took on some elements of this role.

[2] The membership of the Nomination Committee is: the Chairman, one independent non-executive director and one non-executive director. The Chairman, while not independent under the UK Corporate Governance Code, is independent of management and the shareholders.

Read more about **the Nomination Committee** on pages 169 to 172

Read more about **our Remuneration Committee** on pages 182 to 199

Corporate governance report

To be truly effective, Boards must have sufficient diversity in terms of background, experience and expertise

Keith Lough
Chairman

1. Competence and independence

Boards 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.

Members of the Board

(1) Chairman

(2) Executive directors

(2) Non-executive directors

(1) Senior independent non-executive director

(5) Independent non-executive directors

(1) General counsel and company secretary

Overview of the Board's responsibilities

The Board's role is to:

- establish the company's purpose, strategy and values,
- develop and promote the company's purpose in consultation with a wide range of stakeholders,
- determine overall strategic aims and direction consistent with the company's purpose,
- monitor and assess the company's values and culture to ensure that behaviour throughout the business is aligned with the company's purpose,
- have full responsibility for all aspects of the company's regulated business in the long term,
- ensure that the company's obligations to, and interests of, all its stakeholders, including customers, employees, key partners, contractors and regulators, are known and met appropriately,
- provide effective leadership and collective responsibility for the long-term success of the company for the benefit of its members, taking into account the interests of a wide range of stakeholders, including customers, local communities, employees, suppliers and the company's impact on the environment,
- ensure that sufficient resources are available to the Chief Executive Officer and his team to operate, manage and develop the business appropriately to provide an essential public service to our customers, and
- ensure that appropriate and effective processes and controls are in place to assess and appropriately manage risk.

Greensands Holdings Limited

The Shareholders' Agreement of our parent company, Greensands Holdings Limited, reserves certain matters by exception to the Board and shareholders of that company. A schedule of those matters reserved to Greensands Holdings Limited is published at **southernwater.co.uk/greensands-ownership-of-southern-water**.

During the year 2019–20 a number of matters required shareholder approval. These included appointments of Keith Lough as Chairman and Kevin McCullough and Malcolm Cooper as new independent non-executive directors as well as Sebastiaan Boelen's appointment as Chief Financial Officer.

The decision by Southern Water to accept the Final Determination from Ofwat in respect of the period 2020–25 was also approved by Greensands as a reserved matter (see pages 36 to 39). In addition, certain of the re-financing activities undertaken by the company during the year also required approval by the shareholders.

Southern Water governance structure

Shareholders

Greensands Holdings Limited Board of Directors

Certain key matters are reserved to the Board of Greensands Holdings Limited and/or the Shareholders. Please see page 154

Southern Water Services Limited Board of Directors

The Board of Southern Water is ultimately responsible for the company. Details of the Board's responsibilities and activities can be found on pages 156 to 161.

Executive Committee (EXCOM)

Comprising the Chief Executive Officer, Chief Financial Officer, Managing Director and General Counsel and Company Secretary, it meets regularly to discuss and make decisions on areas of strategy and other matters critical to the company.

Executive Leadership Team

Reporting to the Chief Executive Officer, the Executive Leadership Team supports him in driving the implementation of strategy in the company. Comprised of the senior leaders of the functions and operational units, the ELT meets regularly to:

- Consider performance and make decisions on operational matters;
- Oversee the company's transformation programme; and
- Consider health and safety, risk and compliance.

Corporate governance report continued

1. Competence and independence

An effective Board must have a wide range of skills and experience across the field of both the company's activities and beyond

Keith Lough
Chairman

The Board

The following matters are routinely determined by the Board:

- Business and financing strategy
- Business plans
- Approval of annual budgets
- Fixing of principal charges and charges schemes
- Approval of financial statements
- Key regulatory submissions
- Key customer and stakeholder publications
- Entering into significant contracts or commitments
- Approval of dividends
- Commencing new businesses
- Appointment or removal of the auditor, directors and company secretary
- Remuneration of independent non-executive directors.

During the year, the Board's agenda also included:

- Assessment of the Draft and Final Determinations from Ofwat in respect of the company's business plan for 2020–25, including extensive consideration of the implications of the operational and financial constraints resulting from the determinations and consideration of whether to ask Ofwat to refer the Final Determination to the Competition and Markets Authority.
- Assessment of and agreement to the regulatory settlement with Ofwat and reviewing and approving management's proposals to ensure compliance with the undertakings provided to Ofwat and the monitoring thereof.
- Approval of the company's new Code of Ethics and participation in a workshop facilitated by the Institute of Business Ethics regarding ethical decision-making.
- Participation in a cyber incident exercise.
- Considering and approving the proposal to close the company's defined benefit pension scheme to future accrual and to roll out a new defined contribution pension scheme across the business.
- Approval of the re-financing of certain of the group's debt instruments and reviewing and approving an update to the base Prospectus for the ring-fenced group's bond programme.
- Risk-based assessment of the company's activities, opportunities and threats, including one full-day strategy session.
- Receiving, reviewing and discussing reports from the executive directors and others on the company's operations, including its regulatory obligations and its customer focus.
- Reviewing and monitoring the culture of Southern Water, including the decision to appoint Kevin McCullough as an independent non-executive director with the remit of communicating the views of the company's workforce to the Board, see page 164.

Board committees

In line with both the Board leadership, transparency and governance principles published by Ofwat and the UK Corporate Governance Code as well as best practice, the Board has established a number of standing committees with specific responsibilities. These committees are:

- Audit
- Risk
- Nomination
- Remuneration

These committees assist the Board by monitoring and reviewing performance and issues within their respective scopes. Specific responsibilities have been delegated to these committees.

Moreover, the Board and its committees took the opportunity to review and, where appropriate, revise the existing terms of reference of the committees in light of the new guidance published by the Institute of Chartered Secretaries and Administrators as well as emerging practice following the coming into force of the updated UK Corporate Governance Code.

Each committee has written terms of reference, which are published at **southernwater.co.uk/board-committee-terms-of-reference**.

Other committees are constituted if and when required for specific matters. For instance, in early 2019, the Board agreed to establish an Information Security Committee for a temporary period in order to be able to focus on matters such as the company's implementation of the requirements of the NIS Directive, the General Data Protection Regulation as well as on information security risk more generally. Following a review, it was agreed that the Information Security Committee should be disbanded in September 2019 and its responsibilities assigned to the Audit and Risk committees. The Board also constituted ad hoc committees in respect of the re-financing activities and for the final approval of the company's financial statements.

Southern Water Board and committee responsibilities

The Board

- Has full responsibility for the company's business over the long term
- Establishes the company's purpose, values and culture and sets its strategy.

Read more about **our purpose, values and culture** on pages 162 to 165

Audit Committee

- Monitors the integrity of the company's financial statements by challenging the basis of preparation and the judgments made.
- Monitors the integrity of non-financial information reported by the company.
- Keeps under review the company's internal controls and risk management systems.
- Oversees Internal Audit and the relationship with the external auditor.

Read more on pages 175 to 178

Risk Committee

- Advises on the company's overall risk appetite, tolerance and strategy and level of resilience.
- Oversees and advises on current risk exposures.
- Reviews the company's capability to identify and manage new risks.
- Monitors and advises on health, safety, security and wellbeing and makes appropriate recommendations to the Board.

Read more on pages 179 to 180

Nomination Committee

- Reviews the size, structure and composition of the Board.
- Evaluates the balance of independence, skills, experience and diversity on the Board.
- Leads the process for identifying and nominating candidates for approval by the Board of directors.

Read more on pages 169 to 172

Remuneration Committee

- Sets remuneration policy for all executive directors and the Chairman.
- Recommends and monitors remuneration for senior leaders.
- Approves the design of and determines targets for any performance-related pay schemes.
- Reviews the design of all long-term incentive plans.
- Oversees major changes to employee benefit structures.

Read more on pages 182 to 199

Corporate governance report continued

1. Competence and independence

12
financial and performance reports go to Board each year

10
Board meetings were held in 2019–20

Board meetings and attendance

Ten Board meetings were scheduled to take place during the year. However, in addition to the scheduled Board meetings, the Board met to consider matters including: the settlement reached with Ofwat and the Environment Agency prosecution (see page 27); the business plan for 2020–25; and the Draft and Final Determinations from Ofwat.

The attendance at scheduled Board and committee meetings during the year was as follows:

	Board	Audit	Risk	Nomination	Remuneration
Keith Lough[1]	7/7			1/1	
Ian McAulay	10/10				
Sebastiaan Boelen	9/10				
Paul Sheffield	8/10			1/1	4/4
Rosemary Boot[2]	9/10	4/4	2/2		4/4
Malcolm Cooper[3]	3/3	1/1	1/1		
Gillian Guy	8/10		3/3		
Kevin McCullough[4]	7/7		1/1		
Mike Putnam	7/10	4/4	3/3		
Sara Sulaiman	10/10	4/4		1/1	4/4
Wendy Barnes[5]	10/10		3/3		

[1] Appointed 1 August 2019
[2] Interim Chair of Audit Committee until December 2019; member of Risk Committee until January 2020
[3] Appointed 23 December 2019; Chair of Audit Committee from December 2019; member of Risk Committee from January 2020
[4] Appointed 18 July 2019; member of Risk Committee from January 2020
[5] Resigned 27 March 2020

The agenda and papers are sent to Board members in advance of each meeting. The monthly financial and performance reports are also distributed for the months when there is no scheduled meeting.

The Board typically holds its meetings at the company's head office in Worthing or in London. The Board also endeavours to hold one meeting 'off-site' during the year coupled with a strategy day in order to provide an opportunity to discuss the company's future strategy and plans. The Board held its strategy day in September 2019 in London at which it considered the regulatory settlement with Ofwat, the period 2020–25 as well as the potential for new revenue streams. Owing to the COVID-19 pandemic, the Board has met remotely using tele- and video-conferencing facilities.

Where a director has a concern over any unresolved matter, they are entitled to require the Company Secretary to record that concern in the minutes of a meeting. Should the director later resign over the issue, the Chairman would bring it to the attention of the Board.

All members of the Board were and are able to allocate the necessary time to the company in order to be able to discharge their responsibilities effectively.

Board composition

As was disclosed in the company's 2018–19 annual report, the Board has seen a period of change in its composition. This has included the need for a replacement Chairman, Chief Financial Officer and a permanent chair for the Audit Committee while also continuing to refresh its membership with a view toward the key skills, experience and attributes required.

Between Bill Tame's resignation as Chairman with effect from 31 March 2019 and the appointment of Keith Lough on 1 August 2019, Paul Sheffield served as the company's acting Chairman. During this period Paul led the search for a new Chairman. The Board carefully monitored Paul's independence, as the Board was aware that if Paul were to be required to act as chairman for a prolonged period there was a risk of compromising his independence. Fortunately, there was no requirement for a prolonged interim appointment and, as such, the Board was able to conclude that Paul remains independent; he continues as the company's senior independent non-executive director.

The Board was pleased to welcome two independent non-executive directors during the year. Kevin McCullough brings extensive operational experience from the energy sector and Malcolm Cooper brings significant experience from serving on Audit Committees, of large FTSE-listed entities, including as chair.

The Board agreed to confirm Sebastiaan Boelen's appointment as permanent Chief Financial Officer in September 2019.

Following the resignation of Wendy Barnes in March 2020, Marykay Fuller joined the Board as the shareholder representative non-executive director for Greensands Holdings Limited in June 2020.

As at 31 March 2020, women made up 30% of the Board (three out of 10 directors). The company is committed to having a diverse workforce that reflects the communities it operates in. The company published its Gender Pay Gap Report, which showed the median gender pay gap at Southern Water is below the national average median (9.6%). Our report at April 2018 showed a mean gap in favour of male employees of 7.3% and median gap in favour of male employees of 7.5%, compared with 9.5% and 9.0% respectively in 2017. In terms of bonus recipients, 84.3% of female employees and 87.2% of male employees received a bonus, compared with 84.0% and 87.4% respectively in 2017.

We are committed to supporting the aspirations of our talented female workforce and are implementing plans to address the gender pay gap. Read the full report at **southernwater.co.uk/gender-pay-gap**.

In accordance with good governance practice, the roles of the Chairman and Chief Executive Officer are separate.

Chairman

The role of the Chairman is to lead the Board in its shared responsibilities, to encourage and facilitate the contributions of its members and to ensure adherence to the governance principles and processes of the Board. Keith Lough was appointed as the company's Chairman on 1 August 2019. In line with the Ofwat Board leadership, transparency and governance principles as well as the UK Corporate Governance Code, Keith was viewed as independent on appointment.

The Chairman discusses and agrees Board meeting agendas with the Chief Executive Officer and Company Secretary, although any director may sponsor an item to be included on the agenda. The Chairman has authority to act and speak for the Board between its meetings, which includes engaging with the Chief Executive Officer. The Chairman reports to the Board, chairs of its committees and individual directors as appropriate on decisions and actions taken between Board meetings. The Chairman also meets with the non-executive directors, without the executive directors present, to consider the performance of the executive directors and to provide feedback.

The Chairman is not a member of the Greensands Holdings Limited (the company's ultimate parent company) board, although he and others from the company are regular attendees to report on the company's progress.

Chief Executive Officer

The Chief Executive Officer is a member of the Board and has all the responsibilities of a director of the company. In his executive role, responsibility has been delegated to him to deliver the company's strategy. He is empowered to take all decisions and actions that further the company's strategy and which, in his judgment, are reasonable within the Chief Executive Officer's limits set out in the company's internal controls and matters reserved to the Board. The non-executive directors, led by the Chairman, appraise his performance annually.

Chief Financial Officer

The Chief Financial Officer is a member of the Board with all the responsibilities of a director of the company. Sebastiaan Boelen was appointed as the company's interim Chief Financial Officer and member of the Board in December 2018 and this appointment was made permanent in September 2019. In his executive role and reporting to Ian McAulay, he has the responsibility for managing the company's financial affairs and assisting the Chief Executive Officer in the delivery of the company's strategy. His performance is reviewed annually by the Chief Executive Officer.

Senior independent non-executive director

Paul Sheffield is the senior independent non-executive director. Paul chairs the Remuneration Committee and is also a member of the Nomination Committee.

As senior independent non-executive director, ordinarily, Paul would chair Board meetings in the event that the Chairman was unable to do so for any reason. In the capacity of senior independent non-executive director, he is available to discuss matters or concerns with investors as required. In addition, as acting Chairman, Paul led the search for a replacement Chairman during 2019.

Independent non-executive directors

The largest single group on the Board are the independent non-executive directors in accordance with the Ofwat Principles and as a

Read **our Chairman's statement** on pages 140 to 143

Corporate governance report continued

1. Competence and independence

matter of good governance practice. The number of independent non-executive directors is also in accordance with the company's licence conditions, which require at least three independent non-executive directors on the Board.

They provide independent advice and perspectives and review and challenge decisions and reporting on behalf of all stakeholders, including customers and the workforce. The independent non-executive directors have been appointed for their individual external expertise and experience in specific areas, such as customer service, the environment, operations, procurement, capital project delivery, regulation, transformation and for the range of their experience of general corporate management.

The independent non-executive directors also appraise the Chairman's performance.

The standard terms and conditions of the appointments of independent non-executive directors are at **southernwater.co.uk/corporate-governance**.

Shareholder representative non-executive directors

Under the terms of the Subscription and Shareholders' Agreement, certain investors have a right to nominate for appointment a non-executive director to the Board of Southern Water. As a statutory director, such an individual has all the duties, obligations and rights of a director of Southern Water and, as such, act in accordance with the directors' duties set out in the Companies Act 2006, including those set out in section 172 to promote the success of the company for the benefit of its members as a whole, having regard to the long term and the interests of the company's stakeholders.

Sara Sulaiman joined the Board in 2017 and was nominated by one of the company's three major investors. She brings extensive knowledge, skills and resources from her role with her nominating investor as well as her own personal skills, experience and knowledge of businesses and business sectors similar to our own. She does not receive any remuneration from Southern Water.

During the year, Wendy Barnes served as a representative of the Greensands Holdings Limited board. Wendy resigned from the Board in March 2020. Marykay Fuller was appointed as shareholder representative non-executive director for Greensands Holdings Limited on 15 June 2020. Please refer to page 149 for details of Marykay's background and experience.

Company Secretary

All directors have access to the advice and services of the Company Secretary, Richard Manning, and the Company Secretariat team. The Company Secretary is responsible for ensuring that the Board operates in accordance with the adopted governance framework and that there are good information flows to the Board and its

Pictured
Non-executive directors have experience in a range of areas, including customer service and the environment

committees and between senior executives and the non-executive directors. The appointment and removal of the Company Secretary is a matter reserved to the Board.

Directors have access to the advice and services of the Company Secretary and are able to obtain appropriate independent professional advice in connection with the performance of their duties.

Board independence

Throughout the year the majority of non-executive directors have been independent and independent non-executive directors were the largest single group on the Board in accordance with the Board leadership, transparency and governance principles published by Ofwat.

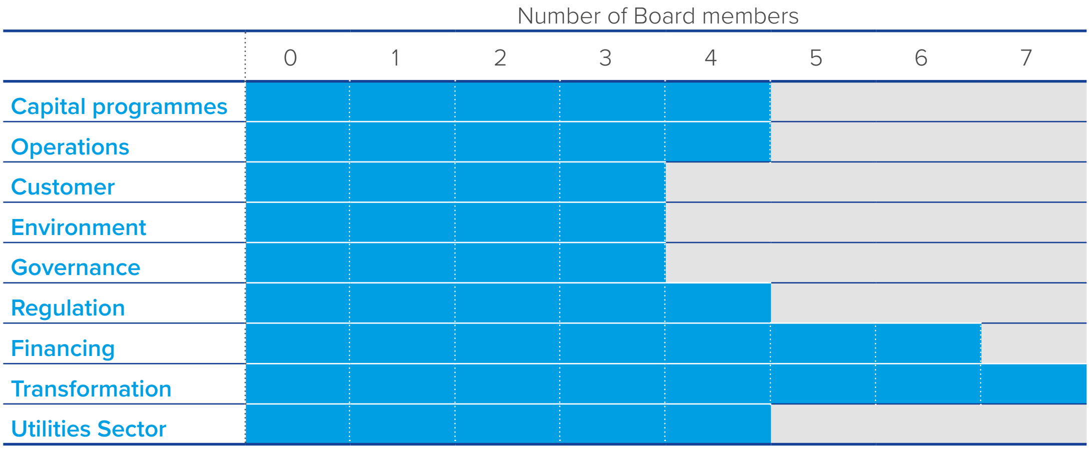
In accordance with best practice, the Board takes into account those matters listed in Provision 10 of the UK Corporate Governance Code as well as any other relevant circumstances or considerations in forming its assessment of the independence of directors. In particular, and as mentioned above, the Board paid particular attention to the risk of Paul Sheffield's independence being endangered as a result of his appointment as acting Chairman.

The Board considers that the independent non-executive directors were throughout the year, and continue to be, independent in character and judgment and persons of standing with relevant experience, collectively having connections with, and knowledge of, the company's area and understanding of the interests of our customers, communities, workforce, suppliers and the environment and how these can be respected and protected.

Conflicts or potential conflicts are governed by the Companies Act 2006. The Board does not have power to authorise conflicts under the company's Articles of Association. If a conflict should arise, the conflicted director takes no part in discussions and may not vote on that issue. During 2019–20, no director declared a material interest at any time during the year in any contract of significance with the company.

Balance of skills and experience of the Board

The Board, as a whole, has an appropriate balance of skills, experience, independence and knowledge of the company, and the Board provides independent support and advice as well as new ideas and healthy challenge. The number of directors with significant and/or material skills, knowledge and experience related to the key areas necessary to deliver the company's strategy is summarised below. Details of the individual Board members' experience are on pages 146 to 149.



Read more about **our Board members** on pages 146 to 149

Corporate governance report continued

2. Purpose, values and culture

A company's values and culture are key components of its ability to fulfil its purpose. The Board's role in setting and monitoring the company's purpose, values and culture is one of its most important tasks

Keith Lough
Chairman

The regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

Establishing Southern Water's purpose

A company's purpose should be the guiding principle that governs all actions within the company. Its strategy must be to deliver its purpose. Fundamentally, the company's purpose is why it exists.

The Board is responsible for establishing Southern Water's purpose and for ensuring that its decisions in respect of its strategy enable it to deliver this purpose. As such, the Board and the company must consult with and take into account the interests of a wide array of stakeholders, including customers, employees, local communities, suppliers, government and investors to ensure that the decisions made with respect to matters such as support for the vulnerable, infrastructure investment, measures to protect the environment and engagement with the public to reduce water consumption support the company's purpose to deliver water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy.

Alignment of Southern Water's purpose with values and culture

The values and culture of a company serve to fulfil the company's purpose. Values dictate how it delivers on its purpose and the company's culture should, in an ideal world, align wholly with the values of the organisation, meaning that decisions are made in a certain way, motivated by certain core principles in order to deliver the company's purpose.

One of the key articulations of the company's values is its Code of Ethics, which sets out the expectations for the company's workforce and its partners. During the year, the Board was heavily involved in the creation and launch of a new Code of Ethics, which serves to make clear the basic expectations of how Southern Water should, indeed, must conduct its business.

The Board played, and continues to play, a key role in setting the tone for the business, and has consistently supported the commitment to embedding ethical business practice throughout the organisation. All Board members signed up to the Code of Ethics, and the Chairman and Chief Executive Officer personally endorsed it.

It is essential that the Board monitors the culture of the company in order to be able to step in and take corrective action where the values and behaviours exhibited do not align with its values and purpose. This has been a key area of focus for the Board in order to ensure that there is no return of the behaviours of the past. The monitoring of the culture of the company is an iterative process and one of the Board's key priorities is to ensure that a robust system of reporting and monitoring is developed and implemented.

Section 172(1) statement

The directors are under a duty to promote the success of the company for the benefit of the members as a whole and in doing so to have regard (among other matters) to the:

- likely consequences of any decision in the long term,
- interests of the company's employees,
- need to foster the company's business relationships with suppliers, customers and others,
- impact of the company's operations on the community and the environment,
- desirability of the company maintaining a reputation for high standards of business conduct, and
- the need to act fairly as between members of the company.

Under the Companies (Miscellaneous Reporting) Regulations 2018, the directors are required to set out how they have had regard to the factors set out above when performing their duty under section 172(1) of the Companies Act 2006.

On page 163 is a summary of the key issues and/or decisions faced by the Board during the year, together with the link to the factor(s) under section 172(1), Southern Water's strategy and Southern Water's principal risks. It should be noted that the company is in the process of implementing the necessary steps to embed consideration of the section 172(1) factors in decision-making throughout the organisation, including improvements in its engagement with its stakeholders and, importantly, how the results of such engagement is communicated to the Board.

Area	How was the Board informed about the views of stakeholders and other interests?	How does this link to Southern Water's strategy?	What risks did the Board consider and/or the decision/ issue seek to address?
COVID-19 Pages 28, 134 **s172(1) and other factor(s) considered:** 172(1)(b) the company's employees; (c) customers and suppliers; (d) the community; (e) high standards of business conduct	Regular updates regarding the latest position with respect to the pandemic within Southern Water and the sector. Attendance by executives at meetings and similar fora with national and local government.	Southern Water remains able to: • provide water and wastewater services • assist vulnerable customers • protect the health, safety and wellbeing of the company's workforce and partners.	Financial and operational resilience (pages 123, 134) Increasing bad debt (page 134) Staff health, safety, wellbeing and shortages (pages 131, 134) Continued supply of services and resource access (pages 129-130, 134) Capital programme (pages 127, 134) Information technology, data protection and information security risks (pages 128, 134)
Ofwat settle-ment and EA prosecution Page 27 **s172(1) and other factor(s) considered:** 172(1)(a) long-term; (c) relations with customers and regulators; (d) impact on communities and the environment; (e) high standards of business conduct	Regular briefings and reports. Continual monitoring of the undertakings given to Ofwat, many of which relate to compensating customers and supporting environmental initiatives. A new Code of Ethics and purpose and values were launched, which were informed by feedback from employees. Regular reports on the general perception of the company. Members engage regularly with regulators and government.	Southern Water remains able to: • improve its transparency of reporting and disclosure of information as well as in respect of the quality and assurance of this information • do the right thing for its customers, making amends to the environment for past wrongs • improve the governance of the organisation.	Compliance with legal and regulatory obligations (page 124) Financial resilience (page 123)
Business plan for 2020–25 Pages 36 to 39 **s172(1) and other factor(s) considered:** 172(1)(a) long-term; (b) employees; (c) suppliers, customers and regulators; (d) impact on communities and the environment	Extensive information regarding the views of key stakeholders, such as customers and regulators was provided during the development of the business plan. During 2019, the Board continued to receive information from key stakeholders, in particular, regulators, throughout the process leading up to the Final Determination by Ofwat in December 2019 and the decision whether or not to accept it. Monitoring of the potential impact of its decisions on the company's workforce and on customers, communities and the environment in particular.	Southern Water remains able to: • deliver water and wastewater services to its customers and can do so over the long term • take steps to improve the local environment for the benefit of local communities and others • improve its operational resilience, particularly in view of the change in weather patterns and climate • offer support to the most vulnerable • accelarate the company's transformation programme to always improve.	Financial resilience (page 123) and the company's going concern and long-term viability (pages 135-137, 204) Climate change and resilience to drought and flooding (pages 120, 125-126) Operational resilience and performance (pages 120, 122) Capital programme (page 127). Meeting the company's regulatory obligations and required levels of performance (pages 121, 132). Delivering on the company's transformation programme (page 133).

Corporate governance report continued

2. Purpose, values and culture

Stakeholder engagement

Throughout the year, the Board has actively engaged with the company's stakeholders, including its regulators, suppliers, investors and government. The company's Chairman and Chief Executive Officer regularly attend meetings with government bodies such as Ofwat, the Department for Environment, Food and Rural Affairs, the Environment Agency and Drinking Water Inspectorate.

The Chief Executive Officer also regularly attends meetings and other events with Water UK in respect of matters pertinent to the water sector as a whole, such as preparations for Brexit and, more recently, the impact of the COVID-19 pandemic on aspects such as operational resilience, workforce absence and availability of key supplies.

Members of the Board with particular knowledge and background in the construction sector also supported the company's management through the re-negotiation of a number of agreements with the company's key construction partners. The directors were able to facilitate the negotiations by giving management a different perspective and this enabled agreement to be reached with the suppliers.

While Southern Water, as a private limited company, is not required to hold an annual general meeting, it was decided to hold an Investor Day for the first time in 2019 in order to give the company's investors a greater insight into the business and its challenges, as well as an opportunity to discuss matters with the company's Chairman and senior executives. The day was held at the company's Peacehaven Wastewater Treatment Works and began with a tour of the site. Following the tour, the company's management presented information in respect of its performance, strategy and the latest update on Ofwat's deliberations on the 2020–25 business plan submitted by the company in 2018. Following positive feedback from the investors, it is proposed to hold similar such events in future.

Living our values

It is essential that the company's values are not simply a set of words and phrases used in company literature and presentations. Southern Water's values must inform every decision made within the organisation and govern the way the company acts. Accordingly, a number of steps have been taken to embed the values within the organisation, including communication of the new values and Code of Ethics and targeted communications exercises focusing on one of the values over a week-long period to highlight examples of how an individual employee or team has 'lived' the company's values.

As part of its Code of Ethics, the company produced an ethical decision-making tool, which, in line with best practice examples from elsewhere, is intended to assist employees (and others) in coming to the ethical answer when faced with a dilemma. This decision-making tool has been widely distributed throughout the company.

During the year, the Board took part in a workshop facilitated by the Institute of Business Ethics. This included working through a specifically tailored dilemma using the decision-making tool for reference.

Monitoring and assessing our culture

It is acknowledged that a key component of ensuring that the company's values are embedded within the organisation is monitoring and assessing the culture of the organisation. The Board has a key role to play in this.

It is acknowledged that such intangibles as 'culture' are difficult to measure, but, based on advice and best practice examples, the company is progressing the development of metrics to provide indicative measures of the company's culture, which will align the company's commitments to do the right thing for customers, businesses, the environment and public health as well as the people who work for Southern Water. Through this initiative, key indicators will be tracked over time to show the impacts of actions and efforts being made to positively influence the company's culture, underpinned by ethical business practice.

A collaborative Cultural Change Group has been established to work across the business and bring best practice and externally-validated principles into consideration.

The Board receives regular updates in terms of the progress in this area and will receive reports on the company's culture once the appropriate metrics and measures have been agreed.

Employee engagement

In line with the UK Corporate Governance Code, as well as the Board's duty under section 172(1) to consider the interests of the company's workforce and to support the Board in its monitoring and assessing of culture, the Board agreed to appoint Kevin McCullough as an independent non-executive director with the remit of communicating the views of the company's workforce (as defined in the UK Corporate Governance Code) to the Board. The scope of this role includes:

- Obtaining and communicating to the Board the views of the company's workforce in respect of matters, including pay and conditions; health, safety and wellbeing; working environment and culture. This enables the Board to give appropriate consideration of the interests of the workforce. Communication methods include: regular meetings with the company's workforce representatives, the HR Director, Head of Communications and Head of Health, Safety, Security and Wellbeing; attendance at workforce events; and visits to operational sites and offices.

- Providing regular reports to the Board.
- At least annually, meeting with the Chair of the Remuneration Committee to enable the committee to take into account the conditions of the workforce when setting executive remuneration policy (in accordance with the UK Corporate Governance Code).

It should be noted that it is expected that this role will evolve with time and as best practice emerges from both within the sector and elsewhere.

In addition, in summer 2019, the company's executive directors and Executive Leadership Team members held a series of roadshows across the company's sites to inform employees about our priorities based on the period between 2020–25, as well as to inform and engage with the workforce about the new purpose and values.

Read more about **employee engagement** on pages 50 to 55

Our culture journey

2017: December
Customer research and 'brand' review.

2018: January
Stakeholder mapping – what do customers think about us?

Spring to summer
Brand propositions test, 70+ colleagues/ partners review.

July
Board holds a session focusing on ethics.

September
Customers review Water for Life. Behavioural expectations launch.

October
Board review. Quick Check decision-making tool released.

November
Values tested at colleague roadshow.

December
Purpose approved by Board.

2019: January
Engagement survey expanded to include culture measures.

February
Water for Life launch. Values approved by Board.

June
Code of Ethics approved by the Board and launched.

October
Values week. Dilemma scenarios released.

November
Board session on ethical business practice facilitated by the Institute of Business Ethics.

2020: January
Ethics and Speak Up training for senior and line management with Institute of Business Ethics.

Pictured
Our Board members regularly spend time with Southern Water teams to better understand the issues they are facing day to day

Case study

Modernising our pension arrangements

In October 2019, Southern Water began a process to modernise its existing pension arrangements

Modernising our pension arrangements allows us to provide more flexibility and options, as well as improve overall efficiency for the future

Ian McAulay
Chief Executive Officer

From 31 March 2020, the defined benefit Southern Water Pension Scheme was closed to future accrual and all active members of the scheme and all other employees were transitioned to a new defined contribution arrangement. The purpose of the change was: to provide more flexibility and options; and to ensure overall spend remains efficient in the future.

The process began in October 2019 with a consultation with all employees and their representatives, including Unison, in respect of the proposal to introduce a single brand new pension scheme for all employees with improved terms compared with the previous defined contribution scheme. All employees were provided with a comprehensive information pack setting out details of the proposal along with access to additional support and information during the consultation period.

Members of the defined benefit scheme were provided with the opportunity to attend face-to-face briefings with the executive team about the changes in their pension arrangements followed by smaller group sessions with the company's pension advisers. Employees were also offered individual meetings with the company's pensions advisers. Following feedback from these meetings, the company agreed to expand the scope of the access to independent financial advisers to members under the age of 54, whereas it had initially been intended to limit this to those over 54 who might want to take advantage of the 'pensions freedoms' available. In addition, the initial 60-day consultation period was extended by 11 days to give employees more time to consider the proposal.

The company consulted with the trustees of the Southern Water Pension Scheme and the scheme's trust deed was amended with effect from 31 March 2020.

330 employee meetings with pensions experts

2,300 employee information packs circulated

Link to governance

The Board agreed to close the defined benefit scheme to future accrual taking into account both the financial impact on the company and the employees. It also approved the replacement of the defined contribution arrangement.

Read more about **our people** on pages 50 to 55

Corporate governance report continued

To ensure the Board remains effective, it must regularly assess its competencies and composition and take steps to address any shortfalls

Keith Lough
Chairman

Nomination Committee members

Keith Lough

Paul Sheffield

Sara Sulaiman

3. Effectiveness

The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.

Board evaluation

In line with the UK Corporate Governance Code and the Ofwat Principles, there is an annual evaluation of the Board in terms of its performance and effectiveness. During 2019–20, the Chairman led the evaluation of the Board, which was conducted by means of a questionnaire sent to all Board members, which asked for their views on matters including: the composition of the Board, its skills and experience; the company's strategy; leadership, including the embedding of the company's purpose, vision and values; communications both internally and externally; and Board meetings and committees, Board resources and administration.

The Board also conducted an evaluation of the Chairman, led by the senior independent non-executive director.

In accordance with best practice from the listed company world, Southern Water conducts an externally-facilitated Board evaluation once every three years.

2018–19
Internal evaluation

2019–20
Internal evaluation

2020–21
External evaluation

Board evaluation outcomes

With the assistance of the Company Secretary, the Chairman collated the feedback received from the Board members and the Nomination Committee of the Board evaluation in March 2020. While responses were positive, there were nevertheless a number of areas requiring attention.

The Board recognised that there had been three recent recruits to the Board and that, based on the company's operational and financial challenges, it was considered appropriate that key areas for development included: customer focus (in particular the new measures for the 2020–25 period), diversity, regulation and the sector, information security and innovation.

In addition, the Board considered that a number of changes should be introduced to the conduct of Board meetings, including: always beginning meetings with a health, safety and environment item; to identify key indicators to form the basis of Board discussion time; and improvements were required to the reports provided to the Board.

The Board considered that the committee structure and compositions were appropriate and that steps should be taken to better utilise the committees' remits. This would free up Board time, which should allow a more focused agenda.

The Board considered that the Chairman had made a good impression during his first few months and were pleased with the changes already introduced or planned. In particular, the good working relationship between the Chairman and the Chief Executive Officer was noted.

Board development

The Board also has access to professional development provided by external bodies and the company's specialist advisers.

This year the Board took part in a cyber security exercise where the Board played through a fictitious cyber incident to improve its awareness of the issues and considerations arising. It also received regular updates on regulatory matters and matters raised by Ofwat, the Drinking Water Inspectorate and the Environment Agency.

In addition, the Chairman, in his annual appraisal of the non-executive directors, considered any specific training needs for the non-executive directors. The Board members, individually, also carry out their own training, such as by attending relevant seminars and workshops, in order to ensure that their knowledge is kept up-to-date.

Nomination Committee Report

Message from the Chair

This year has seen significant changes in terms of the composition of the Board with the appointment of two new independent non-executive directors, a permanent Chief Financial Officer and, indeed, my own appointment as Chair. Given the extent of change, the Board, under Paul Sheffield as acting Chair and supported by independent consultants, took the lead on recruiting the new appointments.

I would like to express my gratitude to Paul for his hard work in this area and for his generous support to me through and beyond our handover.

The Nomination Committee will continue to assess the balance of skills, experience and diversity on the Board, as well as facilitating the process to identify areas of further development of the Board's knowledge and understanding. The appointments of both Kevin McCullough and Malcolm Cooper followed such an exercise carried out during 2018. The committee will keep under review the composition of the Board and its wider advisory network, and monitor its effectiveness, in supporting the company's ambition of creating a resilient water future for customers in the South East.

KGLough

Keith Lough
Chair of the Nomination Committee

Corporate governance report continued

3. Effectiveness

The Nomination Committee plays an important role in evaluating and assessing not just the current composition of the Board and its skills and expertise, but also further skills and expertise it needs

Keith Lough
Chair of the Nomination Committee

Nomination Committee Report

Introduction

The Nomination Committee is responsible for reviewing the structure, size and composition of the Board and, based on the results of this review, for assessing the balance in terms of independence, skills, experience, expertise and diversity on the Board and making appropriate recommendations based on this assessment. The committee leads the process for identifying and nominating candidates to fill independent non-executive director vacancies.

During the year, there were significant changes on the Board. The company's previous Chairman, Bill Tame, resigned on 31 March 2019, which led to Paul Sheffield being appointed as acting Chairman until a successor was found. Following a successful search process led by Paul Sheffield and supported by an external search firm, Ridgeway Partners, I was appointed as Chair on 1 August 2019. Ridgeway Partners has no other connection to Southern Water.

On appointment I met the criteria for independence set out in Provision 10 of the UK Corporate Governance Code.

In July 2019, the Board appointed Kevin McCullough, and in December 2019 appointed Malcolm Cooper as independent non-executive directors to increase the expertise, skills and knowledge of the Board in areas identified as in need of enhancement by the Nomination Committee. Malcolm Cooper was appointed as chair of the Audit Committee.

Although the lack of a permanent Chair precluded the Nomination Committee from meeting formally for part of the year, the members of the Nomination Committee, Paul Sheffield and Sara Sulaiman, led on the search for and appointment of the new directors to the Board, including the production of a short-list of candidates for review and facilitation of meetings between the Board and the individual candidates. Paul Sheffield, as acting Chairman, played a significant role throughout and was supported by the other independent non-executives on the Board.

The Nomination Committee met in March 2020 to review the current composition, skills and expertise of the Board and the outcome of the 2019–20 Board evaluation. More details about the Board evaluation and its outcome can be found on page 168. The committee also reviewed its previous terms of reference and agreed to recommend certain amendments in order to incorporate guidance published by the Institute of Chartered Secretaries and Administrators in respect of the changes introduced by the updated UK Corporate Governance Code.

Board appointment process

In the ordinary course of events, the Nomination Committee would lead the appointment process for a new independent non-executive director based on criteria for skills, experience and knowledge determined as a result of the committee's review of the Board's composition. The committee, usually assisted by an external search firm with no connection to the business, would draw up a role specification and then lead the hunt for appropriate candidates, who would be whittled down to the preferred candidate through a series of meetings between Board members and the candidate(s).

When the committee was satisfied with its preferred choice, it would then recommend the appointment to the Board for approval. Following Board approval, the proposed appointment would also be referred to Southern Water's parent company, Greensands Holdings Limited, for approval as a reserved matter. The candidate is also required to meet with Ofwat under the provisions of the Board leadership, transparency and governance principles. Once the candidate had met with Ofwat and, subject to receipt of the approvals by the Southern Water and Greensands boards, the individual would be appointed as a director on the terms published at **southernwater.co.uk/our-story/our-governance/appointment-of-non-executive-directors**.

The Board, as a whole, supported by the Nomination Committee, appoints those individuals nominated by investors under the terms of the Subscription and Shareholders' Agreement. These candidates are, as with the independent non-executive directors, required to meet with Ofwat prior to appointment.

The current Chair would not chair the committee if it was considering the succession of the Chair.

All Board appointees during the year met with Ofwat prior to their appointment to discuss matters connected to the company and the water sector and Ofwat did not raise any concerns with the company with respect to the proposed appointments.

Director induction

On appointment to the Board, induction coverage is agreed with each appointee and then an appropriate comprehensive and individualised induction is provided. This will include access to and time with the Executive Leadership Team and other key staff, information on the company structure, the regulatory framework of our business, customer service and the operation of assets, strategic plans, financial reports, business plans and our governance framework and holding group structure. In addition, the appointee will meet with the company's external advisers as appropriate. The appointee will also be afforded the opportunity to visit the company's sites.

Board diversity

A key consideration for any decision-making body is the need to ensure that there are diverse views to prevent 'group-think' and, in doing so, ensure that proposals are given sufficient scrutiny and challenge.

In addition, diverse and differing points of view help facilitate innovation and new ways of working, which are crucial for any business. One of the ways to facilitate a diverse range of perspectives is to ensure that the composition of the Board is made up of individuals from a diverse range of backgrounds, industries and professions. However, over and above such diversity of professional experience, a Board must also reflect the communities and other stakeholders served by that business and, as such, there should be representation of different genders and of different ages, ethnic and social groups.

The Board is supportive of the attempts in recent years to ensure greater representation of traditionally under-represented groups in senior leadership positions and seeks to, as a minimum, meet the expectation applicable to listed companies that at least 25% of Board members are female. As at 31 March 2020, three out of 10 (30%) of directors were female.

Approach to succession planning

A considered and thorough assessment of the skills and expertise currently on the Board and what will be required going forward is crucial for the long-term resilience of an organisation. As such, the Board, assisted by the Nomination Committee, has reviewed its current array of skills and expertise as well as what is required in order to ensure that the Board continues to be effective.

For example, during the year, the Board appointed two independent non-executive directors, both were recruited to fulfil specific needs identified by the Nomination Committee in order to improve the skills, knowledge and expertise on the Board. Further details of these appointments can be found below.

Conflicts of interest and time commitments

In order to function as an effective Board, directors must be free of conflicts between the interests of the company and their own interests, or, where such conflicts are unavoidable, appropriate mitigations must be in place. Directors are required to declare any external interests that they or persons closely connected to them might have

Read about the Board's **skills and experience** on pages 146 to 149

Find our **gender pay gap report** on page 50

Pictured
A Board must take into account the interests of the communities the company serves

Corporate governance report continued

3. Effectiveness

24
days per year will be devoted to Southern Water by independent non-executive directors

which could, reasonably, conflict with the interests of Southern Water. Under its Articles of Association, the Board of Southern Water is not permitted to authorise conflicts of interest.

The Board is aware of the potential for conflicts of interest in respect of the directors nominated by the investors and closely monitors this. As statutory directors, these individuals must manage any conflicts arising from their position in accordance with the provisions of the Companies Act 2006.

It is accepted that most directors will also have appointments on other boards (or similar bodies) or, in the case of non-executives, potentially also have full-time executive positions in other companies.

This is no bad thing in and of itself, as it allows for a breadth of experience and enables Southern Water to take advantage of perspectives and expertise from other industries and sectors. However, the director must be able to devote sufficient time to their role at Southern Water and be able to discharge their duties effectively and therefore the number of external appointments of each director is monitored. Under their terms of appointment, independent non-executive directors are expected to devote at least 24 days per year to their role at Southern Water.

The Board is satisfied that all directors were able to devote sufficient time and attention to their role at Southern Water throughout the year.

Appointment of Kevin McCullough Independent non-executive director Appointed: 18 July 2019

Kevin has extensive experience of the utilities sector, particularly in the energy sector. He has significant operational experience of the delivery of large capital programmes.

Link to strategic priorities:

Kevin's background and expertise enhances the Board's knowledge in the areas of operations, including health and safety as well as in respect of capital programmes – both are key areas for the company in terms of its ability to operate as effectively and efficiently as practicable and to deliver on its extensive capital programme, which is so crucial for not only the company's future but also for the customers it serves.

Appointment of Malcolm Cooper Independent non-executive director and Chair of the Audit Committee Appointed: 23 December 2019

Malcolm has significant experience in executive roles in listed companies, particularly in treasury teams, as well as significant experience on audit committees of large FTSE-listed companies, including as chair. He also has many years of experience of the regulated utility sector.

Link to strategic priorities:

Malcolm's appointment not only provides the Board with a permanent Chair for its Audit Committee, but also offers the Board further detailed understanding and expertise of the regulated utility sector, which is key for a company such as Southern Water where such a high proportion of its activities are governed by regulatory requirements and obligations.

Pictured
Board members must take into account the interests of customers in their decision making

Corporate governance report continued

One of the principles, if not the core principle, of corporate governance is the need for companies to be transparent in terms of their performance, and to ensure that the Board is accountable for that performance

Keith Lough
Chairman

Audit Committee members

Malcolm Cooper
Rosemary Boot
Sara Sulaiman

Risk Committee members

Mike Putnam
Malcolm Cooper
Gillian Guy
Kevin McCullough

4. Transparency and accountability

The board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.

One of the key motivations for the adoption of good corporate governance practices, in the wake of the significant corporate failures and scandals of the 1980s and 1990s, was the need to ensure that companies were transparent in terms of their performance through corporate reporting and other information being provided to markets and key stakeholders. In addition, it is necessary for companies to ensure that the Board is accountable for performance in return for the authority given to the Board by the company's owners.

One of the key components of ensuring that companies are transparent is in its disclosures as part of documents and publications such as its financial statements. However, such disclosures and results are only of value if they can be relied upon. Therefore, a company's Audit Committee plays a key role in ensuring that the information published by the company is correct and accurate.

In this, the committee is supported by both internal and external auditors who can give independent assurance of the information presented by management.

In addition to reporting of financial performance and data, a company should also be transparent in terms of the market and environment in which it operates, including the risks that it faces. Accordingly, companies require a clear picture of the risk landscape in which they operate as well as agreement on what level and type of risk the Board is willing to accept as the company goes about its operations.

Audit Committee Report

Message from the Chair

I was appointed as Chair of the Audit Committee in December 2019 and bring with me extensive experience of serving as chair of Audit Committees in FTSE250 listed companies. Prior to my appointment, Rosemary Boot was serving as interim Chair of the committee, following the resignation of the previous Chair in February 2019. I would like to thank Rosemary for her work over this period.

The committee has faced, and will continue to face, a number of challenges, which require thorough consideration. These include: the company's going concern and viability statements in the light of the financeability challenges posed by the Final Determination from Ofwat, as well as the likely significant impact of the COVID-19 pandemic; the need to ensure that the company has adopted a robust framework to assess and monitor the undertakings given to Ofwat as part of the regulatory settlement; and the need to assess and monitor the company's controls in respect of its other non-financial reporting, such as that to the Drinking Water Inspectorate.

As was the case with my predecessor, I will also sit on the Risk Committee to ensure that there are no gaps in the areas covered by the Audit and the Risk Committees.

Malcolm Cooper
Chair of the Audit Committee

Pictured
Malcolm Cooper tours the Balsdean Water Treatment Works

Read more about **operational performance** on pages 58 to 99

Corporate governance report continued

4. Transparency and accountability

The Audit Committee plays a key role in ensuring that Southern Water's data is properly assured and is fit to be disclosed

Malcolm Cooper
Chair of the Audit Committee

Introduction

The work of the Audit Committee is focused on the monitoring and review of the company's internal controls in respect of its financial and non-financial data, as well as the controls put in place to address risk within the business in areas such as legal and regulatory compliance and information governance and information security. The committee also oversees the relationship with the company's external auditor and oversees the work of the company's internal audit function.

A great deal of the committee's attention is focused on the company's annual and interim financial statements, as well as reviewing, assessing and recommending to the Board any relevant judgments and accounting treatments.

As such, throughout the year, the committee received regular reports from the Head of Group Accounts, Group Treasurer, Head of Internal Audit and the company's external financial and non-financial assurers and auditors. The Chief Executive Officer, Director of Risk and Compliance and the company's external financial and non-financial audit partners are all regular attendees at meetings of the Audit Committee. The committee also has access, as appropriate, to external professional advisers.

The committee is comprised of a majority of independent non-executive directors. No executive directors or the Chairman of the Board may be members of the committee, and at least one member of the committee must have recent and relevant financial experience, and at least one member must also have competence in accounting and/or auditing. The Chair of the Risk Committee is also a member of the Audit Committee.

Work of the Audit Committee during the year

Throughout the year, the committee received regular updates on financial reporting, risk, internal audit and the company's regulatory framework. An area of focus continued to be the company's performance in improving its internal controls and reporting in respect of non-financial information.

During the year the work of the Audit Committee focused on the following key areas:

- The company's annual and interim financial statements and going concern and viability statements
- The impact of the implementation of IFRS16
- Non-financial regulatory reporting and improvements in processes and controls, including oversight of external assurance
- Internal controls
- Corporate governance matters, including the new requirement to publish the 'section 172(1) statement'
- Reviewing and monitoring the proposed re-financing activities
- Internal audit reports and plans
- Oversight of internal and external audit, including an assessment of the effectiveness of the external auditor
- Compliance with the company's legal and regulatory obligations in relation to financial and non-financial reporting
- Water and wastewater regulatory compliance
- Speak Up
- Transformation programmes
- The undertakings given to Ofwat as part of the regulatory settlement
- The Environment Agency prosecution and the associated accounting considerations
- The company's information governance and information security, including GDPR and the NIS Directive following the disbanding of the Information Security Committee in September 2019, see page 156 for further details
- The level of non-audit fees paid to the external audit firm.

The committee also reviewed its terms of reference and recommended certain changes to reflect evolving best practice as well as responsibility for monitoring and reviewing the company's resilience action plan and controls as they relate to information governance and information security.

The Chair of the Audit Committee reports to the Board those matters reviewed and discussed by the committee at its previous meeting.

Financial statements

The Audit Committee received and reviewed the financial statements, including the key areas of judgment and estimation uncertainty set out in note 2, and the external audit report from Deloitte regarding the year-end financial statements, considering any items of significant judgment that have been made and comments on the control environment. There were no significant issues raised by Deloitte. The company continues to take steps to address the matters raised by Deloitte's audit and the committee will monitor progress.

Significant issues considered

As identified above, there were a number of areas considered by the committee, which required judgment in terms of how such information would be presented in the financial statements.

The committee discussed at length the need for a financial provision in respect of the extant prosecution by the Environment Agency and their continuing investigations details of which are set out on page 27. Based on extensive input from legal, financial and other advisers, the committee was of the opinion that it is not yet possible to make a reliable overall estimate for the obligation that will arise from this prosecution, notwithstanding the guilty pleas to the charges and the Sentencing Council's Guidelines for Environmental Offences. Given the significance of the matter it was agreed that it would be discussed further by the Board; the Board agreed with the committee that there will be a liability associated with the charges and we have therefore recognised a provision of £1.0 million reflecting a minimum fine amount and an allowance for legal costs. The court has a very broad discretion to assess the level of the fine and the provision is not intended to indicate or predict any particular level. The committee and the Board will continue to review the level of provision made as more information becomes available. The committee and the Board also noted the continuing separate investigation by the Environment Agency.

Other areas of significant consideration were the company's going concern and viability statements, particularly in the context of the financial challenges posed by the Final Determination from Ofwat, the regulatory settlement with Ofwat reached during the year, Environment Agency prosecution and the impact of the COVID-19 pandemic on the impairment of trade receivables. The committee also considered the judgments regarding un-billed revenue and the valuation of certain of the group's derivatives in the financial statements following the changes to some of the group's swaps in 2019. Furthermore, the committee considered the controls in respect of the company's IT systems and processes.

Following discussion and with input from accounting and financial advisers, it was considered appropriate to prepare the financial statements on a going concern basis and it was considered appropriate to make the viability statement out to 2030, so based on two five-year business plan cycles.

The committee reviewed the proposed update to the base Prospectus and the programme in early 2020 to issue bonds by Southern Water Services (Finance) Limited, which successfully concluded in May 2020. In particular, the committee focused on the information required in the Prospectus to reflect the receipt of the Final Determination from Ofwat in December 2019, and consequent impacts on the company's financial position as well as the concerns arising from the COVID-19 pandemic, including the potential for increased bad debts and additional expenditure as a result of the impact of the pandemic on the company's operations. Please refer to page 28 for further details of the company's response to COVID-19 and its impact.

The committee also noted that the company had incurred a number of significant one-off costs as they relate to the company's transformation programme, including those relating to the outsourcing of the customer services team to Capita and the closure of the defined benefit pension scheme to future accrual. The committee considered these costs and their presentation in the context of the Financial Reporting Council's guidance and views on 'exceptional' costs, and it was agreed that no such exceptional costs would be presented in the financial statements.

Our Ofwat performance commitments

The company has an external non-financial assurer to independently confirm its non-financial reporting to Ofwat and that there is a robust system of internal controls in place for non-financial regulatory reporting, such that information in the Annual Performance Report fairly represents the company's progress and delivery of its promises. The assurer attends meetings of the Audit Committee and reports formally the results of its assurance.

Section 19 undertakings

As part of the regulatory settlement reached with Ofwat during the year, the company agreed to certain undertakings to implement improvements in the business in areas such as culture and robustness of non-financial reporting, as well as to recompense current and former customers. The Audit Committee is responsible for monitoring and reviewing the controls and assurance put in place by management in respect of these undertakings and receives regular reports from management about the progress against the agreed action plans and from the company's external assurers in respect of such progress.

Internal controls

The committee keeps under review the company's internal financial controls systems that identify, assess, manage and monitor financial risks along with other internal control and risk management systems and, as such, receives regular reports from both Internal Audit, external audit and any external assurers appointed by the company to review particular areas of concern.

The committee also receives a regular report of any incidents of fraud or bribery, including the actions taken to investigate and respond to the incidents and information on potential incidents of wrongdoing under investigation.

The committee receives updates on matters identified via the company's Speak Up policy. As

Read more about **performance commitments** on pages 58 to 61

Corporate governance report continued

4. Transparency and accountability

disclosed in last year's report, the Audit Committee reviewed the adequacy of the company's procedures for its employees and contractors to raise concerns in confidence about possible wrongdoing and a number of improvements were made to the company's arrangements. Such changes have also been required as part of the undertakings given to Ofwat.

There were no material incidents reported via Speak Up during the year.

The committee received progress reports and independent assurance of the improvement programmes in respect of the company's non-financial reporting. Details of the internal control framework, including the main features of Southern Water's internal control and risk management systems, can be found on pages 116 to 119.

Oversight of internal audit and external audit

The Audit Committee is responsible for overseeing both the work of the Internal Audit function and for the management of the relationship with the external auditor and external non-financial assurer. The committee reviews the performance of external auditors on an annual basis to ensure that they remain effective.

In accordance with best practice, the committee held discussions with both the internal and external auditors and the external non-financial assurers in the absence of management and the Audit Committee will continue this practice.

Internal audit

The Head of Internal Audit and the team report on a day-to-day basis to management on the effectiveness of the company's systems of internal controls and the adequacy of these systems to manage business risk and to safeguard the company's assets and resources.

The committee received regular reports throughout the year from Internal Audit in respect of its work undertaken during the year in accordance with the internal audit plan agreed with the committee at the commencement of the year. These reports included the findings of reviews of the company's joint billing initiative with South East Water, reviews of certain of the company's key supply partners as well as a focus on overdue internal audit actions. The reports from Internal Audit are a key element of the assurance received by the committee on the company's controls. If changes are required to internal audit action dates for medium and high actions, the action owners are required to attend the committee and explain why such changes are required and to seek the committee's approval.

The committee reviews, at least annually, the level of resources and the budget of the Internal Audit function. The Head of Internal Audit is able to raise any issues with the committee or its Chair at any time during the year.

Risk

The Audit Committee is responsible for supporting the Risk Committee's work in overseeing and challenging the effectiveness of Southern Water's approach to risk management. This includes responsibility for monitoring the effectiveness of the company's systems of internal controls and for endorsing an internal audit plan that is informed by principal risk exposures, including overseeing targeted reviews of key risk and control areas.

The committee is also responsible for maintaining an assurance landscape that has integrity, independence and reliability.

External auditor

Deloitte LLP was appointed as the company's auditor for the year ended 31 March 2012, following a tendering process carried out in 2011. The current audit partner, Anthony Matthews, rotated onto the audit for the 2016–17 annual report.

The Audit Committee reviews the external auditor's effectiveness each year, seeking views from the committee and management via a questionnaire, and would report to the Board any concerns over the continuation of the appointment.

The committee undertakes an annual review of the external auditor's independence and objectivity within the context of the applicable regulatory requirements and professional standards. This includes an assessment of the impact of any non-audit work carried out by the audit firm on the auditor's independence and objectivity. The committee monitored the ratio of audit fees to non-audit fees and approved non-audit services and fees paid to Deloitte during 2019–20.

Details of the amounts paid to Deloitte for these services are provided in note 6 to the financial statements.

In accordance with listed company practice, the external audit contract will be put to tender at least every 10 years. A tender process would also be initiated if there were any concerns about the quality of the audit or the independence and objectivity of the auditor. There are no contractual obligations that act to restrict the Board's choice of external auditor, although the Board is mindful of non-audit services currently being undertaken by other potential external audit providers. The next tendering exercise is expected to take place in respect of the year ending March 2022.

Risk Committee Report

Read more about **our principal risks** on pages 120 to 134

Message from the Chair

This has been the first full year of the Risk Committee's operation and we continue to refine the remit and scope of the Risk Committee and, importantly, aim to ensure that there are no gaps between the remit of the Audit Committee and the Risk Committee. I am greatly assisted in this by the Audit Committee chair also being a member of the Risk Committee. In addition, I sit as a member of the Audit Committee. This was a deliberate approach agreed at the outset so that we have full knowledge, visibility and participation in the activities of both committees.

The company's risk exposure continues to evolve and the recent COVID-19 pandemic has shown the value of thorough consideration of risk and adoption of robust mitigation strategies.

The committee has continued to focus on challenging management to improve its articulation and presentation of risks, and we have seen significant improvements over the year. Health, safety, security and wellbeing of the company's workforce also continues to be a priority and I was pleased to welcome Kevin McCullough as a member of the committee, as he brings significant operational experience from the energy sector, which is pertinent to Southern Water.

I am acutely focused on ensuring that the work of the Risk Committee supports the Board's overall responsibility for setting the Company's risk agenda and appetite.

Mike Putnam
Chair of the Risk Committee

Pictured
The recent COVID-19 pandemic has shown the value of thorough consideration of risk

Corporate governance report continued

4. Transparency and accountability

Southern Water operates in an environment of significant risks. It is crucial that the Board has a clear view of the risks faced by the company over the longer term

Mike Putnam
Chair of the Risk Committee

Introduction

The work of the Risk Committee is focused on advising the Board on its overall risk appetite, tolerance and strategy as well as overseeing and advising the Board on current risk exposures and future risk strategy. Risk remains a matter for the Board as a whole. During the year, the committee revised its terms of reference to also incorporate responsibility for advising the Board on the impact of risk on the company's resilience. At the same time, the committee advises the Board on how the company's resilience strategy should address risk.

The committee also reviews, advises on and makes recommendations in respect of health, safety, security and wellbeing in the business.

As such, throughout the year, the committee received regular reports from the Director of Risk and Compliance, the Head of Health and Safety. The Chief Executive Officer, Chief Financial Officer, Director of Risk and Compliance and Head of Health, Safety, Security and Wellbeing are all regular attendees at meetings of the Risk Committee. The committee also has access, as appropriate, to external professional advisers.

The committee is comprised of a majority of independent non-executive directors. The Chair of the Audit Committee is also a member of the Risk Committee and, to ensure no gaps in the remits of the two committees, the Chair of the Risk Committee is a member of the Audit Committee.

Risk

Throughout the year the committee received reports on significant risks faced by the company and the appropriateness of controls and mitigation measures in respect of such risks. Due to its key importance of the delivery of the company's business plan for 2020–25 to not only the business itself, but also to Southern Water's customers, local communities and the environment, one of the key roles of the committee is to ensure that the risks associated with the plan are tracked, monitored and discussed on an ongoing basis. In reviewing these risks, it has been agreed that the Risk Committee and the Board will carry out a review of the company's previously agreed risk appetites in areas such as financeability, transformation and IT. The committee started its work in respect of this matter toward the end of 2019–20 and will continue to advise the Board on this area during 2020–21.

The committee was a key consultee and was heavily involved in the development and recommendation of the company's Resilience Action Plan to the Board, which sets out a number of steps necessary to ensure that the company is able to continue to deliver the essential services it provides even with occurrences such as extreme weather events. Subsequent to the plan's approval by the Board, the committee received regular updates in respect of the company's Resilience Action Plan. Owing to the key importance of the delivery of this plan to enhance the company's resilience, it was considered appropriate that the remit of the Risk Committee should also be expanded to encompass advising and overseeing matters relevant to the company's resilience.

One of the significant improvements during the year was the introduction of the new taxonomy adopted by management with the encouragement of the Risk Committee, in order to be able to articulate the company's risks and the potential exposure in a clear and understandable manner. In addition, the committee reviewed and provided advice in respect of the improvement of Southern Water's Risk Policy and the governance of risk across the business, including at the Executive Leadership Team.

Due to its increasing significance and owing to the fact that Southern Water holds a vast amount of personal data, the committee also receive regular reports on information security and information governance risks. it was agreed that the committee's terms of reference should explicitly refer to its role in monitoring the risks in these areas. Prior to September 2019, the Board delegated responsibility for monitoring and advising on these areas to a specific Information Security Committee. It was always envisaged that this committee would be temporary until such point as the areas within its remit could be absorbed by the Risk and Audit Committees.

Toward the end of the year, the Risk Committee received an update from the Director of Risk and Compliance in respect of the risk of COVID-19, including the steps being taken by the company to monitor the situation. Following the end of the year, the Board has continued to receive regular updates in respect of this area.

The committee reviewed and recommended to the Board the disclosures in respect of the company's principal risks as can be found on pages 120 to 134.

Health, safety, security and wellbeing

During the year, the committee received reports on the company's health and safety performance, including significant near misses, lost time and non-lost time injuries, accidents and incidents. The committee received updates on safety improvements introduced following serious incidents, as well as updates in respect of the company's tracking of training certification. Furthermore, the committee discussed plans for improvement of the management of health and safety as well as employee physical and mental wellbeing. In particular, the committee reviewed the proposals to improve the reporting of hazards and 'near misses' as an important aspect of embedding a robust health and safety culture within the organisation.

Read more about our **health and safety risks** on page 131

Read more about **our Resilience Action Plan** on page 34


In progress
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Directors’ Remuneration Report

Remuneration Committee Report

An important component of delivering the right outcomes for the company and its stakeholders is the need for appropriately designed executive remuneration

Paul Sheffield
Chair of the Remuneration Committee

This report details the activities of the Remuneration Committee for the period to 31 March 2020. It sets out the remuneration policy and remuneration details for the executive and non-executive directors of the company. It has been prepared in accordance with our Code, the guidance issued by Ofwat in Regulatory Accounting Guidance (RAG) 3.11 and, where relevant for a non-listed company, has taken into account the requirements of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

Chairman’s annual statement

I am pleased to present the Remuneration Committee’s report for the year to 31 March 2020.

The key purpose of the Remuneration Committee is to develop and implement incentive and retention structures that allow Southern Water to drive performance improvement, align our employees to deliver the outcomes and expectations of our customers and create value for our shareholders.

Summary of the year

Throughout the year, Southern Water has put customers at the heart of its decision-making and has worked hard to reflect the desires of our customers in the five-year business plan recently agreed with Ofwat. Customer views and expectations have been reflected in the remuneration policies and practices used throughout the organisation and the application of these principles has been governed by the Remuneration Committee, reporting to the Board and in consultation with shareholders. Following Ofwat’s consultation with the company on executive remuneration, the Board and Remuneration Committee have taken measures to adjust targets for 2020–21 to fully reflect their views.

The terms of reference and membership of the Remuneration Committee were reviewed in the year and the majority of members remain independent non-executive directors.

Remuneration outcomes for the 2019–20 year

2019–20 was another critical period for the company with the new executive team continuing to deal with legacy issues, driving improvements to current performance and transforming the organisation ready for the start of the new AMP. In last year’s report, we signalled the potential for penalties to be levied against us for historical breaches and we have indeed seen a very significant penalty imposed on us by Ofwat and we have also agreed a package of reparations to our customers to make good any damage caused in prior periods. It is pleasing to see how well current management – who were not in place at the time of the failings – have responded to the challenges and have made excellent progress in improving the business for the future. We still await the outcome of the legal proceedings instigated by the Environment Agency for these historical breaches.

The Key Performance Indicators (KPIs) chosen to measure performance for the year, have been thoroughly examined and the calculated outcome against these KPIs has been reviewed by the Remuneration Committee, taking into consideration the overall performance of the company in creating the efficiencies needed as we enter the next five-year period. As such, a bonus was awarded at 60% of maximum for all levels of the organisation. Individuals can earn a small amount above or below this overall amount, based on their own personal performance and contribution to the company.

Under the rules of the scheme, the bonus is awarded to an Individual’s ‘Deferred Incentive and Retention pool’ and normally no more than 50% of that pool is actually paid out in-year. Details of how the plan works are covered later in this report.

Remuneration for 2020–21 year

For 2020–21 our updated remuneration policy complies fully with Ofwat's code on executive remuneration and at least 50% of variable pay will be directly linked to customer outcomes, and in practice this will be significantly more. The Executive team has not taken a base pay rise for the year, this being the second year in a row for the CEO. The Chairman and CEO have voluntarily made personal contributions to the communities we serve, through donating 10% of their salary for the first three months of the period, recognising the challenges that so many people are facing with the COVID-19 pandemic.

Bonus schemes are intended to reward the executive for achieving certain financial and non-financial targets, with improving performance leading to increased reward. The Board considers that the Final Determination awarded to the company by Ofwat is very demanding and, as such, an execution plan (EP) has been drawn up that aims to achieve the financial and other performance constraints required. Outperformance will be extremely challenging and the Executive has been set a base performance target of achieving the needs of the EP, with a stretch target beyond the EP, enabling potentially larger bonus earnings.

The arrival of COVID-19 has emphasised the essential service that we provide to our customers and communities and all of our employees remain fully engaged, with no employees being furloughed or made redundant as a result. Our support for vulnerable customers, already excellent, has been extended to many more people and we are proud to be able to do so.

At this stage, it is not possible to be precise on the impact of COVID-19 on business performance and, as a consequence, on remuneration decisions. The significant majority of bonus targets for 2020–21 will not be impacted, but for those that are, the committee will need to use its discretion – within the rules of the scheme – when reviewing performance next year to ensure any awards are appropriate and fair to employees, shareholders and customers.

The Remuneration Committee remains committed to ensuring that we run a modern, forward-looking bonus scheme that is flexible enough to cope with changes in market conditions and the long-term health and performance of the company.

Paul Sheffield
Chair of the Remuneration Committee

10 July 2020

Directors' Remuneration Report continued

Remuneration Committee Report

Read more about **our Board** on pages 146 to 149

Remuneration Committee members

Paul Sheffield

Rosemary Boot

Sara Sulaiman

The Remuneration Committee of Southern Water

The Remuneration Committee has the responsibility for setting the remuneration policy and structure of the executive directors and senior management. It is also responsible for setting the remuneration of the Chairman. The committee has defined terms of reference, which are published at **southernwater.co.uk/board-committee-terms-of-reference**.

We recognise that the independent non-executive directors have an important role to play in determining and challenging remuneration policy and practice. In order to reflect this, the independent non-executive directors are a majority on the committee and neither executive directors nor the Chairman are permitted to be members of the committee.

Following his appointment as a non-executive director with the remit for communicating the views of the workforce to the Board, it is anticipated that Kevin McCullough will attend at least one meeting of the committee per annum as an invitee in order to inform the committee's discussions in respect of executive remuneration.

Only committee members are entitled to attend meetings, with the Managing Director (accountable for People) and the Chief Executive Officer attending by invitation. The Company Secretariat acts as secretary to the committee.

No attendee participates in discussions regarding their own remuneration.

Committee activities and membership for the year

The table below sets out the members of the committee for the year, attendance at meetings and the key activities undertaken at each meeting.

Members	Meeting 1 1 May 2019	Meeting 2 22 May 2019	Meeting 3 27 November 2019	Meeting 4 26 February 2020
Paul Sheffield (Chair)	✔	✔	✔	✔
Rosemary Boot	✔	✔	✔	✔
Sara Sulaiman	✔	✔	✔	✔
Key activities undertaken	• 2018–19 Management corporate objectives outturn • 2019–20 Management corporate objectives targets • Remuneration Policy • Non-executive director fees review	• 2018–19 Management corporate objectives outturn • CEO and Executive Team remuneration review • 2019–20 Management corporate objectives • Remuneration Policy	• Remuneration Policy • 2020–21 Management corporate objectives look ahead • Executive Pensions Policy review	• Gender Pay Gap Report • 2020–21 Management corporate objectives • CEO pay ratio reporting

REMUNERATION POLICY APPLICABLE IN YEAR (UNAUDITED)

Purpose

This remuneration policy applies to all Southern Water employees. The Board of Directors has adopted the remuneration policy at the recommendation of the Remuneration Committee. This policy applies to remuneration earned from 1 April 2018 to 31 March 2020.

Providing transparent alignment between performance-related pay and quality customer outcomes

The policy reflects the Board's commitment to being open and transparent in respect of executive pay. In line with the expectations set out in Ofwat's 'Putting the sector back in balance' the Board has also committed during the year to ensuring that performance-related executive pay has a clearer alignment to delivering in the interests of customers as well as providing sustained and long-term value creation for shareholders by:

- setting stretching performance targets that are based on the performance ambitions set out in our business plan
- ensuring that targets and metrics have a substantial and demonstrable link to stretching performance delivery and quality outcomes that align with the interests of customers
- transparently reporting how performance-related executive pay is linked to the underlying performance of the company
- embedding behavioural competence built around company values to underpin the cultural change and instil a way of working that will increase employee engagement and therefore productivity
- ensuring employees feel encouraged to create sustainable results and that a clear link exists between customers, shareholders and employees' interests
- aligning pay to the market-median position, recognising the need, from time to time, to implement specific arrangements for certain individuals
- ensuring employees are offered a competitive and market median-aligned remuneration package, which balances the fixed and variable remuneration components according to job role
- ensuring that Southern Water is able to attract, develop and retain high-performing and motivated employees in a competitive market.

The table on page 187 summarises the elements of our executive directors' remuneration package and our policy for each item.

Governance, risk management and rigorous application

The Board applies sound and effective risk management principles to ensure that the policy is rigorously monitored and applied through:

- the application of good corporate governance by taking into account regulatory requirements and, among others, the UK Corporate Governance Code and any corporate governance principles issued by its regulator, Ofwat, from time to time
- a stringent governance structure for setting relevant and stretching goals, which are aligned to customer outcomes, and communicating these goals to employees
- clear alignment with our business strategy, company values, priorities and long-term goals
- the Remuneration Committee consists of two independent non-executive directors and one non-executive director and no executive directors, which avoids any conflicts of interest and aligns the principle of protection of customers and the interests of investors
- a commitment to the transparent reporting of executive pay within our Annual Report and Financial Statements, and any other channels as appropriate in accordance with legal and regulatory requirements, including the Ofwat Board leadership, transparency and governance principles
- a commitment to transparently report any changes to the policy, including the underlying reasons, within the Annual Report and Financial Statements, and any other channels as appropriate
- an annual review of the constitution and terms of reference of the Remuneration Committee to maintain its operational effectiveness and publishing these on our website for transparency
- ensuring the ongoing effectiveness of the Board and its committees through regular external and independent evaluation.

Applying stretching targets linked to customer outcomes

The Board sets stretching bonus targets linked to outcomes for customers that require stretching performance. For 2019–20, in-year targets included customer experience delivery, efficient customer service delivery, Totex performance and delivering customer commitments. These metrics were also used throughout the organisation so that all company employees are incentivised to achieve stretching levels of customer service. Of the short-term incentives for 2019–20, 75% were closely aligned with customer expectations and needs. More detail can be found on page 192 of this report.

Directors' Remuneration Report continued

Remuneration Committee Report

Executive remuneration components

Executive remuneration comprises both fixed and variable elements with the four remuneration components detailed as follows:

- Fixed remuneration (including fixed supplements)
- Performance-based remuneration (variable percentage of salary)
- Pension schemes, where applicable
- Other benefits in kind (e.g. car allowance and private medical cover).

The fixed remuneration is determined on the basis of the role and position of the individual employee, including professional experience, responsibility, job complexity and local market conditions and is frequently benchmarked against industry peer groups.

The performance-based remuneration motivates and rewards those employees who significantly contribute to sustainable results, perform according to set expectations for the individual in question, strengthen long-term delivery of quality outcomes for customers and generate income and shareholder value.

The Board of Directors has determined a maximum percentage of performance-based remuneration relative to the fixed salary remuneration for the executive management positions. The table below shows the maximum limit on variable remuneration (excluding any pension allowance) for the CEO and CFO for 2019–20. The maximum percentages are made up of short-term, long-term and personal elements as follows:

	CEO	CFO
Short-term range and maximum:	0% – 80%	0% – 64%
Long-term range and maximum:	0% – 100%	0% – 75%
Personal objectives	0% – 20%	0% – 16%
Total maximum variable remuneration	0% – 200%	0% – 155%

Performance-based remuneration is disbursed as a cash bonus. The total of any executive bonus earned during the year is added to the individual's bonus pool carried over from prior years. Each year, 50% of the pool is paid out in cash, with the remaining 50% deferred and retained as the bonus pool for future years. Rules of the scheme include bonus recovery provisions, which allow for the possibility of a reduction or clawback of bonuses already earned, or those deferred, to incentivise sustained, long-term executive performance.

Executive directors are covered by an insured four times salary 'death in service' lump sum benefit and a contribution to a personal pension arrangement. The CEO receives an 18% of base salary contribution rate and the CFO receives 15%. Where retirement savings have exceeded the Lifetime Allowance (as defined by HMRC for their circumstances) the employer contribution may instead be taken as a pay supplement, subject to the relevant tax and National Insurance deductions.

The policy is that remuneration should be market-competitive relative to other comparable companies, with a significant proportion being performance-related. The performance-related element is only paid out if stretching short-term and long-term targets are achieved that benefit both customers and shareholders. In setting the remuneration policy for executive directors, the committee takes into account the remuneration practices found in other UK companies of a similar size or operating in the same sector. It also ensures that the remuneration arrangements for the executive directors are appropriate when compared with those for other senior executives and the wider workforce. Attracting and retaining first class leadership is vital to the long-term success of the company.

In particular, the committee is kept informed on a regular basis of the following, which it uses to set executive remuneration policy:

- The level of salary increase for the general employee population
- Company-wide benefit provision and any proposed changes
- Overall spend on management bonus arrangements.

An investor representative non-executive director sits on the committee and is closely involved in setting remuneration levels, monitoring the performance of the executive directors, agreeing payments and approving any changes to executive reward packages. This involvement ensures that shareholders play a key part in shaping remuneration policy and decisions. Along with the independent non-executive directors they ensure that the link between pay and performance is closely managed.

To ensure that our remuneration practices remain competitive, the committee periodically calls upon experienced specialist consultants. During the year, the committee also received some guidance and market practice information from external, independent advisers, PwC.

Remuneration components

Element of remuneration	Purpose and link to strategy	Policy and approach	Maximum opportunity 2019–20
Base salary	Takes into account experience and personal contribution to our strategy and performance. Attracts and retains executives of the quality required to deliver our strategy.	• Reviewed annually with changes effective from 1 July if applicable. • Consideration given to individual and company performance. • General pay increases to all employees taken into consideration. • Aim to pay within a mid-market range, but may pay higher salaries to attract and retain executives of the right calibre or for out-performance by the individual or company. • Referenced against UK companies of a similar size, utility companies and other water companies.	Base salary increases are applied in line with the annual review.
Incentive and Retention Plan	Drives and rewards performance against stretching financial, customer and operational KPIs, which are directly linked to business strategy. It is also structured to provide retention incentives to executives.	• Details of the operation of the plan are shown on page 188. • Performance metrics and targets are established annually by the Committee, making sure they are sufficiently stretching while also recognising the nature and risk profile of the company. • Where applicable, between 0% and 80% of the opportunity available for each measure is created for achieving a threshold target. 50%-100% is awarded for achieving the actual target, with stretch targets creating between 100% and 150% for achieving outstanding performance. • The Committee has discretion to amend or withdraw payments based on the consideration of other factors which could significantly affect business performance. • Awards made under the plan are disclosed on pages 191 to 193.	200% of salary for the CEO 155% of salary for the CFO
Pension	Defined contribution scheme minimises the risk to the company associated with defined benefit pension plans.	• A company contribution into a defined contribution scheme, and/or • A cash allowance in lieu of pension.	CEO 18% of salary CFO 15% of salary
Other benefits	Provides market competitive benefits.	May consist of: • Car allowance • Health cover • Disturbance or relocation allowances.	Based on individual circumstances.

Directors' Remuneration Report continued

Remuneration Committee Report

Notes to the policy table

Directors' pay

Executive directors who served during the 2019–20 year are shown below:

Ian McAulay	Chief Executive Officer
Sebastiaan Boelen	Chief Financial Officer (appointed as Interim Chief Financial Officer from 14 December 2018 and appointed as permanent Chief Financial Officer from 1 September 2019)

Details are given on page 190 of the amounts paid to them in the year ended 31 March 2020.

Operation of the Incentive and Retention Plan

The Incentive and Retention Plan operates as follows:

1. **Annual Contribution**: Each year, participants have the opportunity to earn an annual bonus contribution based on performance against targets pre-determined by the Board. This is then added to the 'bonus pool'.
2. **Annual Pay-out**: Each year, following the Annual Contribution, 50% of the total amount in the 'bonus pool' is paid out to participants in cash.
3. **Deferred value**: Each year, the remaining 50% of the 'bonus pool' is carried forward. These deferred amounts will therefore roll over to the subsequent years.
4. **Repeat**: The following year, the process repeats, and continues for an indefinite period of time. This serves to increase the retention incentive and also give the Remuneration Committee a long-term view of sustainable outcomes for the company, customers and shareholders.

Measures used in the Incentive and Retention Plan

During the year, the Remuneration Committee identified and operated both short-term, in-year and critical long-term value performance measures in the Incentive and Retention Plan. Short-term, in-year performance measures for 2019–20 were focused on issues that affect customers such as:

- Customer satisfaction, as measured by our C-MeX performance
- Delivery of our business plan commitments, as measured by our Asset Health ODI performance
- A number of other measures aimed at reducing our operating costs, which ultimately helps us to reduce bills for customers.

Long-term performance conditions for 2019–20 included a number of KPIs, all of which underpinned long-term performance improvement.

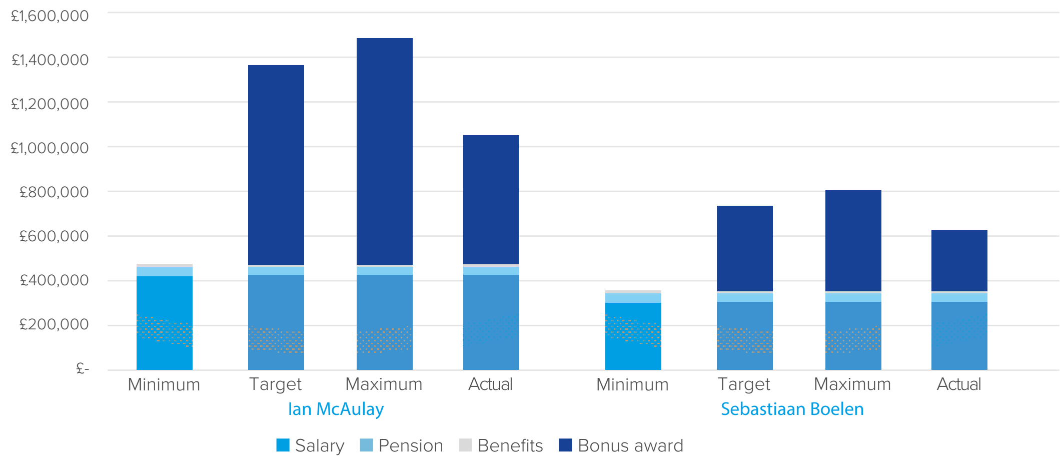
An executive leaving the company will only be eligible for release of any deferred incentives if they are deemed as a 'good leaver' and meets specific targets prior to departure.

An individual is usually deemed to be a 'good leaver' if they leave the company in the following circumstances:

- Retirement
- Redundancy
- Disability
- Death
- Other circumstances which the committee deems appropriate.

Remuneration scenarios for 2019–20

The following chart sets out the remuneration scenarios payable to the executive directors for various levels of performance as well as the actual remuneration for 2019–20.



Notice periods for joiners and leavers

The table below sets out the contractual notice periods for the executive directors. If the notice period is worked, no termination payment is payable, otherwise a payment up to a maximum equivalent to the notice period of basic salary, pension and car allowance is payable.

	Notice period
Ian McAulay, CEO	Twelve months by either party
Sebastiaan Boelen, CFO	Six months by either party

Directors' Remuneration Report continued

Remuneration Committee Report

ANNUAL REMUNERATION REPORT

Single figure of remuneration for 2019–20 (audited)

Details of the remuneration received by the executive directors are shown below. The figures shown are the amounts paid or awarded for each of these financial years. Base salary is generally reviewed in July each year and so the amounts reported for base salary reflect a part-year effect of any pay award granted.

£'000		Base salary paid	Benefits	Relocation	Annual Bonus/ Incentive and Retention Plan[1]	Total	Pension related benefit	Total including pension
Ian McAulay	2019–20	435.0	17.3	–	538.1	**990.4**	78.3	**1,068.7**
	2018–19	431.3	16.8	76.2	570.3	**1,094.6**	77.6	**1,172.2**
Sebastiaan Boelen[2]	2019–20	290.5	12.8	–	277.0	**580.3**	43.6	**623.9**
	2018–19	85.0	4.0	–	75.0	**164.0**	12.8	**176.8**
William Lambe[3]	2019–20	–	–	–	–	**–**	–	**–**
	2018–19	211.3	7.2	0.8	–	**219.3**	31.7	**251.0**

[1] The amount reported is added to the bonus pool for the year as shown in the table under Incentive and Retention Plan on page 193. That table also provides details of payments made from the bonus pool and that carried forward to future years.

[2] Sebastiaan Boelen was appointed to the Board on 14 December 2018.

[3] The amounts reported relate to William Lambe's service as an executive director from 1 April 2018 to 14 December 2018. The additional table below shows further payments made for the period between 14 December 2018 and 4 May 2019.

£'000	Base salary paid	Benefits	Pay in lieu of notice	Annual Bonus/ Incentive and Retention Plan	Total	Pension related benefit	Total including pension
William Lambe							
Dec 18 to May 19	116.9	4.0	–	–	**120.9**	17.5	**138.4**
Pay in lieu of notice	–	–	189.3	–	**189.3**	27.9	**217.2**

William Lambe resigned as a director of the Board on 14 December 2018 and continued working on specific projects and to ensure effective handover until 4 May 2019. He received a payment in lieu of notice following his departure from the business on 4 May 2019 for his contracted notice period to 14 December 2019. The payment comprised £183,065 for base salary and £6,225 for car allowance.

Notes to the single figure of remuneration (unaudited)

Base salary

The base salary for Ian McAulay was reviewed on 1 July 2019 and, at Ian's request, which was supported by the Board, remained unchanged from the 1 July 2018 level of £435,000. The base salary for Sebastiaan Boelen was reviewed on 1 July 2019 and increased from £275,000 to £280,500 in line with the increases given elsewhere in the company's workforce. On his appointment as permanent Chief Financial Officer in September 2019, it was agreed that Sebastiaan Boelen's base salary would be £300,000 per annum. Salary was paid monthly via PAYE.

Incentive and Retention Plan (short and long-term targets)

The performance measures agreed by the committee for 2019–20 were:

- Operating costs (opex) – maintaining operating costs within budgeted levels and help reduce customer bills
- Capital expenditure (capex) – delivery of our investment plan within budget
- Asset Health Output Delivery Incentives – delivery of the operational promises made to customers as part of our business plan
- Capital Programme (Regulatory dates) – delivery of our investment plan on time, ensuring we meet our commitments to customers and Regulators
- Efficiently delivering customer service – efficient delivery of services to customers in line with the industry
- C-MeX – incentivises excellent customer experience for residential customers across the retail and wholesale parts of the value chain
- D-MeX – incentivises excellent customer experience for developer services (new connections) customers
- Customer affordability/vulnerability measures – a measure of the support packages we are putting in place for vulnerable customers
- Written complaints per 10k – improving our customer service performance
- Capex efficiency – forecast view of future efficiency enabled through business change
- Opex – development and delivery of operating cost efficiency initiatives
- Progress against PR19 Maturity Assessment – progress against the commitments agreed with Ofwat to ensure we robustly manage performance to avoid further regulatory breaches
- Gallup Q12 people rating – colleague engagement
- Data accuracy – ensuring transparent and open data quality
- Cash collection – cash receipts from measured and unmeasured customers, ensures good financial performance and provides customers with an affordable service
- CRI – the Compliance Risk Index – measuring drinking water quality

The performance for 2019–20 was assessed by the committee in May 2020. Details of the maximum bonus achievable, targets and outturn percentage for each executive director are shown in the tables below.

CEO	Maximum bonus achievable	Outturn %	Outturn as a % of salary
Short-term targets	80%	64.0%	51.2%
Long-term targets	100%	56.0%	56.0%
Personal objectives	20%	82.5%	16.5%
Total outturn as a percentage of salary			**123.7%**

CFO	Maximum bonus achievable	Outturn %	Outturn as a % of salary
Short-term targets	64%	64.0%	41.0%
Long-term targets	75%	56.0%	42.0%
Personal objectives	16%	74.4%	11.9%
Total outturn as a percentage of salary			**94.9%**

The overall bonus awarded across the business of 60% is the weighted average of the short-term and long-term target performance shown above. The outturn as a percentage of salary is calculated by multiplying the maximum bonus achievable by the outturn percentage.

Directors' Remuneration Report continued

Remuneration Committee Report

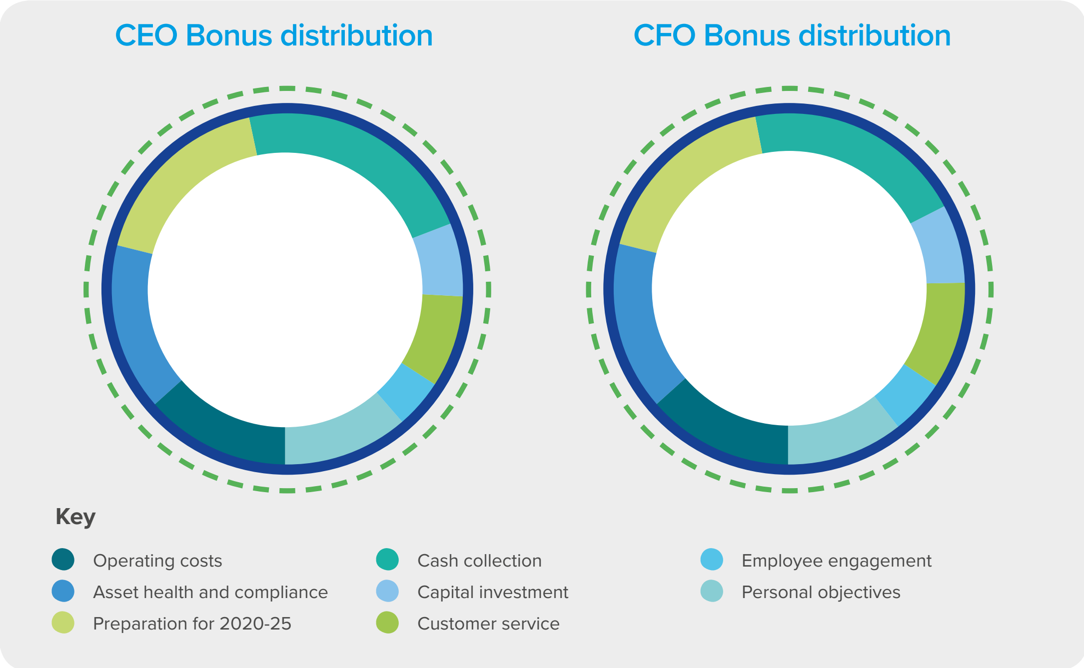
Incentive and Retention Plan 2019–20	2019-20	Threshold performance level	Target performance level	Stretch performance level	Performance for the year[1]	CEO Weighting (% of salary)	CFO Weighting (% of salary)	CEO Pay-out (% of salary)	CFO Pay-out (% of salary)
OPEX (net operating costs; £m)	Performance	£350.0m	£343.0m	£338.0m	£377.6m				
	Bonus percentage	50%	100%	150%		10.0%	8.0%	0%	0%
Capex	Performance	£1,800m	£1,788m	£1,776m	£1,785m				
	Bonus percentage	50%	100%	150%		10.0%	8.0%	10.6%	8.5%
Asset Health Output Delivery Incentives (annual ODI penalty; £m)	Performance	£1.0m	£0.5m	£0.0m	£0.2m				
	Bonus percentage	80%	100%	120%		16.0%	12.8%	17.9%	14.3%
Capital Programme (Regulatory Dates)	Performance	224	241	262	229				
	Bonus percentage	80%	100%	120%		4.0%	3.2%	3.5%	2.8%
Efficiently delivering customer service (£m)	Performance	£69.8m	£66.5m	£63.2m	£64.48m				
	Bonus percentage	80%	100%	120%		16.0%	12.8%	18.0%	14.4%
C-MeX	Performance	15th	9th	7th	16th				
	Bonus percentage	50%	100%	150%		12.0%	9.6%	0.0%	0.0%
D-MeX	Performance	13th	8th	6th	15th				
	Bonus percentage	50%	100%	150%		4.0%	3.2%	0.0%	0.0%
Customers on Schemes and Tariffs	Performance	110,000	125,975	154,000	116,030				
	Bonus percentage	80%	100%	120%		1.6%	1.3%	1.4%	1.1%
Percentage of customers on sustained payment plans	Performance	65%	73%	75%	69%				
	Bonus percentage	80%	100%	120%		0.8%	0.6%	0.7%	0.6%
Number of customers on Priority Services Register (PSR)	Performance	18,490	21,750	23,323	20,420				
	Bonus percentage	80%	100%	120%		1.6%	1.3%	1.4%	1.2%
Written complaints per 10k	Performance	25	23	20	28.22				
	Bonus percentage	80%	100%	120%		4.0%	3.2%	0.0%	0.0%
Capex efficiency	Performance	£700m	£864m	£976m	853				
	Bonus percentage	50%	100%	150%		17.5%	13.1%	17.0%	12.7%
Opex	Performance	£15m	£20m	£40m	12.4				
	Bonus percentage	50%	100%	150%		17.5%	13.1%	0.0%	0.0%
Progress against PR19 Maturity Assessment	Performance	Some progress	Satisfactory progress	Excellent progress	Excellent				
	Bonus percentage	0% - 75%	83% - 125%	133% - 166%		15.0%	11.3%	16.0%	12.0%
Gallup Q12 People rating	Performance	3.81	3.83	3.88	3.75				
	Bonus percentage	80%	100%	120%		20.0%	15.0%	0.0%	0.0%
Data accuracy	Performance	1+ Red	No Red / more than 2 Amber	Maximum 2 Amber	0 Reds / 10 Amber				
	Bonus percentage	0%	50%	100%		10.0%	7.5%	5.0%	3.7%
Cash Collection (£m)	Performance	£811.3m	£836.3m	£861.5m	824.6				
	Bonus percentage	80%	100%	120%		10.0%	7.5%	9.0%	6.7%
CRI	Performance	12.33	11.21	10.09	6.66				
	Bonus percentage	80%	100%	120%		10.0%	7.5%	12.0%	9.0%
Personal objectives	Performance	–	–	–	–				
	Bonus percentage	–	–	–		20.0%	16.0%	16.5%	11.9%
Adjustment applied*	Bonus percentage							-5.30%	-4.00%
Total								123.70%	94.90%

[1] Where the performance for the year has been based on the latest forecast position available at the time, any subsequent changes to the final outcome position will be adjusted for in the following performance year and in accordance with the IRP scheme rules.

* Having reflected on the overall performance of the company and taking into account the views of shareholders, the Board applied a discretionary downward adjustment to the overall short and long-term performance.

Summary of bonus distribution

The diagrams below illustrate the distribution of the director's bonus metrics across different areas of the business.



The threshold, target and stretch bonus percentages shown reflect the level of bonus award for achievement of the threshold, target and stretch performance levels for each metric.

Incentive and Retention Plan Contribution 2019–20	(a) Bonus pool brought forward (£'000)	(b) Bonus awarded in year (£'000)	(c) Bonus paid out (£'000) (50%)	(d) Bonus pool carried forward (£'000) (50%)
Ian McAulay	414.5	538.1	476.3	476.3
Sebastiaan Boelen	37.5	277.0	157.2	157.2

The amounts paid out (c) and carried forward (d) are each calculated as ((a) + (b)) ÷ 2.

Pension contributions

The pension contribution for the Executive Directors is set out in the table below:

Pension	Salary received (£'000)	Pension contribution as a % of base salary	Cash allowance in lieu of pension (£'000)	Pension contribution to scheme (£'000)	Total Pension related benefit (£'000)
Ian McAulay	435.0	18%	68.3	10.0	78.3
Sebastiaan Boelen	290.5	15%	22.5	21.1	43.6

Following the closure of the company's defined benefit pension scheme to future accrual and the introduction of a new defined contribution scheme for the company's workforce, the Remuneration Committee reviewed the pension contribution payable to the executives. In doing so, the Remuneration Committee also considered the expectation in Provision 38 of the UK Corporate Governance Code that the pension contributions payable to the executive directors are aligned to that of the workforce. Accordingly, it was agreed that from 1 April 2020, the employer pension contributions offering for new executive director appointments would be aligned to the 'all employee' rate of 11%.

Non-executive director fees for the year (audited)

The Chairman and the independent non-executive directors each receive a fee and do not participate in any performance-related incentive arrangements. The investor-nominated non-executive director does not receive any remuneration from the company.

The Board as a whole is responsible for setting the level of non-executive director fees and in doing so receives input from the Remuneration Committee.

Directors' Remuneration Report continued

Remuneration Committee Report

Details of the emoluments received by the Chairman and non-executive directors are shown below:

	2019–20			2018–19		
£'000	Fees	Other	Total	Fees	Other	Total
Keith Lough (Chairman) (appointed 1 August 2019)	183.3	2.4	185.7	–	–	–
Bill Tame (Chairman) (resigned 31 March 2019)	–	–	–	250.0	68.5	318.5
Paul Sheffield (Senior independent non-executive director; acting chairman between 1 April and 31 July 2019)	130.0	5.3	135.3	65.0	4.4	69.4
Rosemary Boot (Independent non-executive director)	59.6	1.7	61.3	52.5	1.4	53.9
Mike Putnam (Independent non-executive director)	57.5	4.0	61.5	50.0	6.9	56.9
Gillian Guy (Independent non-executive director) (From 12 September 2018)	50.0	0.0	50.0	19.3	–	19.3
Kevin McCullough (Independent non-executive director) (From 18 July 2019)	36.7	1.3	38.0	–	–	–
Malcolm Cooper (Independent non-executive director) (From 23 December 2019)	17.8	0.1	17.9	–	–	–
Ian Francis (Independent non-executive director) (From 12 Sept. 2018 to 12 Feb. 2019)	–	–	–	24.8	0.1	24.9
Lisa Harrington (Independent non-executive director)	–	–	–	–	0.5	0.5
Wendy Barnes (Greensands Board-nominated non-executive director until 27 March 2020)	60.0	14.9	74.9	60.0	11.7	71.7
Sara Sulaiman (Investor-nominated non-executive director)	–	–	–	–	–	–

The base fees for the non-executive directors are £50,000, with the exception of Sara Sulaiman, who receives no fee from Southern Water as an investor-nominated non-executive director.

With the resignation of the previous Chairman, Bill Tame, on 31 March 2019, it was agreed that Paul Sheffield would be appointed as acting Chairman until such point as a replacement Chairman was appointed. The Remuneration Committee, excluding Paul Sheffield, agreed that a fee of £250,000 per annum, prorated as appropriate, would be paid to Paul during this period instead of this base non-executive director fee and additional fees in connection with his role as senior independent non-executive director and Chair of the Remuneration Committee. This acting Chairman fee was paid to Paul Sheffield between 1 April and 31 July 2019, following which Paul receives, in addition to his base fee, an additional fee of £10,000 per annum for his role as senior independent non-executive director and an additional fee of £10,000 per annum as Chair of the Remuneration Committee.

It was agreed that Bill Tame, who resigned as Chairman with effect from 31 March 2019, would continue to receive his fee until 30 June 2019 during which period he provided assistance to the search for a replacement Chairman and supported the handover to the acting Chairman. The fee payable to Bill Tame during this period was disclosed in 2018–19 within his other emoluments and amounted to £62,500.

In May 2019, the Remuneration Committee reviewed the fees payable to the non-executive directors and assessed these against practice within both the sector and elsewhere using benchmarking data supplied by PwC. Following this assessment, the Remuneration Committee agreed that it was appropriate to keep base fees unchanged and to pay an additional fee to the chairs of the Risk Committee of £10,000 per annum. Furthermore, it was considered appropriate to increase the additional fee payable to the Audit Committee chair from £10,000 a year to £15,000. Both of these changes applied from 1 July 2019. Until the appointment of Malcolm Cooper as a permanent Audit Committee Chair in December 2019, Rosemary Boot, as interim Chair, received the additional fee payable to the Chair of the Audit Committee. These changes were approved by the Board based on the recommendation of the committee.

No changes were made to the fees for the Remuneration Committee Chair, senior independent non-executive director or the role of the Greensands Board-nominated director during the year. Wendy Barnes, as the Greensands Board-nominated director, received an additional fee of £10,000 per annum.

Following the decision by the Board to appoint Kevin McCullough as the independent non-executive director with the specific remit for engaging with and communicating the views of the workforce to the Board in order to give effect to Provision 5 of the UK Corporate Governance Code, it was agreed by the Board, in view of the increased time commitment and responsibility, that it was appropriate to pay an additional fee of £15,000 per annum in connection with this role, with effect from 26 February 2020.

	Current Chair and date appointed	Responsibility supplement	Comments on supplement
Audit Committee Chair	Malcolm Cooper* 23 December 2019	£15,000	Increased from £10,000 with effect from 1 July 2019
Risk Committee Chair	Mike Putnam 1 July 2019	£10,000	Introduced with effect from 1 July 2019
Remuneration Committee Chair	Paul Sheffield 1 April 2015	£10,000	Introduced with effect from 1 October 2018
Senior independent non-executive director	Paul Sheffield 1 July 2015	£10,000	No change from 2018–19
Workforce non-executive director	Kevin McCullough 26 February 2020	£15,000	Role introduced with effect from 26 February 2020
Greensands Board-nominated director	**Vacancy since 28 March 2020	£10,000	No change from 2018–19

* Rosemary Boot was Interim Audit Committee Chair from 1 April 2019 to 22 December 2019.

** Wendy Barnes was Greensands Board-nominated director until she resigned from the Board on 27 March 2020.

The other amounts payable to the non-executive directors include taxable expenses incurred in connection with attendance at Board meetings and shareholder events.

None of the directors who held office during the financial year had any disclosable interests in the shares of Southern Water or the group; there are no share options in place and no payments were made to them by any other group companies.

Gender pay (unaudited)

Creating an environment to enable a diverse and inclusive workforce will have a positive effect on our organisation and this is a key part of Southern Water's People Strategy. The Gender Pay Gap report produced by the company provides details of the company's focus on this area and we are pleased to see that the median pay gap has reduced this year from 7.5% to 2.4%, although in terms of the median bonus gap we have seen an increase from 17.2% to 26.8%. It is acknowledged that there is still more to be done. The company will continue to support the aspirations of its female employees, concentrating on further improvements in the areas of recruitment, talent development and remuneration as well as polices which further support colleagues to achieve a balance of work with family commitments. For more information, see the report on our gender pay gap at **southernwater.co.uk/gender-pay-gap**.

Executive pay gap reporting

From 2020 onwards, the Companies (Miscellaneous Reporting) Regulations 2018 require all publicly listed companies with more than 250 UK employees to publish the ratio between the their CEOs full-time equivalent remuneration and that of employees at the 25th, 50th and 75th percentile when total remuneration is calculated and ranked from highest to lowest.

Directors' Remuneration Report continued

Remuneration Committee Report

Although not a listed company, Southern Water has chosen to publish this information in line with our commitment to providing information about pay diversity and fairness within our organisation.

The regulations set out three options for calculating the pay ratio.

- Option A – takes into account all forms of remuneration and payments (pension etc)
- Option B – uses the Gender Pay calculation figures
- Option C – uses some other method

Our ratio has been calculated using 'Option A' as this takes into account full remuneration and is therefore the most comprehensive comparison.

Year	Method	25th Percentile Ratio	50th Percentile Ratio	75th Percentile Ratio
2019	A	17.8:1	22.8:1	28.7:1

As this is the first year of reporting, we do not have any trend data to draw upon but will comment on trends in this data once a pattern has emerged.

Implementation of policy for 2020–21 (unaudited)

Base salary

The basic salary for Sebastiaan Boelen for 2019–20 was increased in September 2019 from £280,500 to £300,000 following his permanent appointment to the Board. The base salaries for both Ian McAulay and Sebastiaan Boelen will remain unchanged for 2020–21.

The revised base salaries for each Executive director are as follows:

Base salary	Base salary for 2019–20 (£'000)	Base salary increase (%)	Base salary from July 2020 (£'000)
Ian McAulay	435.0	0.0	435.0
Sebastiaan Boelen	300.0	0.0	300.0

Incentive and Retention Plan

The Incentive and Retention Plan will be based on performance conditions designed to focus the Executive directors on the areas of key strategic importance for the company. As such the performance conditions will be based on customer objectives that focus on delivering positive outcomes for our customers and other stakeholders and value objectives, which long-term create value for our shareholders and our customers alike.

Bonus potential for 2020–21

The table below shows the maximum bonus potential for the Executive directors in 2020–21.

	CEO		CFO	
	2019–20	2020–21	2019–20	2020–21
Total maximum variable remuneration	200%	200%	155%	155%

We have fully committed to comply with Ofwat's code of practice for executive remuneration for 2020–25

We had already made significant steps towards compliance in our 2019–20 Remuneration Policy, which set out:

- our policy to provide transparent alignment between executive performance-related pay and stretching outcomes for all our stakeholders and, substantially, for our customers
- our policy to apply stretching targets linked to customer outcomes
- our policy to apply rigorous application of incentive scheme rules and provide independent governance of remuneration decisions, while taking into consideration risk management principles
- our policy to defer an element of bonus so that performance can be measured over the medium to long-term.

Our performance measures for 2020–21 focus on positive outcomes for our customers and other stakeholders

In determining the performance measures for 2020–21, the Remuneration Committee considered the expectation under the Ofwat Principles that the company's short and long-term performance-related elements should be linked to stretching delivery for customers, as well as the steps needed to further embed the Ofwat code of practice for executive remuneration. It was agreed that the following measures will be used to assess our performance:

- ODIs
- Retail cost to serve (Retail Totex, excluding bad debt)
- C-MeX
- D-MeX
- Environment Plan
- Q12 Colleague Engagement
- Health, Safety, Security and Wellbeing
- Totex (Wholesale Totex)
- Progress against four key business transformation plans and the Section 19 undertakings given to Ofwat
- Net operating cash flow

In determining the performance measures, the Remuneration Committee sought to balance the expectations of both the company's investors in terms of an efficient and well-run company as well as the company's obligations to its customers and other stakeholders.

Weightings and targets, along with actual performance, will be fully disclosed in the 2020–21 Remuneration Report.

At this stage, it is not possible to be precise on the impact of COVID-19 on business performance and, as a consequence, on remuneration decisions. The significant majority of bonus targets for 2020–21 will not be impacted, but for those that are, the committee will need to use its discretion – within the rules of the scheme – when reviewing performance next year to ensure any awards are appropriate and fair to employees, shareholders and customers.

We are committed to publishing our new Remuneration Policy for 2020 onwards, which is detailed on page 198.

Directors' Remuneration Report continued

Remuneration Committee Report

Remuneration Policy

Remuneration policy 2020–25 Purpose

The remuneration policy of Southern Water applies to all its employees. The Board of Directors has approved the remuneration policy at the recommendation of the Remuneration Committee. The policy applies to remuneration earned from 1 April 2020.

Total remuneration

Reward within Southern Water refers to all elements of remuneration e.g. Compensation, Benefits and Pensions. The strategic direction described in this document is designed to complement other people-related activity to attract, retain, motivate and engage employees within our organisation:

- We operate a market-informed remuneration framework based on the market median to ensure competitiveness and affordability.
- We ensure employees feel encouraged to create sustainable results and that a clear link exists between customers, shareholders and employees' interests.
- We align pay to the market-median position, recognising the need, from time to time, to implement specific arrangements for certain individuals.
- We ensure employees are offered a competitive and market median-aligned remuneration package, which balances the fixed and variable remuneration components according to job role.
- We ensure that Southern Water is able to attract, develop and retain high-performing and motivated employees in a competitive market.

It is our policy to eradicate bias on gender

We are committed to creating a diverse and inclusive workforce that represents the communities we serve, and the skills each individual brings to our organisation. Gender balance is at the heart of a sustainable workforce and a key focus for Southern Water. We are committed to narrowing the gender pay gap over time and to ensure that our gender pay gap reporting is open and transparent.

Southern Water has four groups of employees; The Executive Leadership Team (ELT), The Senior Management Team (SMT), employees on a personal contract (DPC) and employees under a Collective Bargaining Agreement, all of whom are incentivised over 50% of variable pay to deliver customer outcomes, and to create value.

Executive remuneration

It is our policy to ensure that performance-related executive pay has a clear alignment to delivering stretching performance improvement, which is in the interests of customers as well as providing sustained and long-term value creation for shareholders and other stakeholders.

Salaries for the ELT population are reviewed annually in line with the market and their personal performance against stretching targets. Salaries are reviewed in line with the annual increase applied to all employees.

This group also participates in a non-contractual Incentive and Retention Plan, that incentivises stretching performance improvement across a number of KPIs, but most notably, (at least 50% of these – and in practice, more than this) these are aligned to delivering stretching customer outcomes. All KPIs link to the agreed business plan. The significant majority of total potential remuneration is non-contractual and variable and linked to stretching performance improvement.

The ELT participate in other taxable benefits, including: pension; life assurance; monthly car allowance; family personal medical insurance and health checks.

Executive performance-related pay

It is our policy to provide transparent alignment between performance-related pay and stretching outcomes for all our stakeholders and specifically including our customers.

The policy reflects the Board's commitment to being open and transparent in respect of executive pay, through:

- ensuring that more than 50% of variable pay is directly aligned to customer outcomes with the remainder also benefiting our customers though longer-term value creation and financial resilience
- setting stretching performance targets that are based on the performance ambitions set out in our business plan commitments
- ensuring that targets and metrics have a substantial and demonstrable link to stretching performance delivery and quality outcomes that align with the interests of customers
- transparently reporting how performance-related executive pay is linked to the underlying performance of the company
- embedding behavioural competence built around company values to underpin the cultural change and instil a way of working that will increase employee engagement, productivity and customer delivery.

It is our policy to apply stretching targets linked to customer outcomes

The Board is committed to setting more than 50% of bonus targets that are linked to outcomes for customers that require stretching performance. These will include customer outcomes such as ODIs, C-MeX, D-MeX, efficiency of service delivery, service through people as well as treating the environment as our customer.

Customers will also benefit from the value metrics, which will drive the long-term financial resilience of the organisation and capture the financial consequences of delivering for our customers, aligned with the needs of our shareholders. These will include outcomes such as Totex and cash.

It is our policy to apply rigorous application of scheme rules and to provide independent governance of remuneration decisions, while taking into consideration risk management principles

This is monitored and applied through the Remuneration Committee, which consists of two independent non-executive directors and one non-executive director. This avoids any conflicts of interest and aligns the principle of protection of customers and investors. The Remuneration Committee reports through to the Board.

Our policy is to:

- apply good corporate governance by taking into account regulatory requirements and, among others, the UK Corporate Governance Code, any corporate governance principles issued by our regulator, Ofwat, from time to time, as well as compliance with the Southern Water Code
- maintain a stringent governance structure for setting relevant and stretching goals, which are aligned to customer outcomes, and communicating these goals to employees
- ensure clear alignment with our business strategy, company values, key priorities and long-term goals
- transparently report executive pay within our Annual Report and Financial Statements, and any other channels as appropriate
- report any changes to the policy, including the underlying reasons, within the Annual Report and Financial Statements, and any other channels as appropriate
- review annually the constitution and Terms of Reference of the Remuneration Committee to maintain its operational effectiveness and publishing these on our website for transparency
- ensure the ongoing effectiveness of the Board and its committees though regular external and independent evaluation.

The Board of directors has set a maximum percentage of performance-based remuneration relative to the fixed salary remuneration for the executive management positions. The table below shows the maximum limit on variable remuneration (excluding any pension allowance) for the ELT. The maximum percentages are made up of both customer and value elements:

Performance-related pay is non-contractual and, as such, the range of reward is from zero.

Potential Bonus Range	CEO	CFO, MD, GC*	Other ELT roles
Total maximum variable remuneration	0%-200%	0%-155%	0%-130%

*MD = Managing Director and GC = Company Secretary & General Counsel

It is our policy to defer bonus so performance can be measured over the long term

Performance-based remuneration is disbursed as a cash bonus. Each year, the total of any executive bonus earned is added to the individual's bonus pool. Each year, 50% of the pool is paid in cash, with the remaining 50% deferred. Rules of the scheme include bonus recovery provisions, which allow for the possibility of a reduction or clawback of bonuses already earned, or those deferred, to ensure performance outcomes are measured over the longer term.

It is our policy to take into account the remuneration practices found in other UK companies of a similar size or operating in the same sector

This ensures that the remuneration arrangements for the executive directors are appropriate when compared with those for other senior executives and the wider workforce. Attracting and retaining first class leadership is vital to the long-term success of the company.

To ensure that our remuneration practices remain competitive, the committee periodically calls upon experienced specialist consultants.

Directors' Report

for the year ended 31 March 2020

The directors of Southern Water Services Limited (registered no. 02366670) present their report and the audited financial statements for the year ended 31 March 2020.

Principal activities

The principal activities of Southern Water Services Limited, herein after referred to as 'the company', also referred to as SWS, are the provision of water supply and wastewater services in the South East of England. The company is regulated by the Water Services Regulation Authority (Ofwat) and supplies water to over 2.5 million people and provides wastewater services to over 4.7 million people.

Strategic Report

The information that fulfils the requirement of the Strategic Report can be found in our Annual Report on pages 1 to 137 and the Section 172 statement on pages 162 to 163.

Future developments

The information regarding future developments of the company can be found in our Annual Report on pages 1 to 137 and the Section 172 statement on pages 162 to 163.

Post balance sheet events

In May 2020 the company's subsidiary Southern Water Services (Finance) Limited raised additional financing of £825 million (net £814.9 million) under a sustainability framework which ensures proceeds are used for environmental and social purposes, including the repayment of debt issued for the same purpose. The use of the proceeds will include investment in the 2020–25 plan and the repayment of a £350.0 million bond maturing 31 March 2021. This replaces a short-term revolving credit facility of £700.0 million that was in place from 31 March 2020.

Results and dividends

The income statement on page 208 how the company's results and profit for the year. Further details are also available in the Annual Report on pages 102 to 108.

Interim dividends of £126.64 per ordinary share (2019: £622.41 per share), totalling £7.1 million (2019: £34.8 million) were paid during the year to Southern Water Services Group (SWSG). These dividends, along with associated group tax relief of £1.7 million, enable SWSG to pay the interest of £8.8 million due to SWS on an inter-company loan as disclosed in note 14 to the financial statements.

No ordinary interim dividends were paid during the year (2019: £nil). No final dividend has been declared or paid for the year ended 31 March 2020.

Directors and their interests

The directors who held office during the year ended 31 March 2020 and up to the date of signing the financial statements, unless otherwise stated, were as follows (details can be found on pages 146 to 149):

Keith Lough
Chairman (appointed 1 August 2019)

Ian McAulay
(Executive director – Chief Executive Officer)

Sebastiaan Boelen
(Executive director – Interim Chief Financial Officer to 31 August 2019, Chief Financial Officer from 1 September 2019)

Paul Sheffield
(Senior independent non-executive director, Acting Chairman to 31 July 2019)

Rosemary Boot
(Independent non-executive director)

Malcolm Cooper
(Independent non-executive director) (Appointed 23 December 2019)

Gillian Guy
(Independent non-executive director)

Kevin McCullogh
(Independent non-executive director) (appointed 18 July 2019)

Michael Putnam
(Independent non-executive director)

Wendy Barnes
(Non-executive director) (Resigned 27 March 2020)

Marykay Fuller
(Non-executive director) (Appointed 15 June 2020)

Sara Sulaiman
(Non-executive director)

None of the directors who held office during the financial year had any disclosable interests in the shares of the company or the group.

Research and development

The improvement of existing services and processes, together with the identification and development of new technology and innovative solutions, are important aspects of the company's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure charged to the income statement for the year amounted to £0.5 million (2019: £1.0 million).

Financial risk management

The Financial Risk Management Policy is included in the Strategic Report which can be found in the Annual Report on pages 116 to 134.

Corporate governance

A description of the company's corporate governance arrangements for the purposes of Part

8 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as introduced by regulation 14 of the Companies (Miscellaneous Reporting) Regulations 2018 can be found in the Annual Report on pages 140 to 199.

Employees

The company recognises the importance of its employees and is committed to effective two-way communication and consultation.

The company has established Business Involvement Groups to facilitate meaningful consultation between company management and employees through elected employee representatives. The groups meet regularly at both a functional and company-wide level.

In 2017, the company introduced the Gallup employee survey, which has continued to be undertaken every six months to help develop management action plans and provide insight into the views of employees. The company also conducts further surveys throughout the year on specific matters, the results of which are reported to management and/or the Board as appropriate.

The company recognises the rights of every employee to join a trade union and participate in its activities. Southern Water has a single union agreement with Unison.

General information is posted on the company intranet and regular team briefing sessions are also held. The information in these publications and briefings covers a wide range of subjects that affect the business, including progress on business and capital projects, the impact of regulatory issues and wider financial and economic issues that may affect the company.

As with previous years, during 2019, the company's executive directors and Executive Leadership Team members as well as individual non-executive directors held a series of roadshows across the company's sites to inform and engage with the company's employees about the company's priorities based on the new business plan 2020–25 as well as to inform and engage with the company's employees about the company's new purpose and values.

In addition, the decision to close the company's defined benefit pension scheme to future accrual and to launch a new defined contribution pension scheme for all employees followed an extensive consultation exercise with affected employees.

In line with the UK Corporate Governance Code, one of the company's independent non-executive directors, Kevin McCullough has been given the remit of communicating the views of the company's workforce to the Board.

Further details of the company's employees and the company's engagement activities as well as how the directors have had regard to employee interests can be found on pages 47, 50 to 52, 54 and 162 to 163.

Equal opportunity: The company's policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The company takes full account of the needs of people with disabilities and follows set policies and procedures to support reasonable adjustments in the workplace.

Health, safety, security and wellbeing: The company recognises its duties to make proper provision for the health, safety and welfare at work of its employees.

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety. In addition, there is a Health and Safety Management Review Group which ensures that there is an adequate system for meeting the company's responsibilities for health and safety to its employees, customers and members of the public.

The company holds an annual Health and Safety Conference, which this year focused on wellbeing. It attracted people from across the company and its partners to share the latest developments within the health and safety industry. Southern Water is committed to the 'Time for change' programme to raise awareness and understanding of mental health issues.

The company provides an internal occupational health service for employees, including the provision of physiotherapy. These services have been developed and are continuously reviewed to ensure they meet the needs of the business and our employees at work.

Disabled employees: Applications for employment by disabled persons are always fully considered, bearing in mind the abilities of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

Speak Up: Employees are actively encouraged to Speak Up if they see things that are not quite right. This helps us work better as a company and fosters a culture where we ensure that we are always doing the right thing for each other, our customers, the environment and other stakeholders.

Directors' Report

for the year ended 31 March 2020

Engagement with customers, suppliers and others

The company recognises the importance of its suppliers to ensure the company's ability to continue to deliver an essential public service. Further details of the company's engagement with its suppliers during the year can be found on pages 47 and 55.

Due to the nature of its business and the regulatory framework in which the company operates, engagement with its customers is of key importance. The company undertakes extensive customer engagement activities throughout the year. Further details can be found on page 46.

As a private limited company, Southern Water Services Limited is not required to hold an annual general meeting. During 2019, the company held an investor day in order to give the company's investors a greater insight into the business and its challenges as well as an opportunity to discuss matters with the company's Chairman and senior executives. It is intended to hold more such investor engagement activities in the future.

The company, its senior executives and Board regularly engage with the company's regulators, with local and national government as well as with relevant industry groups through meetings and other events.

The company's statement explaining how the directors have had regard to the matters set out in section 172(1)(a) to (f) of the Companies Act 2006 and which provides further detail in respect of how the directors have taken into account the interests of the company's employees, suppliers, customers and others during the year can be found on pages 162 to 163.

Environmental issues

The company is committed to meeting or improving upon legislative and regulatory environmental requirements and codes of practice and aims to contain the environmental impact of its activities to a practicable minimum.

Ofwat and the Environment Agency have been conducting investigations into our historic wastewater performance and reporting. Further details of these investigations are disclosed on page 27.

The company's environmental performance for 2019–20 is reported on pages 90 to 95. The company recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

Streamlined Energy and Carbon Report (SECR)

This section fulfils the requirements of the Companies (Directors Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018.

Information about the company can be found on pages 1 to 137 of the Annual Report.

Quantification and reporting methodology

The methodology used to calculate operational greenhouse gas emissions for the provision of water and wastewater services follows the GHG Protocol Corporate Reporting Standard.

The water sector employs a bespoke carbon accounting workbook which reflects best practice and is updated every year in order to use the latest emission factors, which are derived from the UK's GHG Conversion Factors.

Operational boundary

The reporting boundary covers all of the company's operational services and is congruous with our financial reporting boundary.

Energy use

Area	2019–20 kWh	2018–19 kWh
Electricity	464,073,076	447,815,328
Imported	399,468,630	386,419,725
Self-generated	64,604,446	61,395,603
Gas	2,525,152	1,945,939
Business transport	16,372,496	17,422,607
Total incl. self-generation	482,970,723	467,183,873
Total excl. self-generation	418,366,277	405,788,271

The company's self-generated supply comes from combined heat and power (CHP), solar PV and diesel generation. In addition, the company exported excess electricity to the grid, predominantly renewable energy from the company's 16 CHP installations.

Greenhouse gas emissions

Scope	Description	Included in scope	2019–20 ($ktCO_2e$)	2018–19 ($ktCO_2e$)
1	Direct emissions from activities that the company own or control including combustion of fuel	Gas oil use, Process emissions, Company transport	**69.4**	72.9
2	Indirect emissions from purchase of electricity (location-based)	Grid electricity	**101.6**	109.2
	Indirect emissions from purchase of electricity (market-based)	Grid electricity	**60.5**	59.6
3	Other Indirect emissions	Business travel on public transport/ private vehicles, Outsourced activities, Grid electricity transmission and distribution	**20.5**	20.6
Total Gross emissions for Scope 1 & 2	Location-based approach		**171**	182
	Market-based approach		**130**	132

*Location-based approach uses the average grid emission factor for power from the electricity grid
**Market-based approach uses the carbon intensity of the energy we procure from the electricity grid

Targets

In order to mitigate the company's climate impact it is committed to delivering net zero operational greenhouse gas emissions by 2030 as a water sector. This target was published in March 2019.

Area	Unit of measurement	2019–20	2018–19
All company (location-based approach)	Tonnes of CO_2e from Scope 1 and 2 gross emissions per £100,000 turnover	**19.5**	20.8
All company (market-based approach)	Tonnes of CO_2e from Scope 1 and 2 gross emissions per £100,000 turnover	**14.8**	15.1
All company energy (incl. self-generation)	kWh/ £100,000 of turnover	**55,008**	53,313
All company energy (excl. self-generation)	kWh/ £100,000 of turnover	**47,650**	46,307
Water services	$kgCO_2e$ per Megalitre (Ml) of water treated	**201**	224
Water services (Electricity incl. self-generation)	kWh/Ml	**742**	741
Water services (Electricity excl. self-generation)	kWh/Ml	**727**	723
Water services (Total energy incl. self-generation)	kWh/Ml	**775**	773
Water services (Total energy excl. self-generation)	kWh/Ml	**760**	756
Wastewater services	$kgCO_2e$ per Megalitre (Ml) of wastewater treated	**261**	305
Wastewater services (Electricity incl. self-generation)	kWh/Ml	**620**	652
Wastewater services (Electricity excl. self-generation)	kWh/Ml	**500**	525
Wastewater services (Total energy incl. self-generation)	kWh/Ml	**645**	680
Wastewater services (Total energy excl. self-generation)	kWh/Ml	**524**	553

Energy efficiency action

Southern Water continues to invest in energy efficiency. 2019–20 represented the final year of its five-year investment cycle so the focus was on identifying new opportunities to deliver in year one of the new investment cycle. The company undertook a number of site energy audits as part of delivering its obligations under the Energy Savings and Opportunities Scheme (ESOS) and found areas of inefficiency on which to focus future work. In addition, the company expanded the resource and capability of its internal energy team, adding additional energy efficiency expertise. In 2019–20, the company spent £1.25 million on energy efficiency schemes and studies, investing in:

- Identifying inefficient pumps for replacement;
- Ancillary plant to improve our self-generation from existing biogas CHP plants;
- Wastewater aeration plant including monitoring systems, inefficient plant replacement and software improvements;
- Improving monitoring and reporting capability;
- Benchmarking site energy efficiency to identify opportunities.

Assurance statement

This quantification of greenhouse gas emissions and energy usage is checked internally through a governance framework and subsequently audited by independent consultants as part of the company's annual regulatory reporting.

Political donations

No political donations were made.

Land and buildings

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

Going concern

The directors believe, after due and careful enquiry, that the company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the financial statements to 31 March 2020.

In forming this assessment the directors have considered the following information:

- The company's business activities, together with the factors likely to affect its future development, performance and position, which are set out in the Strategic Report on pages 1 to 137.
- The potential impact of COVID-19 on the company's operations and financial performance.
- The financial position of the company, its cash flows, liquidity position, covenants and borrowing facilities, which are described in the Financial Performance review on pages 102 to 108.
- The company has available a combination of cash and committed undrawn bank facilities totalling £874.3 million at 31 March 2020 (2019: £577.0 million). These funds are sufficient to fund the operating and capital investment activities of the company for the 12 months from the date of signing the financial statements.
- Additional financing of £825 million (net £814.9 million) was raised in May 2020 by the company's subsidiary Southern Water Services (Finance) Limited, for SWS, under a sustainability framework which ensures proceeds are used for environmental, green, and social purposes, including the repayment of debt issued for the same purpose. The use of proceeds will include investment in the business plan and the repayment of a £350.0 million bond maturing 31 March 2021. This replaces a short-term revolving credit facility of £700.0 million that was in place from 31 March 2020.
- The company operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities.

As a consequence, the directors believe that the company is well placed to manage its business risks successfully.

The directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Thus, they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Long-term viability statement

In accordance with Provision 31 of the UK Code and Ofwat's Information Notice IN 19/07, the Board has assessed the prospects of the company over a longer period than the 12 months required by the 'Going Concern' provision. Details of its assessment and the associated viability statement can be found on page 135 of this report.

Qualifying third party indemnity

Following shareholder approval, the company has also provided an indemnity for its directors and the Company Secretary, which is a qualifying third party indemnity provision for the purposes of the Companies Act 2006.

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 have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS101 'Reduced Disclosure Framework'. 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 these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgments and accounting estimates that are reasonable and prudent
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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
- the Strategic Report includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that it faces.

Statement of disclosure of information to auditor

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

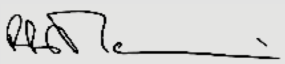
1. so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware
2. they have taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditor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

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

Auditor

Deloitte LLP has indicated its willingness to continue in office.

Approved by the Board of Directors and signed by order of the Board.



Richard Manning
General Counsel and Company Secretary
10 July 2020

Financial Statements

Income statement

For the year ended 31 March 2020

	Note	2020 £m	2019 £m
Continuing operations			
Revenue	5	878.0	876.3
Regulatory settlement	5	–	(135.5)
Total revenue		878.0	740.8
Other operating income	5	1.4	1.2
Operating costs before charge for bad and doubtful debts, depreciation, amortisation and regulatory settlement		(373.5)	(338.6)
Charge for bad and doubtful debts		(29.6)	(10.7)
Operating costs before depreciation, amortisation and regulatory settlement		(403.1)	(349.3)
Depreciation and amortisation		(264.0)	(271.8)
Regulatory settlement		–	(3.0)
Total operating costs		(667.1)	(624.1)
Operating profit	6	212.3	117.9
Operating profit before regulatory settlement		212.3	256.4
Regulatory settlement		–	(138.5)
Operating profit		212.3	117.9
Other income	6	–	0.2
Profit on disposal of fixed assets	6	0.9	0.7
Finance income	9	41.6	53.4
Finance costs	9	(160.8)	(209.2)
Fair value gains/(losses) on derivative financial instruments	22	339.9	(216.6)
Net finance income/(costs)	9	220.7	(372.4)
Profit/(loss) before taxation		433.9	(253.6)
Taxation	10	(105.2)	20.7
Profit/(loss) for the financial year		328.7	(232.9)

The notes on pages 213 to 250 form part of these financial statements.

Statement of other comprehensive income

For the year ended 31 March 2020

	Note	2020 £m	2019 £m
Profit/(loss) for the year		**328.7**	(232.9)
Other comprehensive income/(expense):			
Items that cannot be reclassified to profit or loss:			
Actuarial gain/(loss) on pension scheme	24	**111.7**	(24.2)
Movement on deferred tax relating to retirement benefit obligations	23	**(17.5)**	4.1
Total other comprehensive income/(expense) for the year, net of tax		**94.2**	(20.1)
Total comprehensive income/(expense) for the year attributable to the owner of the company		**422.9**	(253.0)

Statement of financial position

As at 31 March 2020

	Note	2020 £m	2019 £m
Non-current assets			
Intangible assets	12	**42.1**	45.6
Property, plant and equipment	13	**6,325.7**	6,051.1
Investments	15	**29.2**	29.2
Derivative financial instruments	22	**194.3**	46.2
Other non-current assets	14	**130.0**	130.0
		6,721.3	6,302.1
Current assets			
Inventories	16	**5.1**	4.7
Trade and other receivables	17	**273.2**	332.5
Cash and cash equivalents	32	**129.3**	372.0
		407.6	709.2
Total assets		**7,128.9**	7,011.3
Current liabilities			
Borrowings	19	**(713.8)**	(504.3)
Lease liabilities	21	**(2.2)**	(0.2)
Trade and other payables	18	**(260.8)**	(362.3)
Regulatory settlement liability	25	**(35.6)**	(3.0)
Provision for liabilities	26	**(5.1)**	(1.2)
		(1,017.5)	(871.0)
Non-current liabilities			
Borrowings	20	**(2,884.8)**	(3,270.9)
Lease liabilities	21	**(28.2)**	(0.8)
Derivative financial instruments	22	**(1,376.4)**	(1,428.2)
Deferred tax liabilities	23	**(368.7)**	(247.7)
Retirement benefit obligations	24	**(62.5)**	(186.7)
Regulatory settlement liability	25	**(99.9)**	(135.5)
Provision for liabilities	26	**(4.7)**	(5.4)
Other non-current liabilities	27	**(32.7)**	(27.4)
		(4,857.9)	(5,302.6)
Total liabilities		**(5,875.4)**	(6,173.6)
Net assets		**1,253.5**	837.7
Equity			
Called up share capital	28	**0.1**	0.1
Share premium account	29	**46.3**	46.3
Non-distributable reserve	30	**60.2**	53.8
Retained earnings	31	**1,146.9**	737.5
Total equity		**1,253.5**	837.7

The financial statements of Southern Water Services Limited (Registered no. 02366670) on pages 208 to 250 were approved by the Board and authorised for issue on 10 July 2020. They were signed on its behalf by:

Sebastiaan Boelen
Chief Financial Officer

Statement of changes in equity

For the year ended 31 March 2020

	Called up share capital (note 28) £m	Share premium account (note 29) £m	Non-distributable reserve (note 30) £m	Retained earnings (note 31) £m	Total £m
Balance at 1 April 2018	**0.1**	**46.3**	**46.7**	**1,032.4**	**1,125.5**
Profit/(loss) for the financial year	–	–	8.5	(241.4)	(232.9)
Other comprehensive income/(expense) for the year:					
Actuarial loss on pension scheme	–	–	–	(24.2)	(24.2)
Movement on deferred tax relating to retirement benefit obligations	–	–	–	4.1	4.1
Total comprehensive income/(expense) for the year	**–**	**–**	**8.5**	**(261.5)**	**(253.0)**
Reserves transfer*	–	–	(1.4)	1.4	–
Equity dividends paid (note 11)	–	–	–	(34.8)	(34.8)
Balance at 31 March 2019	**0.1**	**46.3**	**53.8**	**737.5**	**837.7**
Profit for the financial year	–	–	7.8	320.9	328.7
Other comprehensive income/(expense) for the year:					
Actuarial gain on pension scheme	–	–	–	111.7	111.7
Movement on deferred tax relating to retirement benefit obligations	–	–	–	(17.5)	(17.5)
Total comprehensive income/(expense) for the year	**–**	**–**	**7.8**	**415.1**	**422.9**
Reserves transfer*	–	–	(1.4)	1.4	–
Equity dividends paid (note 11)	–	–	–	(7.1)	(7.1)
Balance at 31 March 2020	**0.1**	**46.3**	**60.2**	**1,146.9**	**1,253.5**

* The non-distributable reserve arose upon adoption of IFRS 15 and relates to deemed revenue on adoption of assets from customers and is being amortised to reserves in line with the depreciation of the related assets.

Statement of cash flows

For the year ended 31 March 2020

	Note	2020 £m	2019 £m
Cash from operations	32	478.3	498.0
Tax paid		(1.7)	(8.2)
Net cash from operating activities		476.6	489.8
Investing activities			
Interest received		38.5	51.9
Purchase of property, plant and equipment		(461.6)	(396.5)
Purchase of intangible assets		(11.8)	(7.2)
Receipt of grants and contributions		–	2.3
Proceeds on disposal of property, plant and equipment		0.5	0.3
Repayments of intercompany loan receivables		54.4	683.4
Proceeds from disposal of business		–	1.8
Net cash (used in)/generated from investing activities		(380.0)	336.0
Financing activities			
Equity dividends paid		(7.1)	(34.8)
Interest paid		(258.9)	(198.7)
Preference share dividends		(9.0)	(6.5)
Repayment of borrowings		(417.8)	(425.1)
Repayments of obligations under finance leases		(1.5)	(0.6)
Advances/(payments) on restructure of derivative instruments		140.0	(122.5)
Proceeds of new loans		215.0	170.0
Net cash used in financing activities		(339.3)	(618.2)
Net (decrease)/increase in cash and cash equivalents		(242.7)	207.6
Cash and cash equivalents at beginning of the year		372.0	164.4
Cash and cash equivalents at end of the year		129.3	372.0

Notes to the financial statements

For the year ended 31 March 2020

1 Accounting policies

The principal accounting policies, which have been applied consistently throughout the current and preceding year, are set out below.

Basis of preparation

Southern Water Services Limited is a company incorporated in the United Kingdom under the Companies Act 2006. The company is a private company limited by shares and is registered in England and Wales. The address of the registered office is given on page 1. The nature of the company's operations and its principal activities are set out in the Strategic Report on pages 1 to 137.

These financial statements have been prepared in accordance with FRS 101 incorporating the Amendments to FRS 101 issued by the FRC in July 2015 and the amendments to Company law made by The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015.

The financial statements have been prepared on a going concern basis under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments and retirement benefit obligations) at fair value through profit and loss or other comprehensive income.

Historical cost is generally based on the fair value of the consideration given in exchange for the goods and services.

Fair value is the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the company takes into account the characteristics of the asset or liability as if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement purposes in these financial statements is determined on such a basis, except leasing transactions that are within the scope of IFRS 16 'Leases', and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 'Inventories' or value in use in IAS 36 'Impairment of Assets'.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly
- Level 3 inputs are unobservable inputs for the asset or liability.

The financial statements contain information about Southern Water Services Limited (SWS) as an individual company and do not contain consolidated financial information as the parent of subsidiary companies. The company is exempt under Section 401 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it and its subsidiary undertaking are included by full consolidation in the consolidated financial statements of the ultimate holding company, Greensands Holdings Limited. The group financial statements of Greensands Holdings Limited are available to the public and can be obtained at **southernwater.co.uk/our-story/our-governance/our-ownership**.

As permitted by FRS 101, the company has taken advantage of the disclosure exemptions available under that standard in relation to standards not yet effective, financial instruments, fair value measurement, revenue from contracts with customers, leases, presentation of a statement of financial position as at the beginning of the preceding period following a retrospective accounting policy application or restatement, capital management, related party disclosures and impairment of assets. Where required, equivalent disclosures are given in the group financial statements of Greensands Holdings Limited.

The company has elected not to take advantage of the exemption regarding the requirements of IAS 7 'Statement of Cash Flows' in order to align with regulatory reporting requirements and provide additional transparency for users of the financial statements.

Adoption of new and revised accounting and financial reporting standards

This is the first set of the company's annual financial statements where IFRS 16 'Leases' has been applied.

IFRS 16 'Leases' sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, i.e. the customer ('lessee') and the supplier ('lessor') and is effective for the company from 1 April 2019. The changes effected by the new lease accounting model resulted in all leases (including those currently classified as operating leases) of more than 12 months (with some limited exceptions such as low value leases of £5,000 or less) being recognised on the company's statement of financial position.

Changes to significant accounting policies including the impact on the results or net assets of the company are set out in note 3.

Notes to the financial statements continued

For the year ended 31 March 2020

1 Accounting policies continued

Going concern

The company's business activities, together with the factors likely to affect its future development and position, are set out in the Strategic Report pages 1 to 137.

The directors have undertaken a detailed review of the company's liquidity requirements compared with the cash and facilities available, the financial covenant position including projections based on future forecasts, the current credit ratings and financial risk.

On the basis of their assessment of the company's financial position the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements. For this reason they continue to adopt the going concern basis of accounting in preparing the annual financial statements, further details can be found in the Directors' Report on page 204.

In addition and in accordance with provision C.2.2 of the UK Code and Ofwat's Information Notice IN 19/07, the Board has assessed the prospects of the business over a longer period than the 12 months required by the 'Going Concern' provision.

The Board has selected to conduct this review for the period to March 2030 and full details of the assessment and the viability statement are set out within the Strategic Report on pages 135 to 137.

Segmental reporting

The company's revenue arises from the provision of services within the United Kingdom. It has a large and diverse customer base and is not reliant on any single customer.

The Southern Water Board and management team review all internal management information on a single segment basis and accordingly no segmental information is provided in this report.

Revenue recognition

The company adopted IFRS 15 'Revenue from Contracts with Customers' with effect from 1 April 2018.

Revenue represents the income receivable (net of value added tax) in the ordinary course of business for goods and services provided. In respect of unbilled charges, revenue includes an estimate of the consumption between the date of the last meter reading and the period-end. The revenue accrual is estimated using a defined methodology based upon historical billing, consumption information and the applicable tariff.

Revenue from the supply of services represents the value of services provided under contracts to the extent that there is a right to consideration and is recorded at the fair value of the consideration due.

The company recognises revenue when it transfers control over a product or service to a customer.

Revenue is recognised when the amount of revenue can be measured reliably, the performance obligation has been satisfied, and it is probable that the economic benefits associated with the transaction will flow to the company. Revenue is not recognised when it is considered probable that economic benefits will not be received. In these circumstances revenue is only recognised when collectability is reasonably certain. Payments received in advance of revenue recognition are recorded as deferred income.

Water and wastewater services

The company supplies water and wastewater services to customers in Sussex, Kent, Hampshire and the Isle of Wight. The performance obligation is the supply of services over the contractual term and is considered to be satisfied as the customer consumes based on the volume of water supplied. This is the point at which revenue is recognised.

For provisioning purposes, revenues and outstanding arrears are segmented based on customer characteristics. Since the company is under a statutory obligation to provide water and wastewater services to its domestic properties these services could be provided to customers who are unlikely to pay. Should a group of customers attract a provision rate of 100%, i.e. assessed as not generating economic benefit, revenue would not be recognised. In 2019–20 no segment of customers met this criteria and so revenue relating to the provision of water and wastewater services has been recognised in full.

Unmetered income is based on either the rateable value of the property or on an assessed volume of water supplied. Metered income is based on actual or estimated water consumption. Customer rebates are shown as a reduction in revenue.

New connections and infrastructure charges

Under IFRS 15 the performance obligation is satisfied at the point of provision of the new connection to the network, so fees received in respect of the connection are recognised at this point.

Requisitions
For requisitions of water mains and public sewers, the company has determined that the performance obligation is satisfied at the point of completion of the requisition works and connection of the water main or lateral drain, and the total consideration receivable is recognised in full as revenue at that point.

Diversions
Contributions received in respect of diversions of water mains and sewers are recognised upon completion of the diversion of the water main or sewer.

Adoptions
Adoptions of assets are recognised at fair value of the asset upon adoption, i.e. the point at which control of the asset is obtained, within revenue as an increase to non-distributable reserves.

Provision for impairment of trade receivables
The provision for impairment of trade receivables is calculated by applying estimated recovery rates to various categories of trade receivables, reflecting past collections experience and expectations of future recovery of outstanding receivables at the date of the statement of financial position.

This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

The model considers current and forward looking macroeconomic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment.

Taxation
Taxation in the income statement represents the sum of the tax currently payable and deferred tax.

Current taxation is based on the result for the year as adjusted for disallowable and non-taxable items and items of income or expense which are taxable or deductible in other years. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred taxation is tax expected to be payable on temporary differences between the treatment of certain items for taxation and accounting purposes. Deferred taxation is provided on all temporary differences that have originated, but not reversed, by the end of the reporting period. It is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted or substantively enacted at the reporting date.

Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is regarded as probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the company intends to settle its current tax assets and liabilities on a net basis.

Intangible assets
Intangible assets comprises:

i. Assets in development.

ii. Other assets – comprising software, studies and development projects.

Intangible assets are measured at cost less subsequent amortisation and any impairment. Amortisation of intangible assets is calculated on a straight-line basis over the estimated useful lives, which are primarily three to 10 years. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Capitalised development costs are for plant installed on some of our sites to test new processes for performance data and scalability. The data is used to identify innovative and efficient future assets and processes to meet new higher environmental or quality standards. Development costs capitalised are depreciated over three to five years.

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Notes to the financial statements continued

For the year ended 31 March 2020

1 Accounting policies continued

Property, plant and equipment

Property, plant and equipment comprises:

i. Freehold land and buildings – comprising land and non-operational buildings.
ii. Plant and machinery – comprising structures at sites used for water and wastewater treatment; pumping or storage, where not classed as infrastructure, along with associated fixed plant.
iii. Infrastructure assets – comprising a network of systems consisting of mains and sewers, impounding and pumped raw water storage reservoirs, sludge pipelines and sea outfalls.
iv. Assets under construction.
v. Other assets – comprising vehicles, computers, mobile plant and meters.

All property, plant and equipment is stated in the statement of financial position at cost or at deemed cost on transition to FRS 101, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

The costs of repairs to the infrastructure network are recognised in the income statement as they arise.

Expenditure which results in replacement or renewal of infrastructure or enhancements to the operating capability of the infrastructure network is capitalised.

Items of property, plant and equipment that are transferred to the company from customers or developers are initially recognised at fair value in accordance with IFRS 15 'Revenue from Contracts with Customers'.

The corresponding credit is recorded as revenue through non-distributable reserves and released to retained earnings over the expected useful lives of the related assets.

Borrowing costs directly attributable to the construction of qualifying assets, that necessarily take a substantial period of time to get ready for their intended use, are capitalised during the period of time that is required to complete and prepare the asset for its intended use. The commencement of capitalisation begins when both finance costs and expenditures for the asset are being incurred and activities that are necessary to get the asset ready for use are in progress. Capitalisation ceases when substantially all the activities that are necessary to get the asset ready for use are complete. Other borrowing costs are expensed.

Subsequent costs are included in the asset's carrying amount or recognised as separate assets, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the company and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the income statement as incurred.

Assets are depreciated on a straight-line basis over their estimated operating lives, which are principally as follows:

		Years
Land and buildings:	– Land[1]	Not depreciated
	– Buildings	10–60
Plant and machinery:	– Operational structures[2]	15–80
	– Fixed plant	10–40
Infrastructure assets:	– Water mains	100–120
	– Sewers	80–200
	– Reservoirs	200
	– Ancillary structures	10–70
Assets under construction[1]:		Not depreciated
Other:	– Vehicles, computers and mobile plant	3–10

1. Freehold land is not depreciated, nor are assets in the course of construction until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor, following completion of performance and take-over tests.
2. Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

The estimated useful lives and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis.

Right-of-use assets are depreciated over the shorter period of the lease term and the useful life of the underlying asset. If a lease transfers ownership of the underlying asset or the cost of the right-of-use asset reflects that the company expects to exercise a purchase option, the related right-of-use asset is depreciated over the useful life of the underlying asset.

Impairment of tangible and intangible assets
At the end of each reporting period, the company reviews the carrying amounts of its tangible and intangible assets, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Grants and contributions
Grants and contributions received are treated as either revenue or deferred income in line with IFRS 15 as defined by the nature of the receipt.

Infrastructure receipts associated with new connections are recognised as revenue when they are receivable.

Deemed contributions from the transfer of non-current assets from customers are recognised as revenue through non-distributable reserves and released to retained earnings over the life of the asset.

Grants and contributions receivable in respect of other non-current assets are treated as deferred income and released to other operating income over the useful economic life of those fixed assets.

Grants and contributions received in respect of new connections to the water and sewerage networks are treated as deferred income and released to revenue in line with the expected expenditure they are intended to compensate.

Grants and contributions received in respect of diversions of water mains and sewers are treated as deferred income and recognised as revenue upon completion of the diversion.

Grants and contributions which are given in compensation for expenses incurred with no future-related costs are recognised in revenue in the period that they become receivable.

Leases
The company has adopted IFRS 16 'Leases' with effect from 1 April 2019.

The company as lessee
The company assesses whether a contract is or contains a lease, at inception of the contract. The company recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets (£5,000 or less). For these leases, the company recognises the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

Lease payments included in the measurement of the lease liability comprise:

- fixed lease payments;
- variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date;
- the amount expected to be payable by the lessee under residual value guarantees;
- the exercise price of purchase options, if the lessee is reasonably certain to exercise the options; and
- payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.

The lease liability is presented as a separate line in the statement of financial position.

The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made.

Notes to the financial statements continued

For the year ended 31 March 2020

1 Accounting policies continued

The company remeasures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever:

- The lease term has changed or there is a significant event or change in circumstances resulting in a change in the assessment of exercise of a purchase option, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate.
- The lease payments change due to changes in an index or rate or a change in expected payment under a guaranteed residual value, in which case the lease liability is remeasured by discounting the revised lease payments using an unchanged discount rate (unless the lease payments change is due to a change in a floating interest rate, in which case a revised discount rate is used).
- A lease contract is modified and the lease modification is not accounted for as a separate lease, in which case the lease liability is remeasured based on the lease term of the modified lease by discounting the revised lease payments using a revised discount rate at the effective date of the modification.

The company did not make any such adjustments during the year.

The right-of-use assets comprise the initial measurement of the corresponding lease, lease payments made at or before the commencement day and any direct initial costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

Right-of-use assets are depreciated over the shorter period of lease term and useful life of the underlying asset. The depreciation starts at the commencement date of the lease.

The right-of-use assets are presented separately from other assets in the notes to the financial statements.

The company applies IAS 36 to determine whether a right-of-use asset is impaired and accounts for any identified impairment loss as described in the ‘Property, Plant and Equipment’ policy.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. The company has used this practical expedient with respect to the maintenance element associated with vehicle leases.

The company as lessor

The sale of income rights relating to aerial masts and sites owned by the company to third parties is treated as an operating lease. Income received from such sales is received entirely in advance and is therefore taken to deferred revenue and credited to the income statement over the life of the lease.

Non-current asset investments

Investments held as non-current assets, including investments in subsidiaries, are stated at cost less, where appropriate, provision for any impairment in value. The carrying values of non-current asset investments are reviewed for impairment in periods, if events or changes in circumstances indicate the carrying value may not be recoverable.

Cash and cash equivalents

Cash and cash equivalents comprise cash and short-term bank deposits.

Inventories

Inventory is held for use in the production of water supply and treatment of wastewater. Raw materials and work in progress are valued at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. Net realisable value is the estimated selling price, less further costs expected to be incurred to completion and costs to be incurred in marketing, selling and distribution.

Deferred revenue

Deferred revenue includes monies received from customers where the related service has not yet been provided.

Amounts are deferred to the statement of financial position and released to the income statement in line with the period of the service provided.

Provisions

Provisions are recognised when the company has a present obligation (legal or constructive) as a result of a past event, it is probable that the company will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

An environmental provision is made for the costs relating to decommissioned or dormant assets which have been identified as having an environmental impact.

Retirement benefits

SWS operated a defined benefit pension scheme which closed on 31 March 2020, the assets of which are held separately from those of the company in independently administered funds. An independent actuary conducts a valuation of this pension scheme every three years.

The liability recognised in the statement of financial position in respect of the defined benefit pension scheme is the present value of the defined benefit obligation at the end of the period less the fair value of plan assets. The current service cost, which is the increase in the present value of the liabilities of the company's defined benefit pension scheme expected to arise from employee service in the period, is charged to operating costs. The net interest on the scheme's net assets/(liabilities) is included in other finance charges. Actuarial gains and losses are recognised in the statement of other comprehensive income.

The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 24.

Profit before taxation and net assets are affected by the actuarial assumptions used. The key assumptions include: discount rates, pay growth, mortality and increases to pensions in payment and deferred pensions, and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants.

The company also operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the company in an independently administered fund. Company contributions to the scheme are charged to the income statement in the period to which they relate. Differences between contributions actually paid are shown as either accruals or prepayments in the statement of financial position.

Financial instruments

The company adopted IFRS 9 'Financial Instruments' with effect from 1 April 2018.

IFRS 9 contains requirements for (1) the classification and measurement of financial assets and financial liabilities, (2) impairment for financial assets and (3) general hedge accounting.

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires companies to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

Financial assets and financial liabilities are recognised in the company's statement of financial position when the company becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss (FVTPL)) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVTPL are recognised immediately in the income statement.

Notes to the financial statements continued

For the year ended 31 March 2020

1 Accounting policies continued

Financial assets

(i) Loans receivable

Loans receivable that have fixed or determinable payments that are not quoted in an active market are classified as 'held to collect'. Loans receivable are measured at fair value on initial recognition and subsequently measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

(ii) Trade receivables and accrued income

Trade receivables and accrued income are classified as 'held to collect' and measured at fair value on initial recognition. If there is objective evidence that the amount receivable is impaired it is written down to its recoverable amount, with the irrecoverable amount being recognised as an expense in operating costs.

The company applies an approach permitted by IFRS 9 for estimating expected credit losses on trade receivables. For trade receivables that are assessed not to be impaired individually, expected credit losses are estimated based on company's historical experience of trade receivable write-offs, and forward-looking macroeconomic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment.

The provision for impairment of trade receivables is calculated by applying estimated recovery rates to various categories of debt, reflecting past collections experience and expectations of future recovery of outstanding receivables at the date of the statement of financial position.

This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred or are expected to occur after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account.

Derecognition of financial assets

The company derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. On derecognition of a financial asset the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

Financial liabilities

Fixed rate interest-bearing borrowings are initially measured at fair value, net of transaction costs and are subsequently measured at amortised cost using the effective interest method, with the interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Issue costs in relation to index-linked and variable rate bonds are separately disclosed within creditors.

The carrying value of index-linked debt instruments is adjusted for the annual movement in the retail price index. The change in value arising from indexation is charged or credited to the income statement in the year in which it arises.

Premiums and proceeds such as those from gilt lock agreements received on issue of debt instruments are credited to the income statement over the term of the debt at a constant rate on the carrying amount.

Derecognition of financial liabilities

The company derecognises financial liabilities when, and only when, the company's obligations are discharged, cancelled or they expire.

Derivative financial instruments

The company enters into a variety of derivative financial instruments to manage its exposure to inflation and interest rate risk in line with the company's risk management policy and no speculative trading in financial instruments is undertaken. Further details of derivative financial instruments are disclosed in note 22.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at the end of each reporting period. The resulting gain or loss is recognised in the income statement immediately.

Certain derivative instruments, principally index-linked swaps, do not qualify for hedge accounting and, as such, the company does not currently apply hedge accounting.

A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

Embedded derivatives

In accordance with IFRS 9 the company has reviewed all contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value through profit and loss.

An embedded derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the hybrid instrument to which the embedded derivative relates is more than 12 months and is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

2 Critical accounting judgments and key sources of estimation uncertainty

In the application of the company's accounting policies, which are described in note 1 above, the directors are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgments

Critical judgments, apart from those involving estimations, applied in the preparation of the financial statements are discussed below:

Regulatory settlement in 2018–19

The treatment of the regulatory settlement was considered in the light of the specific circumstances of the approach agreed with Ofwat as noted on page 27. Reflecting that this relates to past performance and matters outside the normal regulatory framework for agreeing amounts for future billing to customers it was considered appropriate to accrue for this settlement in the 2019 financial statements when it became possible to quantify the financial impact.

There is no clear accounting standard guidance for the income statement treatment of this regulatory settlement. It was considered whether the settlement should be recognised as an expense; however, given that this is an agreed reduction in customer bills in the future, with a requirement to show this separately on invoicing as required by Ofwat, the most appropriate treatment was concluded to be to treat the invoice reductions as a reduction in revenue in 2018–19. This will be separately identified and unwound on the face of the income statement in future periods. The £3 million penalty payable to Ofwat was treated as an operating expense.

Provisions and contingent liabilities

The company evaluates its exposures to contingent liabilities relating to pending litigation or other outstanding claims subject to negotiated settlement, mediation, arbitration or Government regulation. A provision is recognised when it is probable that an obligation exists for which a reliable estimate can be made after careful analysis of the individual matter. Analysis includes assessing the likelihood that a pending claim will succeed, or a liability will arise, and the point of recognition for the associated liability.

Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed as contingent liabilities in note 33, unless the possibility of transferring economic benefits is remote.

Provisions determined may change in the future due to new developments and as additional information becomes available. Reflecting the inherent uncertainty in this evaluation process actual costs may be different from the estimated provision. Details of provisions are disclosed in note 26 (in particular disclosure of the EA investigations) and the value provided at 31 March 2020 was £9.8 million (2019: £6.6 million). Accordingly if the amount provided was 50% under or over estimated then the provision would change by £4.9 million (2019: £3.3 million).

Notes to the financial statements continued

For the year ended 31 March 2020

2 Critical accounting judgments and key sources of estimation uncertainty continued

Property, plant and equipment

The company recognises property, plant and equipment (PPE) on its water and wastewater infrastructure assets where such expenditure enhances a significant length of the network or increases the capacity of the network, whereas any expenditure classed as maintenance is expensed in the period it is incurred. Determining enhancement from maintenance expenditure is a subjective area, particularly when assessing whether the length of network replaced enhances the network. In addition, management capitalise time and resources incurred by the company's support functions on capital programmes based on judgments made in respect of the proportion of capital work performed by these functions.

Sources of estimation uncertainty

The key assumptions about the future and other key sources of estimation uncertainty at the reporting period end that may have a risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are discussed below:

Measured income accrual

The measured income accrual is an estimation of the amount of water and wastewater unbilled at the period end. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff. The calculation is sensitive to estimated consumption for measured customers. Actual consumption may differ from the estimate made which could impact future operating results positively or negatively.

The value of household billings raised in the year ended 31 March 2020 for consumption in prior years was £129.2 million. The value of these billings was lower than the accrual made at 31 March 2019. The estimation difference was £5.8 million and this has been recognised in the current year's turnover. This difference is well within our view of acceptable tolerances for accounting estimates.

Impairment of trade receivables

The impairment of trade receivables at each reporting date is calculated by segmenting customer debt based on historic debt collection and payment performance, demographic information and the age of debt outstanding. For each segment, forecast cash collection rates are determined which result in a corresponding provision percentage. This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

The model considers current and forward looking macroeconomic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment. Our underlying charge to the income statement on this basis was £13.6 million.

To reflect the significant impact that the COVID-19 pandemic is having on the macroeconomic environment we have recognised an additional charge of £16.0 million, for the impairment of trade receivables, to the income statement in 2019–20. This is a significant judgment as the overall impact that the pandemic will have on the economy is continuing to evolve.

The value of the provision for doubtful debts as at 31 March 2020 was £216.4 million (2019: £188.7 million). The actual level of receivables collected may differ from the estimated levels of recovery, which could impact future operating results positively or negatively.

Our sensitivity analysis suggests that the impairment provision would vary by £1.9 million and £5.7 million if cash collections estimates were between 1% and 3% above or below those predicted.

Impairment provision sensitivity analysis	31 March 2020	Sensitivity			
		1%	3%	-1%	-3%
Impairment provision estimate (£m)	216.4	1.9	5.7	-1.9	-5.7

Retirement benefit obligations

The company operates a defined benefit scheme as well as a defined contribution scheme. Under IAS 19 'Employee Benefits' the company has recognised an actuarial gain of £111.7 million (2019: loss of £24.2 million).

The pension cost and liabilities under IAS 19 are assessed in accordance with directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on CMI 2018 actuarial tables with a smoothing factor of 7.5 and a 1.25% pa allowance for future longevity improvement.

The major assumptions used to measure schemes' liabilities, along with sensitivities to changes in those assumptions and future funding obligations are set out in note 24 to the financial statements.

3 Changes in significant accounting policies

A number of new standards and amendments are effective for periods beginning from 1 January 2019, including IFRS 16 'Leases'. The effect of this new standard on the company's financial statements is described below.

Other changes to accounting standards in the current year had no material impact and are as follows:

- IFRIC 23 'Uncertainty over Income Tax Treatments'
- Annual improvements to IFRS Standards 2015–17 Cycle
- Amendments to IAS 19 'Employee Benefits'
- Amendments to IFRS 9 'Financial Instruments'

IFRS 16 introduces new or amended requirements with respect to lease accounting. It introduces significant changes to lessee accounting by removing the distinction between operating and finance lease, requiring the recognition of a right-of-use asset and a lease liability at commencement for all leases, except for short-term leases and leases of low value assets.

In contrast to lessee accounting, the requirements for lessor accounting have remained largely unchanged.

The company acts as a lessor in respect of the sale of income rights relating to aerial masts and sites owned by the company to third parties. Income received from such sales is received entirely in advance and is taken to deferred revenue and credited to the income statement over the life of the lease. This accounting treatment remains unchanged from previous periods.

Other than the aerial mast agreement detailed above, the company is not party to any material leases where it acts as a lessor, but does have a number of material property and vehicle leases.

Details of the company's accounting policies under IFRS 16 are set out in note 1, and a description of the impact of adoption is shown below.

Transition approach

The company has applied IFRS 16 using the modified retrospective approach, without restatement of comparative information. In respect of those leases previously treated as operating leases, the company has elected to measure its right-of-use assets using the approach set out in IFRS 16 C8(b)(ii). Under IFRS 16 C8(b)(ii) right-of-use assets are calculated as an amount equal to the lease liability (being the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application), adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of application.

The company's weighted average incremental borrowing rate applied to lease liabilities as at 1 April 2019 is 3.509%.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. The company has used this practical expedient with respect to the maintenance element associated with vehicle leases.

As part of the modified retrospective approach to transition to IFRS 16 for leases previously classified as operating leases applying IAS 17, the company has also elected to use the practical expedient permitted to apply a single discount rate to portfolios of leases with reasonably similar characteristics.

Notes to the financial statements continued

For the year ended 31 March 2020

3 Changes in significant accounting policies continued

Impact on lessee accounting

Former operating leases

IFRS 16 changes how the company accounts for leases previously classified as operating leases under IAS 17, which were off-balance sheet.

Applying IFRS 16, for all leases, the company now recognises right-of-use assets and lease liabilities in the statement of financial position, initially measured at the present value of the future lease payments as described above.

Under IFRS 16, right-of-use assets will be tested for impairment in accordance with IAS 36 Impairment of Assets.

Under IFRS 16, the company recognises depreciation of right-of-use assets and interest on leases liabilities in the income statement, whereas under IAS 17 operating leases previously gave rise to a straight-line expense in operating expenditure.

Under IFRS 16, the company separates the total amount of cash paid for leases that are on balance sheet into a principal portion (presented within financing activities as repayments of obligations under finance leases) and interest (presented within financing activities as interest paid) in the cash flow statement. Under IAS 17 operating lease payments were presented as operating cash flows.

Former finance leases

The main differences between IFRS 16 and IAS 17 with respect to assets formerly held under a finance lease is the measurement of the residual guarantees provided by the lessee to the lessor. IFRS 16 requires that the company recognises as part of its lease liability only the amount expected to be payable under a residual value guarantee, rather than the maximum amount guaranteed as required by IAS 17. This change did not have a material effect on the company's financial statements.

Financial impact

The application of IFRS 16 to leases previously classified as operating leases under IAS 17 resulted in the recognition of right-of-use assets and lease liabilities. Prepayments of rentals as at the transition date have been derecognised and adjusted through the value of the related assets. The adjustments as at the date of initial application are shown in the table below.

	As previously reported at 31 March 2019 £m	Impact of IFRS 16 £m	As restated at 1 April 2019 £m
Non-current assets			
Property, plant and equipment	6,051.1	33.2	6,084.3
Current assets			
Prepayments	17.4	(2.7)	14.7
Total impact on assets		**30.5**	
Current liabilities			
Lease liabilities	(0.2)	(2.1)	(2.3)
Non-current liabilities			
Lease liabilities	(0.8)	(28.4)	(29.2)
Total impact on liabilities		**(30.5)**	
Retained earnings		**–**	

Of the total right-of-use assets of £33.2 million recognised at 1 April 2019, £30.9 million related to leases of property and £2.3 million to leases of vehicles.

The table below presents a reconciliation from operating lease commitments disclosed at 31 March 2019 to lease liabilities recognised at 1 April 2019.

	£m
Operating lease commitments disclosed under IAS 17 at 31 March 2019	20.1
Effect of discounting	(0.9)
Contracts reassessed under IFRS 16 to contain a lease	11.7
Prepayments on reassessed contracts as at 31 March 2019	(0.4)
Right-of-use assets recognised at 1 April 2019	30.5
Finance lease liabilities recognised under IAS 17 at 31 March 2019	1.0
Total lease liabilities recognised at 1 April 2019	31.5

In terms of the income statement impact, the application of IFRS 16 resulted in a decrease in other operating expenses and an increase in depreciation and interest expense compared to IAS 17. During the year ended 31 March 2020, in relation to leases under IFRS 16, the company recognised the following amounts in the income statement:

	£m
Depreciation	3.0
Interest expense	1.2

4 Segmental analysis

The directors believe that the whole of SWS's activities constitute a single class of business. The company's revenue is generated wholly from within the United Kingdom. The Southern Water Board and management team review all internal management information on a single segment basis and accordingly no segmental information is provided in this report.

5 Income

An analysis of the company's income is as follows:

Continuing operations	2020 £m	2019 £m
Water and sewerage services:		
Household – measured	544.3	537.3
Household – unmeasured	130.7	133.2
Non-household – measured	140.4	141.6
Non-household – unmeasured	5.1	5.0
Total water and sewerage services	820.5	817.1
Bulk supplies	3.9	3.8
Infrastructure charge receipts	9.7	12.2
Requisitioned mains and sewers (see note (a) below)	(0.6)	0.1
Diversions	0.6	2.9
Adoptions (see note (b) below)	7.8	8.5
Other services	36.1	31.7
Total revenue before regulatory settlement	878.0	876.3
Regulatory settlement (see note (c) below)	–	(135.5)
Total revenue	878.0	740.8
Other operating income (see note (d) below)	1.4	1.2
Other income (see note 6)	–	0.2
Profit on disposal of fixed assets	0.9	0.7
Interest receivable (note 9)	32.8	10.4
Interest revenue from Southern Water Services Group Limited	8.8	43.0
Total income	921.9	796.3

(a) Income from requisitions of mains and sewers is offset by refunds to developers in the year made against income recognised in previous periods.

(b) Revenue associated with the adoption of assets from customers is treated as non-distributable upon recognition, and amortised to retained earnings in line with the depreciation of the related assets.

(c) As reported on page 27 the company co-operated with Ofwat in relation to its investigation into the management, operation and performance of our wastewater treatment works.

To ensure that our customers are not disadvantaged as a result of these matters, the company has agreed to make direct customer rebates totalling £135.5 million in forecast outturn prices (£122.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches identified in the investigation. A provision for these rebates was made in the financial statements for 2018–19.

(d) Other operating income includes the release of deferred grants and contributions relating to non-current assets from the balance sheet, as amortised in line with the useful economic life of the related assets, and rents receivable.

Notes to the financial statements continued

For the year ended 31 March 2020

6 Profit for the year

Profit for the year has been arrived at after charging/(crediting):	2020 £m	2019 £m
Depreciation on:		
– Owned assets	247.2	248.6
– Assets held under finance leases	3.7	1.0
	250.9	249.6
Included within *Operating costs: Depreciation and amortisation* in the income statement:		
Amortisation of intangible assets	13.1	22.3
Other income (see note (a) below)	–	0.2
Profit on disposal of fixed assets	0.9	0.7
Research and development expenditure	0.5	1.0
Rentals under operating leases (see note (b) below):		
– Properties	0.2	1.9
– Vehicles	1.1	2.5
Employee costs (note 7)	78.6	67.4
Amortisation of grants and contributions (note 27)	(1.2)	(1.1)
Regulatory settlement (see note (c) below)	–	138.5
Fees payable to the company's auditor in respect of:		
– statutory audit of the company's financial statements	0.5	0.3
– other services pursuant to legislation (see note (d) below)	0.1	0.1
– all other services	0.1	0.1

(a) On 1 April 2017 the company completed the disposal of its non-household water and wastewater retail business, principally comprising billing and customer service activities, to Business Stream. Final reconciling transactions from the contract of sale resulted in a £0.2 million profit after costs in the prior period. Cash proceeds in the prior year of £1.8 million are disclosed under proceeds from disposal of business in the cash flow statement on page 212.

(b) The company has adopted IFRS 16 'Leases' with effect from 1 April 2019. Rentals under operating leases comprise payments on leases that have been assessed as short-term (12 months or less) agreements and leases of low value assets (£5,000 or less) (see note 1 Accounting Policies for more information on the company's approach to IFRS 16 Leases).

(c) As reported on page 27 the company co-operated with Ofwat in relation to its investigation into the management, operation and performance of our wastewater treatment works.

In addition to the provision for direct customer rebates of £135.5 million disclosed in note 5, a provision of a further £3.0 million was made within operating costs in 2018–19 for the fine imposed by Ofwat in relation to these matters.

(d) Other services pursuant to legislation and other non-audit services primarily relate to regulatory assurance fees.

7 Employee information

	2020 £m	2019 £m
(a) Employee costs (including directors' emoluments):		
Wages and salaries	105.2	95.7
Social security costs	11.3	10.7
Pension costs – Defined contribution	4.9	3.9
– Defined benefit	7.7	8.0
Total employee costs	129.1	118.3
Less: charged as capital expenditure	(50.5)	(50.9)
Charged to the income statement	78.6	67.4

Employee costs that are charged as capital expenditure are those directly related to the construction or acquisition of assets.

(b) Average number of persons employed by activity

The average monthly numbers of persons (including Executive directors) employed by the company during the year was:

	2020 Number	2019 Number (restated)
Operations	1,169	1,111
Customer services	98	235
Corporate centre	937	939
	2,204	2,285

The prior year figures have been restated to reflect the average numbers rather than the March year end numbers.

8 Directors' emoluments

	2020 £000	2019 £000
Aggregate emoluments (including benefits in kind)	2,317	2,152
Payments in lieu of notice	–	208
Pension contributions in lieu of notice	–	9
	2,317	2,369

No retirement benefits accrued to directors (2019: nil) under a Southern Water Services Limited defined benefit scheme. Retirement benefits of £31,075 accrued to directors (2019: £29,795) under a Southern Water Services Limited defined contribution scheme.

On 14 December 2018, William Lambe resigned as a director. He left Southern Water on 4 May 2019 at which point he received a payment in lieu of notice of £189,289 together with pension-related benefits of £27,916.

On 31 March 2019, Bill Tame resigned as Chairman and in addition to the emoluments disclosed above, received a payment of £62,500 for services performed for the company other than as a director to support the handover to Paul Sheffield as Acting Chairman.

Further details can be found in the Directors' Remuneration Report on pages 182 to 199.

Details of emoluments and benefits for the highest paid director:

	2020 £000	2019 £000
Highest paid director's aggregate emoluments and benefits	1,069	1,172

During the year the company made contributions of £10,000 (2019: £10,000) to a money purchase pension scheme in respect of the highest paid director's qualifying services.

Notes to the financial statements continued

For the year ended 31 March 2020

9 Net finance income/(costs)

	2020 £m	2019 £m
Finance income		
Interest receivable on swap instruments	31.9	8.7
Interest revenue from Southern Water Services Group Limited	8.8	43.0
Deposit income on short-term bank deposits	0.9	1.7
	41.6	53.4
Finance costs		
Interest payable on bank loans	(3.0)	(2.4)
Interest payable on other loans	(7.5)	(12.9)
Interest paid to Southern Water Services (Finance) Ltd	(146.0)	(175.9)
Indexation	(29.3)	(34.7)
Amortisation of issue costs	(1.5)	(1.5)
Amortisation of gilt lock proceeds	0.1	0.1
Amortisation of deferred credits	4.8	9.7
Amortisation of bond premium	0.7	0.7
Finance lease interest	(1.2)	–
Other finance expense (note 24)	(4.2)	(4.4)
Dividends on preference shares – see notes (a), (b), (c) and (d) below	(6.5)	(10.9)
	(193.6)	(232.2)
Amounts capitalised on qualifying assets	32.8	23.0
	(160.8)	(209.2)
Fair value gains/(losses) on derivative financial instruments		
Derivative financial instruments not designated as hedges (note 22)	339.9	(216.6)
Net finance income/(costs)	220.7	(372.4)

The interest revenue from Southern Water Services Group Limited relates to the long-term loan disclosed in note 14.

Borrowing costs included in the cost of qualifying assets during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 3.96% to expenditure on such assets (2019: 4.12%).

Dividends on preference shares

(a) Dividends due to Class B preference shareholders of £70 per share totalled £6.2 million (2019: £8.3 million). Of this amount, £3.8 million was paid during the year (including amounts on the redemptions detailed in notes (c) and (d) below of £0.3 million and £0.3 million respectively), with £2.4 million accrued at 31 March 2020.

(b) Final dividends due to the Class A2 preference shareholders of £10.31 (2019: £85.52) per share totalling £0.1 million (2019: £1.7 million) were settled in the year to 31 March 2020 for out-performance and savings in the year ended 31 March 2019 (see note 20(ix)).

(c) On 28 June 2019, the company redeemed the balance of 9,863 of its Class A1 and Class A2 preference shares, and 19,340 of its Class B preference shares, at nominal value plus the premium on issue, including settlement for fixed or base value dividends due to that date. The total amount paid was £34.0 million comprising principal redemption of £29.2 million and dividends of £4.8 million (including the amounts accrued to 31 March 2019 of £4.3 million). Fixed dividends due in the period 1 April 2019 to redemption were as follows: A1: £0.1 million, A2: £0.1 million and B: £0.3 million.

(d) On 11 December 2019, the company redeemed 20,831 of its Class B preference shares, at nominal value plus the premium on issue, including settlement for fixed dividends due to that date, and settlement for A2 out-performance and savings in the year ended 31 March 2019 accrued. The amount paid totalled £25.0 million comprising principle redemption of £20.8 million and dividends of £4.2 million (including an amount of £0.6 million accrued to 31 March 2019 for A2 out-performance and savings dividends, and £0.1 million detailed in note (b) above).

10 Taxation

	2020 £m	2019 £m
Current tax:		
Current year	1.7	8.2
Total current tax charge	1.7	8.2
Deferred tax:		
Origination and reversal of timing differences	64.0	(30.8)
Adjustment in respect of prior years	(0.8)	1.9
Effect of corporation tax rate change	40.3	–
Total deferred tax charge/(credit)	103.5	(28.9)
Total tax charge/(credit) on profit/(loss)	105.2	(20.7)

The tax assessed for the year is different to the standard rate of corporation tax in the UK due to the following factors:

	2020 £m	2019 £m
Profit/(loss) before tax	433.9	(253.6)
Tax at the UK corporation tax rate of 19% (2019: 19%)	82.4	(48.2)
Permanent differences	2.2	30.5
Group relief received for nil payment	(11.4)	(8.5)
Differences between current and deferred tax rates	(7.5)	3.6
Impact of tax rate changes	40.3	–
Adjustment in respect of prior years:		
Deferred tax	(0.8)	1.9
Total tax charge/(credit) for year	105.2	(20.7)

Factors that may affect future tax charges:

Reductions in the main rate of corporation tax to 17% from the 1 April 2020 were enacted in the Finance Bill 2016, and deferred tax balances at 31 March 2019 were calculated based on these reduced rates. It was subsequently announced in March 2020 that the corporation tax rate would instead be maintained at 19% from 1 April 2020. This change has been substantively enacted in Finance Bill 2020 at the Balance sheet date, and deferred tax balances at 31 March 2020 have been calculated using the 19% rate. A £40.3 million charge has been recognised in the income statement in the period to reflect the increase in the deferred tax liability as a result of the rate change. In addition, a credit of £1.5 million has been recognised in the statement of other comprehensive income to reflect the increase in the deferred tax asset relating to the pension deficit.

Based on current capital investment plans, the company expects to continue to be able to claim capital allowances in excess of depreciation in future years at a similar level to the current year.

In addition to the amount recognised in the income statement, the following amounts relating to tax have been recognised in the statement of other comprehensive income:

	2020 £m	2019 £m
Deferred tax		
Arising on income and expenses recognised in other comprehensive income:		
Tax charge/(credit) relating to retirement benefit obligations	17.5	(4.1)
Total deferred tax charge/(credit) recognised in other comprehensive income/(expense)	17.5	(4.1)

Notes to the financial statements continued

For the year ended 31 March 2020

11 Dividends

	2020 £m	2019 £m
Dividends available for distribution to investors in the ultimate parent company:		
Current year interim dividend	–	–
	–	–
Dividends not available for distribution to investors in the ultimate parent company:		
Current year interim dividend of £126.64 (2019: £622.41) per share	7.1	34.8
	7.1	34.8

The interim dividends of £7.1 million are paid to Southern Water Services Group Limited (SWSG). These dividends, along with associated group tax relief of £1.7 million, enable SWSG to pay the interest of £8.8 million due to Southern Water Services Limited on an inter-company loan as disclosed in note 14. These transactions are illustrated in the diagram on page 114 of the Annual Report.

No additional interim or final dividend has been declared for the year ended 31 March 2020 (2019: Interim additional – £nil, final – £nil).

12 Intangible assets

	Externally generated		
	Assets in development £m	Other £m	Total £m
Cost			
At 1 April 2019	11.8	116.3	128.1
Additions	9.6	–	9.6
Transfers	(3.0)	3.0	–
Disposals	–	–	–
At 31 March 2020	18.4	119.3	137.7
Amortisation			
At 1 April 2019	–	82.5	82.5
Charge for the year	–	13.1	13.1
Disposals	–	–	–
At 31 March 2020	–	95.6	95.6
Net book amount			
At 31 March 2020	18.4	23.7	42.1
At 31 March 2019	11.8	33.8	45.6

The company does not currently have any internally generated intangible assets.

Included within additions above is £0.5 million of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing Costs'. The cumulative net book value of the borrowing costs capitalised amount to £1.5 million (2019: £1.4 million).

Other intangible assets include software, studies and development projects.

13 Property, plant and equipment

	Land & buildings £m	Plant & machinery £m	Infra-structure assets £m	Assets under construction £m	Other £m	Total £m
Cost						
As previously reported at 31 March 2019	1,538.2	3,264.0	2,711.2	657.7	651.5	**8,822.6**
Recognition of right-of-use assets at 1 April 2019 (note 3)	30.9	–	–	–	2.3	**33.2**
As restated at 1 April 2019	1,569.1	3,264.0	2,711.2	657.7	653.8	**8,855.8**
Additions	–	–	–	492.3	–	**492.3**
Transfers	1.8	130.2	70.1	(227.1)	25.0	**-**
Disposals	–	(24.8)	(1.2)	–	(30.9)	**(56.9)**
At 31 March 2020	1,570.9	3,369.4	2,780.1	922.9	647.9	**9,291.2**
Depreciation						
At 1 April 2019	761.7	1,406.0	144.3	–	459.5	**2,771.5**
Charge for the year	41.6	129.7	32.9	–	46.7	**250.9**
Disposals	–	(24.8)	(1.2)	–	(30.9)	**(56.9)**
At 31 March 2020	803.3	1,510.9	176.0	–	475.3	**2,965.5**
Net book amount						
At 31 March 2020	**767.6**	**1,858.5**	**2,604.1**	**922.9**	**172.6**	**6,325.7**
At 31 March 2019	776.5	1,858.0	2,566.9	657.7	192.0	**6,051.1**

Freehold land is stated at a cost of £51.7 million at 31 March 2020 and 31 March 2019 and is not depreciated.

The company's interests in land and buildings are almost entirely freehold.

Included within additions above is £32.3 million (2019: £21.9 million) of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing costs'. The cumulative net book value of the borrowing costs capitalised amount to £216.9 million (2019: £191.8 million).

Assets held under finance leases

Included in the amounts shown above are the following amounts in relation to property, plant and equipment held under finance leases:

	Land & buildings £m	Other £m
As previously reported at 31 March 2019	–	2.9
Recognition of right-of-use assets at 1 April 2019 (note 3)	30.9	2.3
Depreciation charge for the year	(2.0)	(1.7)
Net book amount at 31 March 2020	**28.9**	**3.5**

14 Other non-current assets

Non-current receivables	2020 £m	2019 £m
Amounts owed by group undertakings	**130.0**	130.0

Amounts owed by group undertakings represent a loan to Southern Water Services Group Limited which is secured on the assets held under the Southern Water Services Group Security agreement and repayable on 31 July 2052 with interest payable at 7% per annum. During the previous year, repayments towards this loan totalling £682.3 million were paid to the company by SWSG. No repayments were made in the year to 31 March 2020.

Notes to the financial statements continued

For the year ended 31 March 2020

15 Investments

Shares in subsidiary Southern Water Services (Finance) Limited	2020 £m	2019 £m
At the beginning and end of the year	29.2	29.2

The company has the following direct investments in subsidiary undertakings at 31 March 2020:

	Registered Office	Class of share capital	Activity
Southern Water Services (Finance) Ltd (SWSF)	Ugland House, PO Box 309, George Town, Grand Cayman	Ordinary (100%)	To raise debt finance
Southern Water Executive Pension Scheme Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant
Southern Water Pension Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant

SWSF is tax resident in the UK for tax purposes. The directors are satisfied that the carrying value of the investment in SWSF is supported by the underlying assets and activities of SWSF.

The company is currently in the process of closing SWSF.

16 Inventories

	2020 £m	2019 £m
Raw materials	4.3	4.0
Work in progress	0.8	0.7
	5.1	4.7

17 Trade and other receivables

	2020 £m	2019 £m
Trade receivables	315.9	299.1
Provision for impairment	(213.3)	(185.8)
Net trade receivables	102.6	113.3
Loan to Southern Water Services (Finance) Limited	56.3	110.7
Amounts owed by other group undertakings	4.8	2.8
Other amounts receivable	17.9	16.4
Net accrued income	77.3	71.9
Prepayments	14.3	17.4
	273.2	332.5

Trade receivables comprise balances from contracts with customers where the company has performed some or all of its contractual obligations.

Amounts owed by group undertakings are unsecured, interest-free and settled regularly. All entities are wholly owned within the group.

Accrued income as at 31 March 2020 includes water and sewerage income not yet billed of £62.4 million (2019: £58.3 million).

The directors consider that the carrying values of trade and other receivables are reasonable approximations of their fair values.

Provision for impairment

Movements on the impairment provision were as follows:

	2020 £m	2019 £m
At 1 April	(188.7)	(180.0)
Impairment charge	(29.6)	(10.7)
Amounts written off during the year	1.9	2.0
At 31 March	(216.4)	(188.7)

At each reporting date, the company evaluates the recoverability of trade receivables and records allowances for impairment of receivables based on experience.

The company does not include in revenue and trade receivables those accounts that are deemed irrecoverable.

The following table provides information regarding the ageing of receivables that are specifically provided for:

	2020 £m	2019 £m
Current	–	0.3
1–2 years	0.1	0.2
2–3 years	0.1	0.3
3–4 years	0.1	0.4
more than 4 years	2.4	0.6
	2.7	1.8

A collective provision is recorded against assets which are past due but for which no specific provision has been made. This is calculated based on historical experience of levels of recovery.

The aged analysis of receivables that were overdue at the reporting date but not individually provided for is as follows:

	2020 £m	2019 £m
Current	76.8	75.9
1–2 years	44.4	47.1
2–3 years	38.9	38.9
3–4 years	33.8	31.3
more than 4 years	90.6	73.9
	284.5	267.1

The amounts above are reconciled to gross and net receivables in the tables below:

At 31 March 2020	Gross £m	Provision £m	Net £m
Accrued income – not due	80.4	(3.1)	77.3
Trade receivables			
Not due	28.7	–	28.7
Overdue not specifically provided	284.5	(210.6)	73.9
Overdue and specifically provided	2.7	(2.7)	–
	396.3	(216.4)	179.9

At 31 March 2019	Gross £m	Provision £m	Net £m
Accrued income – not due	74.8	(2.9)	71.9
Trade receivables			
Not due	30.2	–	30.2
Overdue not specifically provided	267.1	(184.0)	83.1
Overdue and specifically provided	1.8	(1.8)	–
	373.9	(188.7)	185.2

Notes to the financial statements continued

For the year ended 31 March 2020

18 Trade and other payables

	2020 £m	2019 £m
Trade payables	30.5	18.1
Amounts owed to group undertakings	27.7	134.7
Capital creditors and capital accruals	104.2	114.2
Taxation and social security	2.8	2.6
Accruals	65.0	57.0
Deferred revenue	30.6	35.7
	260.8	362.3

The directors consider that the carrying values of trade and other payables are not materially different from their fair values.

All amounts owed to group undertakings due within one year are unsecured, interest-free and repayable on demand. All entities are wholly owned within the group.

19 Current borrowings

	2020 £m	2019 £m
Unamortised debt issuance costs (note 20 (iii))	(1.5)	(1.5)
Bond premium deferred	0.7	0.7
Deferred gilt lock proceeds (note 20 (iv))	0.1	0.1
Deferred proceeds	4.7	4.7
Revolving credit facility	330.0	170.0
Class A £350m – 5.010% fixed rate 2021	349.5	–
Class A £300m – 6.135% fixed rate 2019	–	300.0
Other loans from subsidiary SWSF (note (i) below)	30.3	30.3
Current borrowings excluding finance leases	713.8	504.3
Obligations under finance leases	2.2	0.2
Total current borrowings including finance leases	716.0	504.5

The Class A £300 million bond was repaid on 1 April 2019.

(i) The loan from SWSF is unsecured, interest-free, and shall be repayable in whole or part upon demand at any time, provided that:

(a) On the date of such demand, no class A debt is outstanding, no class B debt is outstanding and no mezzanine debt is outstanding; or

(b) The consent of the Security Trustee is given.

20 Non-current borrowings

	Note	2020 £m	2019 £m
Loans from subsidiary Southern Water Services (Finance) Limited:	20(i)		
Class A £350m – 6.202% fixed rate 2029	20(ii)	**348.7**	348.6
Class A £150m – 3.716% index linked 2034		**243.7**	237.1
Class A £35m – 3.716% index linked 2034		**56.8**	55.3
Class A £350m – 6.650% fixed rate 2026	20(ii)	**349.0**	348.8
Class A £150m – 3.826% index linked 2023		**243.7**	237.1
Class A £350m – 5.010% fixed rate 2021	20(ii)	**349.5**	349.0
Class A £150m – 5.010% fixed rate 2041	20(ii)	**147.1**	147.0
Class A £200m – 4.510% fixed rate 2052	20(ii)	**197.2**	197.2
Class A £300m – 5.135% fixed rate 2056	20(ii)	**292.7**	292.6
Class A £300m – 6.135% fixed rate 2019	19, 20(ii)	**–**	300.0
Class A £175m – 2.790% fixed rate 2031	20(ii)	**174.0**	174.0
Class A £75m – 2.970% fixed rate 2036	20(ii)	**74.6**	74.6
Artesian £165m – 4.086% index linked 2033		**268.2**	261.0
Artesian £156.5m – 3.645% index linked 2032		**248.2**	241.5
Total Class A debt from Southern Water Services (Finance) Limited		**2,993.4**	3,263.8
Unamortised debt issuance costs	20(iii)	**(11.5)**	(13.0)
Bond premium deferred		**8.2**	8.8
Deferred gilt lock proceeds	20(iv)	**4.6**	4.8
Deferred proceeds	20(v)	**81.1**	85.8
Other loans from Southern Water Services (Finance) Limited	20(vi)	**30.3**	30.3
Total loans and other borrowings from Southern Water Services (Finance) Limited		**3,106.1**	3,380.5
Revolving credit facility – LIBOR plus margin	20(vii)	**330.0**	170.0
Class A £60m – 0.000% index linked 2025	20(viii)	**51.7**	61.1
Class A £40m – 0.000% index linked 2026	20(viii)	**41.0**	43.7
Class A1 and A2 Preference shares	20(ix)	**–**	9.9
Class B Preference shares	20(ix)	**69.8**	110.0
Obligations under finance leases	21	**30.4**	1.0
Total borrowings		**3,629.0**	3,776.2
Disclosed as current borrowings	19	**716.0**	504.5
Disclosed as non-current borrowings		**2,913.0**	3,271.7

These loans (excluding the preference shares) are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertakings of each of SWS, Southern Water Services (Finance) Limited (SWSF), SWS Holdings Limited, and SWS Group Holdings Limited. In the case of SWS, this is to the extent permitted by the Water Industry Act 1991 and Licence. Further, the company has a contingent liability arising on certain inter-company financing arrangements which will have the effect that if certain refinancings do not take place when the underlying instruments mature in 2021–29, the company will make good certain obligations of its subsidiary SWSF. The directors do not believe this to be likely and the liability, if any, cannot currently be quantified as it will depend wholly on the circumstances at the time of the maturity.

Notes to the financial statements continued

For the year ended 31 March 2020

20 Non-current borrowings continued

Notes in respect of the specific instruments above:

(i) Under the loan agreements between SWS and SWSF, SWSF advances an amount equal to each bond or other debt raised at the same interest rate plus 0.01%. Therefore, each individual back-to-back inter-company loan has been separately disclosed.

(ii) Fixed rate borrowings are recognised net of issue costs and discounts on issue and are carried at amortised cost using the effective interest rate method.

(iii) Unamortised debt issuance costs represent issue fees paid to SWSF that are not otherwise accounted for within the amortised cost of specific loans. Where these costs are attributable to a specific instrument they are being amortised over the life of that instrument. The remaining costs are being amortised over the weighted average life of the loans advanced at the time the costs were incurred. As at 31 March 2020 unamortised debt issuance costs amounted to £13.0 million of which £1.5 million represents the short-term amount which is disclosed separately in note 19.

(iv) Prior to the issue of the Class A £300 million bond in the year to 31 March 2008, SWSF entered into a gilt lock agreement, resulting in the receipt of £6.3 million, which was advanced to SWS along with the proceeds of the bond issue. The proceeds have been deferred in the financial statements of SWS and are being released to the income statement over the life of the loan.

(v) Deferred proceeds represent consideration received by the company in connection with taking on various debt obligations that were 'out of the money' at the time the debt obligations were entered into. The deferred proceeds are amortised over the lives of the related debt instruments.

(vi) The loan from SWSF is unsecured, interest-free, and shall be repayable in whole or part upon demand at any time, provided that:

(a) On the date of such demand, no Class A debt is outstanding, no Class B debt is outstanding and no mezzanine debt is outstanding; or

(b) The consent of the Security Trustee is given.

(vii) Revolving credit facility drawdowns accrue interest at LIBOR plus an applicable margin between 0.30% and 0.70%, determined by reference to the credit rating of the company.

(viii) The Class A £60 million loan is index linked with an interest rate of 0.00% until August 2025.
The Class A £40 million loan is index linked with an interest rate of 0.00% until May 2026.

(ix) The preference shares are redeemable at the option of SWS at any time.

The Class A1 and B preference shares, which do not carry voting rights, were issued on 23 July 2003, and are redeemable at their nominal value plus the share premium paid, on 31 March 2038 or at the company's option anytime earlier. Class A1 and B shares were issued at £1,000 per share and the amounts received totalled £260.0 million for both classes of shares. Class A2 preference shares were issued for £0.01 per share on 7 May 2003 and the amount received totalled £1,500. Class A2 shares, which do not carry voting rights, are also redeemable at nominal value. Shareholders are entitled to receive dividends annually as follows:

Class A1 – £40 per share

Class A2 – the base value dividend plus an amount for company out-performance and any savings arising from any refinancing of the mezzanine debt. The base value is £nil per share increasing by £15 every five years. (Out-performance from 1 April 2007 onwards is the difference between Southern Water Services Limited's audited 'profit before interest and taxation' and the targeted 'profit before interest and taxation' as determined by Ofwat in the periodic review.)

Class B – £70 per share

These dividends are payable on 31 March and 30 September each year.

On winding up the preference shareholders rank above ordinary shareholders with the preference shareholders being paid in order of Class A1, Class A2 then Class B.

On 28 June 2019, the company redeemed the remaining 9,863 of its Class A1 and Class A2 preference shares, and 19,340 of its Class B preference shares, at nominal value plus the premium on issue, including settlement for fixed or base value dividends due to that date. The total amount paid was £34.0 million comprising principal redemption of £29.2 million and dividends of £4.8 million.

On 11 December 2019, the company redeemed 20,831 of its Class B preference shares, at nominal value plus the premium on issue, including settlement for fixed dividends due to that date, and settlement for A2 out-performance and savings in the year ended 31 March 2019 accrued. The amount paid totalled £25.0 million.

The maturity profile of borrowings disclosed within this note is given below:	2020 £m	2019 £m
Borrowings excluding finance leases:		
Between one and two years	4.0	353.0
Between two and five years	255.8	249.2
After five years	2,625.0	2,668.7
	2,884.8	3,270.9
On demand or within one year	713.8	504.3
	3,598.6	3,775.2
Finance leases:		
Between one and two years	2.2	0.1
Between two and five years	6.2	0.7
After five years	19.8	–
	28.2	0.8
On demand or within one year	2.2	0.2
	30.4	1.0
Borrowings including finance leases:		
Between one and two years	6.2	353.1
Between two and five years	262.0	249.9
After five years	2,644.8	2,668.7
	2,913.0	3,271.7
On demand or within one year	716.0	504.5
	3,629.0	3,776.2

It is the company's policy to lease its commercial vehicles under finance leases. Obligations under finance leases relating to commercial vehicle leases comprise optional residual value balloon payments due at the end of the lease period, where the minimum lease payments (including finance charges) have been prepaid at the start of the lease. If the company opts not to pay the balloon payment, it must return the vehicle to the lessor.

For adjustments to finance leases following adoption of IFRS 16 in the current year, see note 3.

The average lease term is 30.2 years.

For the year ended 31 March 2020, the average effective borrowing rate for leases was 3.85% (2019: 4.17%). Interest rates are fixed at the contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

All lease obligations are denominated in sterling.

The fair value of the company's lease obligations is approximately equal to their carrying amount.

The company's obligations under finance leases are secured by the lessors' rights over the leased assets disclosed in note 13.

Notes to the financial statements continued

For the year ended 31 March 2020

21 Leases

This note provides information for leases where the company is a lessee.

i) Amounts recognised in the statement of financial position

The statement of financial position shows the following amounts relating to leases:

	2020 £m	2019* £m
Right-of-use assets within Property, Plant and Equipment:		
Buildings	28.9	–
Other	3.5	2.9
	32.4	2.9
Lease liabilities		
Current	2.2	0.2
Non-current	28.2	0.8
	30.4	1.0

* In the previous year, the company only recognised lease assets and lease liabilities in relation to leases that were classified as 'finance leases' under IAS 17 Leases. The assets were presented in property, plant and equipment and the liabilities as part of the company's borrowings. For adjustments recognised on adoption of IFRS 16 on 1 April 2019, please refer to note 3.

Additions to the right-of-use assets during the financial year to 31 March 2020 were £33.2 million.

ii) Amounts recognised in the income statement

The income statement shows the following amounts relating to leases:

	Year to 31 March 2020 £m
Depreciation charge of right-of-use assets	
Buildings	(2.0)
Other	(1.7)
	(3.7)
Interest expense (included in finance costs)	(1.2)
Expense relating to short-term leases (included in operating costs)	(1.3)

ii) Amounts recognised in the cash flow statement

Total cash outflow for leases in the year to 31 March 2020	(1.5)

iv) The company's leasing activities and how these are accounted for

The company leases various offices and vehicles.

Rental contracts are typically made for fixed periods, but may have extension options. Contracts may contain both lease and non-lease components. For leases of vehicles for which the company is a lessee, it has elected not to separate lease and non-lease components and instead accounts for these as a single lease component.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowing purposes.

Until the year to 31 March 2019, leases of property, plant and equipment were classified as either finance leases or operating leases, see note 1 for details. From 1 April 2019, leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the company.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease payments included in the measurement of the lease liability comprise (where applicable):

- fixed lease payments;
- variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date;
- the amount expected to be payable by the lessee under residual value guarantees;
- the exercise price of purchase options, if the lessee is reasonably certain to exercise the options; and
- payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.

The lease liability is presented as a separate line in the statement of financial position.

Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, which is generally the case for leases in the company, the lessee's incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

The company has a lease on its outfall pipes which contains variable lease payments. These payments will increase by RPI every 10 years. The next review date is on 1 April 2022 and the lease expires on 31 March 2096.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability
- any lease payments made at or before the commencement date less any lease incentives received
- any initial direct costs, and
- restoration costs.

Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. If the company is reasonably certain to exercise a purchase option, the right-of-use asset is depreciated over the underlying asset's useful life.

Payments associated with short-term leases of equipment and vehicles and all leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise assets less than £5,000.

22 Derivative financial instruments

Categories of financial instruments at fair value	2020 £m	2019 £m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	194.3	46.2
Total derivative financial assets	194.3	46.2

	2020 £m	2019 £m
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	(1,376.4)	(1,428.2)
Total derivative financial liabilities	(1,376.4)	(1,428.2)

Changes in value of financial instruments at fair value	2020 £m	2019 £m
Profit for the year has been arrived at after crediting/(charging):		
Financial assets at fair value		
Designated as FVTPL	148.1	3.2
Financial liabilities at fair value		
Designated as FVTPL	191.8	(219.8)
Fair value gains/(losses) on derivative financial instruments	339.9	(216.6)

Notes to the financial statements continued

For the year ended 31 March 2020

22 Derivative financial instruments continued

In November 2018 work was undertaken to amend the inflation-linked swaps held at Southern Water Services (Finance) Limited. Firstly, swaps were legally re-assigned from Southern Water Services (Finance) Limited to Southern Water Services Limited, before extending mandatory breaks from 2019 to 2025 on swaps with a notional value of £177.0 million, and re-couponing the receipt leg to increase the interest receivable of the extension period.

Other swaps with maturity dates of 2031, 2037, and 2041 were extended until 2046 by acquiring new instruments starting from the maturity date of the existing agreements.

These extensions, along with the existing remaining long-dated swaps, were then bifurcated with the result of increasing the interest receivable.

Upfront payments from Southern Water to the co-ordination bank/counterparties were required for all of these amendments, with the amounts totalling £113.6 million. The change in fair value of the related swap instruments immediately resulting from this restructure has been deferred to the balance sheet for amortisation in line with the related re-couponed period.

In December 2019 a further restructure took place to separate accretion related cash flows from the 2055 swap resulting in an upfront cash receipt of £140.0 million. The change in fair value of the related swap instrument immediately resulting from this restructure has been deferred to the balance sheet for amortisation in line with the related new instrument.

The fair values of derivative instruments (interest rate swaps) at the reporting date are determined using quoted prices adjusted for credit risk and are stated net of the deferred fair values mentioned above.

The regulatory framework, under which revenues and the RCV are indexed, exposes the company to inflation risk. The company enters into inflation-linked derivative financial instruments to manage its exposure to that risk.

Under interest rate swap contracts, the company agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the company to mitigate inflation risk on issued fixed rate debt held.

23 Deferred tax liabilities

Deferred tax is provided as follows:

	Accelerated tax depreciation £m	Revaluation of financial instruments £m	Retirement benefit obligations £m	Other – timing differences £m	Total £m
At 1 April 2018	513.6	(200.6)	(29.2)	(3.1)	280.7
(Credit)/charge to income statement	(4.5)	(27.2)	1.6	(0.7)	(30.8)
Prior year adjustment:					
– Charge to income statement	1.9	–	–	–	1.9
– Credit to other comprehensive income	–	–	(4.1)	–	(4.1)
At 1 April 2019	511.0	(227.8)	(31.7)	(3.8)	247.7
Charge/(credit) to income statement	(3.7)	65.3	2.7	(0.3)	64.0
Prior year adjustment:					
– Charge/(credit) to income statement	1.0	–	(1.8)	–	(0.8)
– Charge to other comprehensive income	–	–	19.0	–	19.0
Effect of change in tax rate:					
– income statement	59.8	(19.1)	0.1	(0.5)	40.3
– other comprehensive income	–	–	(1.5)	–	(1.5)
At 31 March 2020	**568.1**	**(181.6)**	**(13.2)**	**(4.6)**	**368.7**

Deferred tax assets and liabilities are offset where the company has a legally enforceable right to do so. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2020 £m	2019 £m
Deferred tax liabilities	568.1	511.1
Deferred tax assets	(199.4)	(263.4)
	368.7	247.7

24 Retirement benefit obligations

The deficit associated with retirement benefit obligations has decreased to £62.5 million (2019: £186.7 million). The main reason for the decrease in the deficit over the year is a decrease in the level of expected future price inflation, which has reduced the value placed on the scheme liabilities, as well as higher than assumed asset returns over the year and company contributions. This has been partially offset by an increase in assumed life expectancy and, less significantly, allowance for the Scheme closing to further accrual.

Pension schemes operated

The company principally operates one defined benefit pension scheme (final salary) and one defined contribution scheme, details of which are shown below:

1. Southern Water Pension Scheme (SWPS), a funded defined benefit scheme, was closed to new members on 31 December 1998, re-opened in July 2003 and closed once more to new entrants on 1 April 2005. This scheme has nine trustee directors. The Southern Water Services Executive Pension Scheme (SWEPS) was also closed to new entrants and merged with the SWPS on 1 April 2005.

   The Scheme closed to accrual with effect from 31 March 2020.

   The Trustees are responsible for administrating the fund which is held separately from the company. Legal and General and Blackrock are unit registrars for Southern Water Pension Scheme unit holdings, and appoint custodians at individual pooled fund level (not client holding level). The directors of SWS are responsible for setting the accounting assumptions for the fund for inclusion in these financial statements.

   As part of the company's interactions with both the Trustees and when required The Pensions Regulator, the company looks to agree a long-term funding and risk management strategy for the pension liability. Following on from regular dialogue with the Trustees, and discussions and correspondence with The Pensions Regulator regarding the deficit, the Board agreed a long-term funding solution for the scheme in 2018.

   The main risks of the scheme are as follows:

   a) Asset volatility
      For the purpose of setting the contribution requirements, the calculation uses a discount rate set with reference to Government bond yields, with allowance for additional return to be generated from the investment portfolio – whereas under FRS 101, the defined benefit obligation is calculated using a discount rate set with reference to corporate bond yields.

      The schemes hold a significant proportion of their assets in growth assets. The returns on these assets may be volatile and are not correlated to the value placed on the liabilities. This means that the deficit may be volatile in the shorter term, which may result in an increase in the contribution requirements and an increase in the net defined benefit liability recorded on the statement of financial position.

      However, the company believes that return-seeking assets offer an appropriate level of return over the long-term for the level of risk that is taken. Furthermore, the scheme's other assets are well diversified by investing in a range of asset classes, including liability driven investments, Government bonds and corporate bonds.

   b) Changes in bond yields
      A fall in bond yields increases the value placed on the liabilities for reporting purposes and for setting the company's contribution requirements. However, in this scenario the scheme's investment in corporate and Government bonds is expected to increase and therefore offset some of the increase in the value placed on the liabilities.

   c) Life expectancy
      The majority of the scheme's obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the scheme's liabilities. This is particularly significant where the longer duration and inflation-linked nature of the payments result in higher sensitivity to changes in life expectancy. The scheme does not contain a hedge against increases in future life expectancy.

   d) Inflation risk
      The majority of the scheme's benefit obligations are linked to inflation and higher outturn inflation will lead to a higher benefit obligation (although in most cases caps on the level of inflationary increases are in place to protect the plan against extreme inflation). The majority of the scheme's assets do not provide a direct hedge against changes in inflation as they are either fixed-interest in nature, e.g. corporate bonds and Government bonds, or have an indirect link to inflation, e.g. equities.

2. A second company stakeholder scheme, which is a defined contribution scheme, is also available to all employees.

   Contributions made to the defined contribution scheme for the year ended 31 March 2020 amounted to £4.9 million (2019: £3.9 million). No contributions were outstanding at either year-end.

Notes to the financial statements continued

For the year ended 31 March 2020

24 Retirement benefit obligations continued

Members of all schemes receive an annual statement of their accrued benefits.

The latest actuarial valuation of the SWPS was carried out as at 31 March 2019 using the projected unit method. For closed schemes under this method the current service cost will increase as the members of the schemes approach retirement.

The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on investments, and the level of inflation, which drives pension increases in the SWPS.

The principal assumptions in the valuation were as follows:

	2019 SWPS % per annum (pa)
Return on investments: pre-retirement	FI Gilt curve + 65 bps
Return on investments: post-retirement (pensioner/non-pensioner)	FI Gilt curve + 65 bps
Salary growth	2.50%
Pension increases on the excess over guaranteed minimum pensions (where capped at 5% pa)	3.00%

The term 'FI Gilt curve' refers to the generally available fixed interest gilt yield curve agreed by the Trustees and the company for the purposes of the 2019 actuarial valuation.

The assets of the scheme had a market value of £755.6 million at 31 March 2019. This was sufficient to cover 76% of the scheme's benefits. The weighted average duration of the scheme liabilities is 17.5 years.

The timing and quantum of future contributions in relation to the deficit have now been agreed with the Trustees and The Pensions Regulator. These contributions will be dependent on future levels of RPI, but if market breakeven rates are borne out at 31 March 2019 the expected base deficit contributions will be paid annually and total £211.8 million over the period from 1 April 2019 to 1 April 2029. The first payment was made in November 2018.

Expected employer contributions to the defined benefit scheme for 2020–21 are £17.5 million under the current Schedule of Contributions.

IAS 19 – assumptions, asset, liability and reserves disclosures

The company has employed an independent actuary to approximately update this valuation allowing for differences between the actuarial assumptions used by the scheme for funding purposes and those adopted by the company to measure the scheme's liabilities in the financial statements, as well as adjusting for benefit accrual and benefits paid by the scheme.

The major assumptions used by the actuary are set out in the table below:

	2020 % pa	2019 % pa
Price inflation (RPI)	2.5	3.2
Price inflation (CPI)	1.7	2.2
Rate of increase in salaries (plus an age-related promotional scale)	2.4	2.4
Rate of increase of pensions in payment (MIS* members only)‡	1.7	2.2
Rate of increase of pensions in payment (Old section† members only)‡	2.5	3.2
Rate of increase of pensions in payment (New section and ex FSLP (RPI max 5%))‡	2.5	3.1
Rate of increase of pensions in payment (Post 5 April 1988 GMP (CPI max 3%))‡	1.6	2.0
Rate of increase of pensions in payment (All sections post 31 March 2013 service (RPI max 2.5%))‡	1.9	2.2
Rate of increase for deferred pensions (MIS* members only)‡	1.7	2.2
Rate of increase for deferred pensions (Old section† members only)‡	2.5	3.1
Rate of increase for deferred pensions (New section and ex FSLP (RPI max 5%))‡	2.5	3.1
Rate of increase for deferred pensions (Post 5 April 1988 GMP (CPI max 3%))‡	1.6	2.0
Rate of increase for deferred pensions (All sections post 31 March 2013 service (RPI max 2.5%))‡	1.9	2.2
Discount rate	2.4	2.4

* MIS refers to the Southern Water Mirror Image Pension Scheme. Pensions in payment and deferment for this section will be indexed in line with the Consumer Price Index.

† For this section the Trustee will endeavour to meet any indexation of excess pension above the 5% per annum cap on increases that apply to other sections of the scheme.

‡ Pension increase assumptions allow for caps and floors where appropriate based on a statistical model (the Black–Scholes model).

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. For 2019–20, base tables have been updated in line with best estimate basis from the Trustees' 2019 Actuarial Funding Valuation, together with future improvements in line with CMI 2018 improvements with a long-term improvement rate of 1.25% per annum. Improvements rates are the same as those used in the prior year, as assuming greater improvements is not considered appropriate in light of the ongoing COVID-19 pandemic.

Assumed future life expectancy at age 65	2020 Years	2019 Years
Currently aged 65:		
Male	23.0	22.3
Female	24.9	24.0
Currently aged 45:		
Male	24.4	23.7
Female	26.4	25.6

The assets and liabilities in the scheme and the expected rates of return at 31 March 2020 and 31 March 2019 were:

	Value at 2020 £m	Value at 2019 £m
Equities	176.0	241.5
Government bonds	239.7	181.8
Non-Government bonds	343.5	313.7
Cash	18.4	18.8
Total market value of plan assets	777.6	755.8
Total value of plan liabilities	(840.1)	(942.5)
Accrued deficit in the plan	(62.5)	(186.7)
Related deferred tax asset	13.2	29.2
Net retirement benefit obligations	(49.3)	(157.5)

The equity investments and bonds which are held in plan assets are quoted and are valued at the current bid price.

The Government bond and cash allocation set out above includes £244.0 million held in a Liability Driven Investment (LDI) portfolio to mitigate interest rate risks arising from the liabilities.

Reconciliation of the present value of the scheme liabilities	2020 £m	2019 £m
At 1 April	942.5	908.4
Current service cost	6.4	6.2
Past service cost	–	1.8
Interest expense	22.2	24.1
Member contributions	0.3	0.1
Experience gain on liabilities	(27.2)	(3.3)
Actuarial loss/(gain) on liabilities:		
– due to changes in demographic assumptions	12.7	55.6
– due to changes in financial assumptions	(78.2)	(13.7)
Benefits paid	(39.9)	(36.7)
Settlements/Curtailment	1.3	–
Scheme liabilities at 31 March	840.1	942.5

Notes to the financial statements continued

For the year ended 31 March 2020

24 Retirement benefit obligations continued

Sensitivity analysis of the scheme liabilities

The sensitivity of the present value of the scheme liabilities to changes in the major assumptions used is set out below:

	Change in assumption	Impact on scheme liabilities (£m)
Discount rate	+ 0.1% p.a.	(13.4)
	- 0.1% p.a.	13.7
Price inflation (RPI measure)*	+ 0.1% p.a.	10.8
	- 0.1% p.a.	(11.0)
Mortality	+ 1 year	35.5
	- 1 year	(34.1)

* These movements have been calculated assuming that changes in the inflation assumption have a knock-on effect on the pension increase and salary growth assumptions (i.e. the 'real' increase rates are maintained).

The above sensitivity analysis is based on reasonably possible changes of the respective assumptions occurring at the end of the reporting period, while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. The methods and types of assumptions used in preparing the sensitivity analysis did not change compared to the previous period.

Reconciliation of the value of the scheme assets	2020 £m	2019 £m
At 1 April	755.8	736.7
Interest income	18.0	19.7
Gain on assets above interest	19.0	14.4
Employer contributions	24.4	21.6
Member contributions	0.3	0.1
Benefits paid	(39.9)	(36.7)
Bid value of scheme assets at 31 March	777.6	755.8

The total return on scheme assets was £40.7 million (2019: return of £34.0 million).

Total cost recognised as an expense	2020 £m	2019 £m
Current service cost	6.4	6.2
Past service cost	–	1.8
Curtailment	1.3	–
Net interest cost	4.2	4.4
Total income statement expense before deduction for tax	11.9	12.4

Analysis of the amounts recognised in other comprehensive income	2020 £m	2019 £m
Gain due to liability experience	(27.2)	(3.3)
Loss due to changes in demographic assumptions	12.7	55.6
Gain due to changes in financial assumptions	(78.2)	(13.7)
Return on plan assets greater than discount rate	(19.0)	(14.4)
Total (gain)/loss recognised in OCI before adjustment for tax	(111.7)	24.2

The cumulative amount of actuarial losses recognised in other comprehensive income is £167.7 million (2019: £279.4 million).

Analysis of the movement in the scheme deficit during the year	2020 £m	2019 £m
Deficit in the scheme at 1 April	(186.7)	(171.7)
Employer's contributions	24.4	21.6
Employer's current service cost	(6.4)	(6.2)
Employer's past service cost	–	(1.8)
Curtailment	(1.3)	–
Financing charge	(4.2)	(4.4)
Actuarial gain/(loss)	111.7	(24.2)
Deficit in the scheme at end of year	**(62.5)**	(186.7)

25 Regulatory settlement liability

	2020 £m	2019 £m
At 1 April	138.5	–
Settlements in year	(3.0)	–
Increase in year	–	138.5
At 31 March	**135.5**	138.5

Included in:	2020 £m	2019 £m
Current liabilities	35.6	3.0
Non-current liabilities	99.9	135.5
	135.5	138.5

In 2018–19 Ofwat concluded its investigation in relation to the management, operation and performance of the company's wastewater treatment works. That investigation resulted in Ofwat taking enforcement action, issuing Southern Water with a financial penalty of £3.0 million. To ensure that customers are not disadvantaged, the company has agreed to make customer rebates totalling £135.5 million in outturn prices (£129.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches between 2010 and 2017 identified in the investigation and these amounts have been provided for in the financial statements for 2018–19. The company has given a number of formal undertakings to Ofwat in relation to the numerous measures that have been put in place and are being put in place to ensure that the issues identified have ceased and cannot be repeated.

Notes to the financial statements continued

For the year ended 31 March 2020

26 Provisions for liabilities

	Environmental obligations £m	Other £m	Total £m
Balance at 1 April 2018	3.4	–	3.4
Utilised in year	(0.1)	–	(0.1)
Increase in year	3.3	–	3.3
Balance at 31 March 2019	**6.6**	**–**	**6.6**
Balance at 1 April 2019	6.6	–	6.6
Utilised in year	(1.0)	–	(1.0)
Increase in year	0.2	4.0	4.2
Balance at 31 March 2020	**5.8**	**4.0**	**9.8**

Included in:	**2020 £m**	2019 £m
Current liabilities	**5.1**	1.2
Non-current liabilities	**4.7**	5.4
	9.8	6.6

The environmental provision relates to management's best estimate for the decommissioning of abandoned sites and commitments made for environmental ecology work following the South Hampshire abstraction inquiry for the period up to 2030. No reimbursement is expected.

Other provisions includes £3.0 million relating to the payment of compensation for missed appointments under our Guaranteed Standards of Service Scheme and represent a best estimate of the value of payments to be made over the course of the coming year.

Environment Agency

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

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

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

The company is working proactively with the Environment Agency to resolve its separate investigation into sampling compliance and reporting issues 2010 and 2017 (inclusive). The Board, supported by external legal advice, has again and for similar reasons concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from this separate investigation but will also keep this under review.

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

27 Other non-current liabilities

	Deferred Revenue £m	Grants & contributions £m	Total £m
Balance at 1 April 2019	13.4	14.0	27.4
Receivable in year	–	6.8	6.8
Released to income statement	(0.3)	(1.2)	(1.5)
Balance at 31 March 2020	**13.1**	**19.6**	**32.7**

These grants and contributions relate to property, plant and equipment.

Deferred revenue of £13.1 million (2019: £13.4 million) relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by SWS. The income will be credited to the income statement evenly over the life of the lease.

28 Called up share capital

	2020 £m	2019 £m
Equity shares		
Authorised		
46,050,000 ordinary shares of £1 each	**46.1**	46.1
Allotted and fully paid		
56,000 ordinary shares of £1 each	**0.1**	0.1
Non-equity shares		
Issued		
Preference shares		
Nil (2019: 9,863) Class A1 shares of £1 each	**0.0**	0.0
Nil (2019: 9,863) Class A2 shares of £0.01 each	**0.0**	0.0
69,829 (2019: 110,000) Class B shares of £1 each	**0.1**	0.1

The redeemable preference shares are presented as a liability (see note 20) at an amount of £69.8 million including share premium of £69.7 million and accordingly are excluded from called up share capital in the balance sheet. The total statutory company share premium of £116.0 million includes ordinary share premium of £46.3 million.

On 28 June 2019, the company redeemed the remaining 9,863 of its Class A1 and Class A2 preference shares, and 19,340 of its Class B preference shares, at nominal value plus the premium on issue, including settlement for fixed or base value dividends due to that date. The total amount paid was £34.0 million comprising principal redemption of £29.2 million and dividends of £4.8 million.

On 11 December 2019, the company redeemed 20,831 of its Class B preference shares, at nominal value plus the premium on issue, including settlement for fixed dividends due to that date, and settlement for A2 out-performance and savings in the year ended 31 March 2019 accrued. The amount paid totalled £25.0 million.

29 Share premium account

	2020 £m	2019 £m
Equity share premium		
Balance at 1 April and at 31 March	**46.3**	46.3

Notes to the financial statements continued

For the year ended 31 March 2020

30 Non-distributable reserve

	£m
Balance at 1 April 2018	46.7
Profit for the financial year	8.5
Transfer to retained earnings	(1.4)
Balance at 1 April 2019	53.8
Profit for the financial year	7.8
Transfer to retained earnings	(1.4)
Balance at 31 March 2020	**60.2**

Non-distributable reserves comprise the value of sewer adoptions previously recognised at fair value, deferred and amortised to the income statement over the life of the related assets. Under IFRS 15 the company recognises the fair value upon adoption, i.e. the point at which control of the asset is obtained, through profit and loss to non-distributable reserves. This reserve is released to retained earnings in line with the amortisation of the related assets.

31 Retained earnings

	£m
Balance at 1 April 2018	1,032.4
Equity dividends paid	(34.8)
Loss for the financial year	(241.4)
Other comprehensive expense for the year	(20.1)
Transfer from non-distributable reserve	1.4
Balance at 1 April 2019	737.5
Equity dividends paid	(7.1)
Profit for the financial year	320.9
Other comprehensive income for the year	94.2
Transfer from non-distributable reserve	1.4
Balance at 31 March 2020	**1,146.9**

32 Notes to the statement of cash flows

	2020 £m	2019 £m
Continuing operations		
Operating profit	**212.3**	117.9
Adjustments for:		
Fair value of sewer adoptions	**(7.8)**	(8.5)
Depreciation of property, plant and equipment	**250.9**	249.6
Amortisation of intangible assets	**13.1**	22.3
Receipt of grants and contributions*	**6.8**	–
Difference between pension charge and cash contributions	**(16.7)**	(13.7)
Amortisation of grants and contributions	**(1.2)**	(1.1)
Operating cash flows before movements in working capital	**457.4**	366.5
Increase in inventories	**(0.3)**	(1.8)
Decrease/(increase) in receivables	**7.9**	(11.0)
Increase in payables	**13.1**	2.6
(Decrease)/increase in regulatory settlement liability	**(3.0)**	138.5
Increase in provisions	**3.2**	3.2
Cash from operations	**478.3**	498.0
Tax paid	**(1.7)**	(8.2)
Net cash from operating activities	**476.6**	489.8

* Contributions and grants received of £6.8 million have been presented as operating cash flows in 2019–20 (investing cash flows in 2018–19) as these credits are released to operating costs over the useful economic life of the non-current asset to which they relate. These were not material in 2018–19 therefore no change to prior period cash flow presentation was made.

Cash and cash equivalents	2020 £m	2019 £m
Cash and bank balances	129.3	372.0

Cash and cash equivalents comprise cash and short-term bank deposits. The carrying amount of these assets is equal to their fair value. Net debt comprises borrowings including re-measurements for changes in fair value of derivatives, finance lease liabilities, net cash and cash equivalents.

The table below details changes in liabilities arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the cash flow statement as cash flows from financing activities.

Analysis of net debt (including changes in liabilities from financing activities)	At 1 April 2019 £m	Cash flow changes £m	Fair value adjustments £m	New finance leases £m	Other non-cash changes £m	At 31 March 2020 £m
Cash and cash equivalents	372.0	(242.7)	–	–	–	129.3
Net liabilities from financing activities:						
Term facilities/index linked loans (note 20)	(274.8)	(147.2)	(0.7)	–	–	(422.7)
Loans from subsidiary (note 20)	(3,380.5)	300.0	(29.6)	–	4.0	(3,106.1)
Finance lease liabilities (notes 20, 21)	(1.0)	1.5	–	(30.9)	–	(30.4)
Redeemable preference shares (note 20)	(119.9)	50.0	–	–	0.1	(69.8)
Net interest rate swaps (note 22)	(1,382.0)	(140.0)	339.9	–	–	(1,182.1)
Total liabilities from financing activities	(5,158.2)	64.3	309.6	(30.9)	4.1	(4,811.1)
Net debt	(4,786.2)	(178.4)	309.6	(30.9)	4.1	(4,681.8)

Other non-cash changes to loans from subsidiary of £4.0 million relate to the amortisation of loan issue costs, bond premium, gilt lock proceeds and deferred proceeds.

Balances at 31 March 2020 comprise:	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m	Total £m
Cash and cash equivalents	–	129.3	–	–	129.3
Derivative financial instruments	194.3	–	–	(1,376.4)	(1,182.1)
Unamortised debt issuance costs	–	–	1.5	10.0	11.5
Gilt lock proceeds	–	–	(0.1)	(4.5)	(4.6)
Borrowings due within one year	–	–	(715.2)	–	(715.2)
Borrowings due after one year	–	–	–	(2,890.3)	(2,890.3)
Finance leases	–	–	(2.2)	(28.2)	(30.4)
Net debt	194.3	129.3	(716.0)	(4,289.4)	(4,681.8)

Borrowings due within one year relate to amounts repayable on demand or within 12 months of the balance sheet date (see note 20).

33 Contingent liabilities

Companies of the size and scale of Southern Water Services Limited are sometimes subject to a number of claims, disputes and potential litigation. The significant ones currently include ongoing investigations by regulatory bodies (the EA and DWI) as well as a potential claim in respect of property search income. The directors consider that, where a liability is probable, and where it is possible to be estimated reasonably, an appropriate position has been taken in reflecting such items in these financial statements. Separate consideration of the EA investigations is et out in note 26.

Following the South Hampshire abstraction inquiry, Southern Water Services Limited has committed to undertake certain environmental work on the rivers Itchen, Test and Candover Stream between 2018 and 2030. A provision has been made in the accounts of 2018–19 in relation to costs of the ecology work associated with this agreement and further details are disclosed in note 26 to the accounts. Certain compensatory costs may become due in the future, subject to conditions at that time and the impact of the ecology work undertaken. These have not been provided for and could increase the obligation by approximately £2 million.

Contractors submit claims to the company for the estimated final cost of their works. These claims are reviewed to assess where the liability for the costs rests and the amount that will actually be settled. The expected amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractor's claim and Southern Water Services Limited's valuation.

The company had no contingent liabilities for capital claims at the year-end (2019: £nil).

Notes to the financial statements continued

For the year ended 31 March 2020

34 Financial commitments

(a) Capital commitments are as follows:

	2020 £m	2019 £m
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	301.3	615.2
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	10.7	15.8

(b) The company as lessee

	2020 £m	2019 £m
Lease payments under operating leases recognised as an expense in the year	1.3	4.4

As at 31 March 2020 and 2019, the company had outstanding commitments for future minimum lease payments under non-cancellable operating leases in respect of vehicles and land and buildings which fall due as follows:

	Land and Buildings		Other	
	2020 £m	2019 £m	2020 £m	2019 £m
Within one year	–	1.7	–	–
In the second to fifth years inclusive	–	7.0	–	–
After five years	–	11.4	–	–
	–	20.1	–	–

Operating leases are charged to the income statement over the lease term.

In the previous year, operating lease payments represented rentals payable by the company for certain of its office properties and company vehicles, not classified as 'finance leases' under IAS 17 Leases. These are now presented in property, plant and equipment and the liabilities as part of the company's borrowings. For adjustments recognised on adoption of IFRS 16 on 1 April 2019, please refer to note 3.

Commercial vehicle leases are negotiated for an average term of five years, and rentals are fixed for an average of five years, with an option to extend on an ad hoc basis at the then prevailing market rate.

35 Related party transactions and ultimate controlling party

The immediate parent undertaking is SWS Holdings Limited.

The ultimate parent company and ultimate controlling party is Greensands Holdings Limited (GSH), a company incorporated in Jersey, which is the parent undertaking and controlling party of the smallest, largest and only group to consolidate these financial statements. Copies of the consolidated financial statements may be obtained from the registered office of GSH at Southern House, Yeoman Road, Worthing, BN13 3NX, or from the Southern Water website.

The largest shareholder in GSH as at 31 March 2020 is an institutional investment company advised by JP Morgan Asset Management owning 31.24%.

The company has taken advantage of the exemption under FRS 101 'Reduced Disclosure Framework' in not disclosing details of transactions with other companies which are 100% wholly owned. Equivalent disclosures are given in the group financial statements of GSH.

36 Post balance sheet events

In May 2020 the company's subsidiary Southern Water Services (Finance) Limited raised additional financing of £825 million (net £814.9 million) under a sustainability framework which ensures proceeds are used for environmental, green, and social purposes, including the repayment of debt issued for the same purpose. The use of the proceeds will include investment in the business plan 2020 to 2025 of SWS and the repayment of a £350.0 million bond maturing 31 March 2021. This replaces a short-term revolving credit facility of £700.0 million that was in place from 31 March 2020.

Independent Auditor's report

To the members of Southern Water Services Limited

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of Southern Water Services Limited (the 'company'):

- **give a true and fair view of the state of the company's affairs as at 31 March 2020 and of its profit for the year then ended;**
- **have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and**
- **have been prepared in accordance with the requirements of the Companies Act 2006.**

We have audited the financial statements which comprise:

- the income statement;
- the statement of other comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- the statement of cash flows; and
- the related notes 1 to 36.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including Financial Reporting Standard 101 "Reduced Disclosure Framework".

Basis for opinion

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

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other 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.

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Litigation and claims associated with the waste water plants; • Provision for bad and doubtful debts; • Revenue recognition – estimating unbilled household revenue; and • Classification of costs between operating and capital expenditure. Within this report, key audit matters are identified as follows: Newly identified Increased level of risk Similar level of risk Decreased level of risk
Materiality	The materiality that we used was £11m which was determined on the basis of 5% of operating profit.
Scoping	The company is in full scope of our audit. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.
Significant changes in our approach	Our approach is consistent with the previous year.

Independent Auditor's report continued

to the members of Southern Water Services Limited

Conclusions relating to going concern

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

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

We have nothing to report in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgment, 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.

Litigation and claims associated with the wastewater plants

Key audit matter description

During the year ended 31 March 2020, the company has been under investigation from the Environment Agency ('EA') in respect of two significant matters.

The first relates to permit breaches at wastewater treatment works during the period 2010–15. In February 2020 the EA presented 51 charges before the court and the company has entered guilty pleas to these charges. The exact nature and scale of the permit breaches over the period are still under investigation.

The ultimate obligation arising from this matter cannot presently be determined because of the very wide range of possible outcomes in the sentencing guidelines, the uncertain and disputed levels of culpability and environmental harm, the lack of precedent, and the fact that for sentencing purposes Southern Water would be considered a Very Large Organisation meaning that the court has broad discretion in determining the penalty that might be applied. The Board, supported by legal advice, was not able to make a reliable overall estimate of the financial obligation that will arise from this EA prosecution, notwithstanding the guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, recognising that there will be a minimum liability associated with the permit breaches the Board has therefore recognised a provision of £1.0m for the 51 cases brought to date, reflecting a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs.

The second separate investigation is into sampling compliance and reporting issues between 2010 and 2017 (inclusive) and is ongoing. The Board, supported by legal advice, has again and for similar reasons concluded that it is not yet possible to make a reliable estimate of the financial obligation and this is disclosed as a contingent liability.

We have identified a potential risk of bias in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance.

Further details are included within the Audit Committee report on pages 176 to 177 , critical accounting estimates and judgments note (note 2) and in note 26 to the financial statements.

How the scope of our audit responded to the key audit matter	With regards to the EA investigation above we have: • obtained an understanding of key controls; • reviewed relevant recent correspondence with the EA; • performed enquiries of management regarding the status and views on the EA investigation and the charges announced; • read Board minutes and considered the Board's assessment in relation to quantifying the risk of penalty, if any, arising from the EA investigations; • evaluated the competence, capabilities and objectivity of external lawyers, performed enquiries and read documentation received to understand their views and position in regards to the EA investigation and charges; • considered whether there are any industry or legal precedents that are applicable in forming the judgments applied; • challenged management on the provisioning basis, accounting approach for the EA liability, impact of the EA provision assumption on the going concern assessment and disclosures in the annual report; • assessed the completeness and accuracy of the disclosures made by the company in respect of the regulatory matters.
Key observations	We are satisfied that the treatment of the EA investigations reflects the best available evidence at the time of issuing the financial statements and consider that the disclosures in the financial statements are appropriate.

Provision for impairment of trade receivables

Key audit matter description	At 31 March 2020 the company held a bad debt provision of £216.4m (2019: £188.8m) and accrued a bad debt charge during the year of £29.6m (including £16.0m estimate in relation to COVID-19 impact) that represents 3.3% of the company's revenue (2019: £10.7m and 1.3% of revenue). The company has a significant domestic customer base and due to regulations is not allowed to interrupt water supply, including in the event of non-payment. A proportion of the company's customers do not or cannot pay their bills, which results in the need for a provision to be made for non-payment of the customer balance. The bad debt provision is a key area of judgment and is based on assumptions made on the forecast collectability of debts across both invoiced amounts and accrued revenues. We focused our work on the estimation of the bad debt provision on the following areas: • The accuracy of customer data included within the aged debt report, specifically whether customer data has been correctly classified based on the age of debt; • The reasonableness of the cash collection assumptions made by management, including the impact of COVID-19. We have identified a potential risk for bias in relation to this audit matter due to its influence on key metrics which management use to monitor and report business performance. Further details are included within the audit committee report on pages 176 to 177, critical accounting estimates and judgments note (note 2) and in note 17 to the financial statements.

Independent Auditor's report continued

to the members of Southern Water Services Limited

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

We have:

- obtained an understanding of key controls within the bad debt estimation process;
- engaged an IT specialist to test management's IT system logic and methodology;
- performed test of details to verify the accuracy of information within the aged debt report to assess whether customer debt is accurately categorised based on information contained within the company's billing cycle;
- verified that the final provision has been calculated in line with the policy of the company and in line with the requirements of IFRS 9 Financial Instruments;
- challenged management's bad debt policy and methodology specifically on whether the recoverability assumptions are reflective of current cash collection rates and whether the final provision is in line with industry peers;
- assessed the cash collection performance in the year against management's budgets;
- analysed post balance sheet cash collection and direct debit cancellation trends;
- assessed that the increase in bad debt due to COVID-19 is supported by macroeconomic metrics and forecasts and considered contradictory evidence, including water industry reports; and
- audited specific provisions and adjustments included in the total provision balance by understanding the rationale for the adjustment including agreement to supporting documentation.

Key observations

We are satisfied that the assumptions applied in assessing the impairment of trade receivables are reasonable and have been applied appropriately to compute the bad debt provision.

Revenue recognition – estimating unbilled household revenue

Key audit matter description

For customers with meters, the revenue recognised depends upon the volume of water supplied, including an estimate of the sales value of water supplied between the date of the last meter reading and the year end. The total unbilled income accrual for the year to 31 March 2020 is £241m (2019: £134m).

The most judgmental area of the estimation of unbilled revenue related to the usage estimate, which is based on historical data and assumptions around consumption patterns. Due to the level of management judgment, the estimation of unbilled household revenue has been identified as a key audit matter. Incorrect estimates of water consumption could lead to overstatement of revenue in the period.

We have identified a potential risk for bias in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance.

Further details are included in the critical accounting estimates and judgments note (note 2) and in note 5 to the financial statements.

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

We have:

- obtained an understanding of key controls within the unbilled revenue estimation process;
- reperformed management's analysis of the accrued income amount;
- performed a retrospective assessment of the previous year's accrual by comparing bills raised during 2019–20 relating to the 2018–19 accrual to determine the accuracy of management's forecasting;
- tested the accrued income balance by selecting a sample of individual properties and verified historical billing rates for each selection to confirm the appropriateness of the accrual;
- performed substantive testing of manual adjustments applied by management to the period end accrued income balance; and
- involved IT audit specialists to test the accuracy of the system generated reports utilised by management in determining the required accrual.

Key observations

We are satisfied that management's estimates in relation to the recognition of unbilled revenue are appropriate.

Classification of costs between operating and capital expenditure	
Key audit matter description	The company continues to invest significantly in infrastructure renewal and replacement, with property, plant and equipment and intangible asset additions, excluding any additions due to IFRS 16 adoption, of £501.8m (2019: £442.2m) in the period that includes £56.5m (£60.2m) of capitalised overheads. Expenditure incurred to increase the capacity or enhance 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 judgmental. This risk also includes the inappropriate capitalisation of overheads. We have identified a potential risk for bias in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance. Further details are included within critical accounting estimates and judgments note (note 2) and in note 13 to the financial statements.
How the scope of our audit responded to the key audit matter	We have: • obtained an understanding of key controls surrounding the capitalisation of costs; • assessed the company's capitalisation policy to determine compliance with relevant accounting standards; • assessed the application of the capitalisation policy to the costs incurred by selecting a sample and agreeing to third party invoices; • analysed and considered the changes from prior year and performed detail audit testing on a sample basis of all the cost centres and agreeing the basis of the calculation to supporting documentation; • inspected the calculations behind the percentages applied to new cost centres and validated the calculations for accuracy and consistency across the business; and • tested the accuracy of the overheads capitalisation by re-performing management's calculation for a sample of cost centres, and agreeing key inputs to supporting documentation.
Key observations	We consider that the classification of costs between operating and capital expenditure is appropriate.

Our application of materiality

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

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

Materiality	£11.0m (2019: £12.7m)
Basis for determining materiality	Materiality has been determined as 5% (2019: 5%) of operating profit.
Rationale for the benchmark applied	We determined materiality based on operating profit as this is the key metric used by management, investors, and lenders.

Independent Auditor's report continued

to the members of Southern Water Services Limited

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. Company performance materiality was set at 60% of company materiality for the 31 March 2020 audit (2019: 70%). In determining performance materiality, we considered factors including impact of COVID-19 on business operations and account balances, our ability to rely on general IT controls, management's willingness to make process improvements as well as to correct errors identified.

Error reporting threshold

We agreed with the Audit Committee that we would report to the committee all audit differences in excess of £0.56m (2019: £0.64m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

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

Other information

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

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

We have nothing to report in respect of these matters.

Responsibilities of directors

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

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

Auditor's responsibilities for the audit of the financial statements

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

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.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

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

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

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

Opinion on other matters prescribed by our engagement letter

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the provisions of the Companies Act 2006 that would have applied were the company a quoted company.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

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

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

We have nothing to report in respect of these matters.

Directors' remuneration

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

We have nothing to report in respect of this matter.

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.

Anthony Matthews

Anthony Matthews FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
15 July 2020

Notes

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