Annual Performance Report

Regulatory reporting 2021–22

from Southern Water

Contents

Regulatory information and annual performance report

Introduction

Our Annual Performance Report sets out the performance in 2021–22 of Southern Water's regulated business, as defined under our Licence[1], in financial terms and against our business outcome and performance commitments.

This Annual Performance Report comprises four sections:

1. Regulatory financial reporting
2. Price control and additional segmental reporting
3. Performance summary
4. Additional regulatory information – service level.

The additional information required under RAG 3.13, including a copy of all the data tables, has been published alongside this document as an appendix to the Annual Performance Report and can be found at **southernwater.co.uk/our-reports**.

The Annual Performance Report also includes:

- a Board statement of company direction and performance
- a compliance statement in relation to our compliance with relevant statutory, licence and regulatory obligations and how we are taking appropriate steps to manage and/or mitigate any risks we face
- a Board assurance statement on the accuracy and completeness of data and information
- Board assurance statement on Condition P (ring fence certificate)

These are supported by the publication of a data assurance summary on our website – **southernwater.co.uk/our-reports**. This sets out the results of the data assurance undertaken on our reporting and other key activities for 2021–22.

Board Statement of Company Direction and Performance

In the sections below we, as the Board of Southern Water, describe how we set the direction of the company and ensure it is delivering performance that meets customers' and stakeholders' expectations. In particular, we describe how the company developed the longer-term vision and Business Plan for the period 2020–25 and how it has continued to engage with customers in the delivery phase of the plan. We describe our initial planning for the next regulatory period, 2025–30 and beyond. We also describe how we, the Board, monitor performance and risk, how we have performed against our business plan objectives during 2021–22 and how performance affects the returns to shareholders and the pay of our executive team.

Our vision and business plan for 2020–25

The purpose of Southern Water is to provide water for life to:

- enhance health and wellbeing,
- protect and improve the environment,
- sustain the economy.

To deliver that purpose, we have set out an ambitious vision to create a resilient water future for customers in the South East.

Our vision and purpose reflect careful consideration and analysis of the key influences on our sector and within our region including:

- The future challenges facing our sector, our region and society
- The future direction of regulation and Government policy
- The views of our stakeholders and customers

Our stakeholders and customers played a key role in shaping our vision and our business plan for the period 2020–25. We carried out over 42,000 direct interviews with customers and other stakeholders to inform our strategy and develop our business plan. In the development of our business plan for 2020–25, 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. These twin goals of delivering the basics brilliantly and planning for the future are reflected in our plan which is built around five service-based outcomes and five transformational programmes.

As we deliver our plan we continue to engage with and capture insight from our customers every day, through our formal structures, such as our Water Futures 2050 and Water Futures 2030 customer panels, through focused research on specific issues and through our normal customer contact channels, social media and stakeholder discussions. (For more details of how we engage with our customers see section on Customer Expectations on page 8.)

[1] We operate in accordance with an Instrument of Appointment (our 'Licence') issued, by the Secretary of State, to us as a water and sewerage undertaker under the Water Industry Act 1991. The Water Services Regulation Authority (Ofwat) has a duty under the Water Industry Act 1991 to ensure compliance with the conditions of this Licence.

Planning for the future

Although we are only two years into delivery of our current five-year plan the process for developing our plan for the next five-year period, which runs from 2025–30 is already underway.

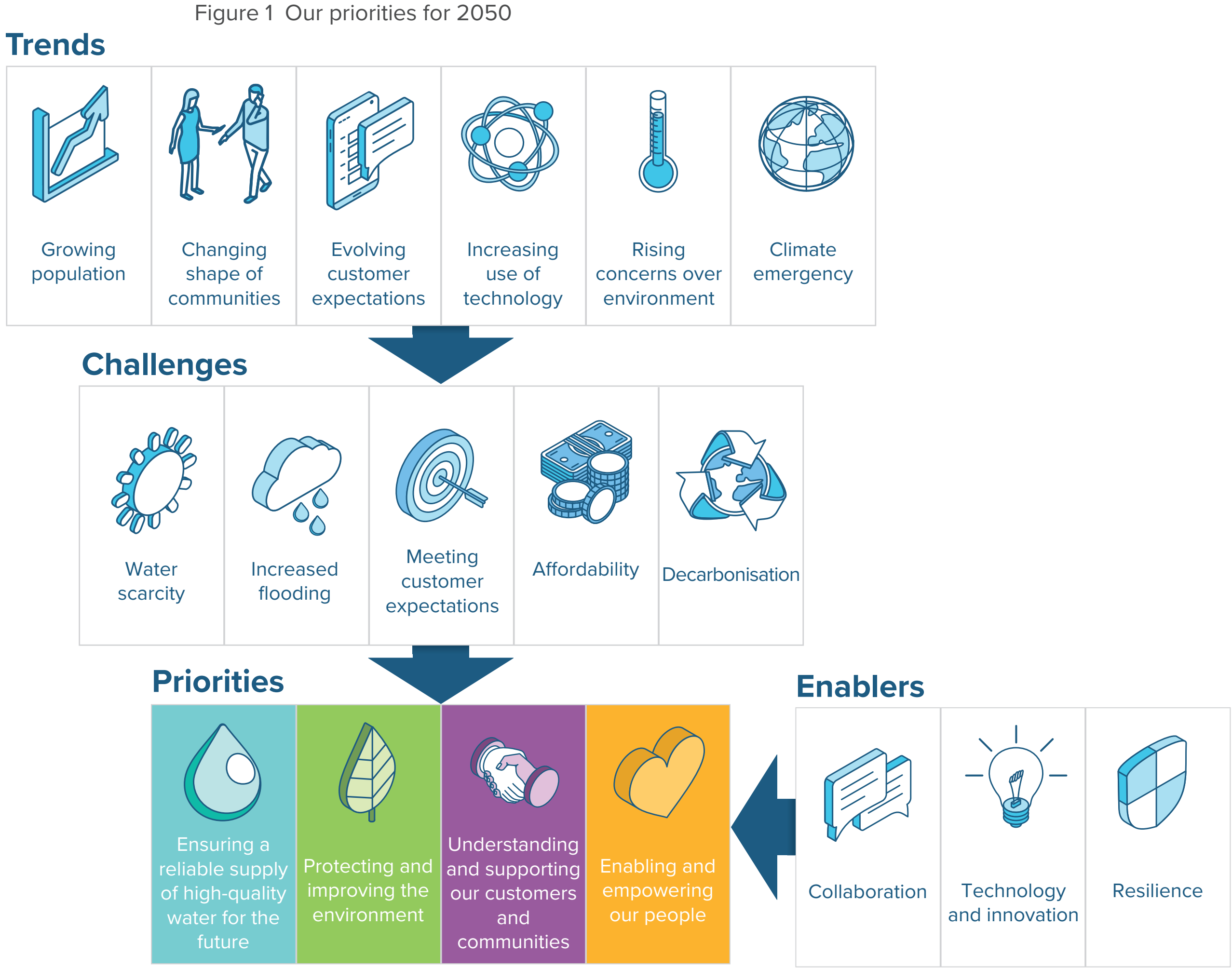
In September 2017, we published Water Futures in the South East: Towards 2050, an independent report outlining the unprecedented change, challenges and opportunities facing our already water-stressed region. To inform our long-term planning we recently revisited and updated this analysis, identifying a number of current and longer-term trends that will impact us, our customers and the environment leading to five key long-term challenges and opportunities for the period between now and 2050. These are shown in Figure 1 below.

Based on our analysis of these long-term challenges and opportunities, alongside our understanding of what our customers want from us and what our stakeholders expect, we have identified four key priorities which will allow us to deliver our ambitions for stakeholders. These priorities include three direct outcomes where stakeholders will be able to see the benefits to them and the region and one 'enabling' priority that will ensure our successful delivery of our vision.

These long-term priorities will inform the development of our detailed long term delivery plan to 2050, which we will publish next year. This will include the setting of ambitious targets in these key areas, and will also build on the work that has been ongoing for the last 18 months to develop our Water Resources Management Plan, which sets out our plan for balancing the supply and demand for water over the next 80 years, and our Drainage and Wastewater Management Plan, which analyses the key wastewater challenges and solutions in each of our drainage catchments over the next 25 years.

Based on consultation with our customers, including careful consideration of the balance between the need to invest to meet the challenges and make the most of the opportunities we face, and the affordability of bills for our customers, we will develop our plan for the next five-year period from 2025–30. We will submit our five-year plan to Ofwat in October 2023, with final decisions coming from Ofwat in December 2024.

Figure 1 Our priorities for 2050



To support this process, and ensure we build a plan that reflects the needs and priorities of all of our customers, we have created two customer groups:

- Water Futures 2050 (our young person's group); and
- Water Futures 2030 (our household customer panel).

These groups provide a central hub for members to provide insight, help us develop clear materials for engagement with other customers and challenge our strategic plans. These hubs help to connect the range of engagement activity and ensure customer insight can feed in at every stage quickly, efficiently and through best practice guidance as set out by the Consumer Council for Water (CCW). And to ensure that we effectively capture, understand and translate this insight in to our 2025–30 business plan we recently established an independent Customer and Communities Challenge Group, who will oversee all of our customer engagement, advise the board on how best to reflect customer views in our plan and, ultimately, report to Ofwat on how effectively we have done this.

Delivering for our customers

We are now two years into the delivery of our business plan for the 2020–25 period. These two years have been dominated by the COVID-19 pandemic and have been extraordinarily challenging for both our customers and our staff. Despite the challenges we are proud that we have continued to deliver an essential service to our customers and communities.

As we emerge from the worst of the pandemic we now face a new cost of living challenge with general price inflation at levels not seen in a generation. Through the Ofwat regulatory rules our prices are linked to the main measure of inflation, CPIH, which provides some protection for us. But we are not immune to the cost challenges, which affect the cost of delivering services and, in particular, the costs of our construction projects to deliver environmental and customer improvements, with the price of construction materials increasing by much more than general inflation. Despite this, recognising the acute pressure on the household budgets of our customers, the Board took the decision in January 2022 to limit our annual price increases below the level allowed by Ofwat, with prices for dual service customers actually falling by 1.3% from £407 a year to £402.

Our business plan for 2020–25 includes some ambitious targets to improve the service that we provide to customers by 2025. These include:

- A 15% reduction in leakage and a 23% reduction in water supply interruptions
- A 20% reduction in both internal and external sewer flooding incidents and an 80% reduction in the number of pollution incidents
- Generating 24% of our energy from renewable sources
- Further increasing the number of beaches achieving Good and Excellent water quality status
- Improving the health of the rivers in our region

Details of our performance against our targets for the second year of this business plan period 2021–22 are provided in the Strategic Report section of our Annual Report and Financial Statements. In addition, details of our performance against our commitments are set out in Table 3A on page 55.

The past year has seen improvements in a number of areas including water and wastewater treatment works compliance, where the number of works not meeting their discharge permit requirements reduced from 10 to 7, pollution incidents, which reduced by 7.5% from 402 to 372 (though there was an increase in serious pollution incidents from 4 to 12) and the average duration of supply interruptions which fell from 12 minutes 43 seconds to nine minutes and 22 seconds. Although these improvements have supported our ODI performance all were subject to scrutiny as part of the EA Environment Performance Assessment for 2021 (see page 10 for detail).

Nonetheless performance overall has fallen short of the very challenging performance targets that Ofwat set within its final determination (the basis on which our plan for 2020–25 was approved), and as a result we have incurred significant penalties under Ofwat's Outcome Delivery Incentive (ODI) regime.

Penalties for missing performance targets in this second year totalled £40 million[1,2], which will be reflected in reductions in customer bills in 2023–24. This is a slight reduction compared with the 2020–21 of £47 million. As with last year the vast majority (more than three quarters) of these penalties relate to a small number of our ODIs: wastewater treatment works compliance (£11 million); Pollution incidents (£8 million); Internal sewer flooding (£8 million); and customer performance, C-MeX (£5 million).

[1] Including estimated penalties for C-MeX and D-MeX comparative measures

[2] All ODI penalties are expressed in 2017–18 prices, consistent with the basis of Ofwat's final determination

While it is disappointing to not be meeting the Ofwat targets, performance overall for most of the water and retail parts of our business is in line with the improvement trajectory that we set in our internal delivery plan. Performance for wastewater was behind our internal delivery plan, principally as a result of the impact of very severe weather and atypical incidents, leading to us incurring higher penalties than we projected for both internal and external sewer flooding.

Our delivery plan builds on the transformational operational and asset management improvements that have been delivered over the last five years. Improvements in performance will also be supported by delivery of three strategic new programmes which commenced last year - Network Digitisation; Logistics Optimisation; and, Dynamic Asset Maintenance. The implementation of these programmes, along with continued optimisation of our operational processes should see us meeting most Ofwat targets by the end of the 2020–25 period, with some modest rewards for outperformance in a number of areas.

The Board closely monitors the delivery of operational improvements and tracks the performance against our regulatory commitments through a performance dashboard which is focused on those performance measures that have the greatest customer, stakeholder and environmental impact. The Board is supported by the Executive level Operations Committee, which focuses on tracking performance through leading indicators, identifying corrective actions where necessary and driving our focused performance improvement plans.

Aligning performance and rewards

Ofwat has put in place mechanisms that provide financial and reputational incentives for us to deliver more of what our customers want for less.

We have 47 performance commitments, agreed as part of the price review process, that we report on annually (see Section 3 of this report). Reporting our performance in this way to stakeholders provides a reputational incentive to meet our commitments.

In addition, 29 of our performance commitments include financial penalties and rewards associated with delivering for our customers. If we beat our targets, delivering more of what customers want, we can earn rewards, which means shareholders enjoy higher returns. If we fail to meet our performance targets we can incur penalties, meaning shareholders receive a return below market rates. These incentive mechanisms provide a strong alignment between the interests of our shareholders and our customers. As noted above, for the 2021–22 reporting year we have incurred total penalties of £40 million.

We are also strongly incentivised to deliver efficiently. At each price review Ofwat assesses the efficient costs for delivering our business plan. If we are able to beat these, we share the benefits of that outperformance with our customers. Between 2020 and 2025, for every pound that we save, around 64 pence is returned to customers via lower bills, while 36 pence is retained by the company. If we overspend, we must bear 64 per cent of the cost, while customers share 36 per cent.

During the year our employees were incentivised to deliver for customers through a company-wide bonus scheme, ‘yourBonus’. 50% of the measures associated with the bonus scheme related to delivering excellent customer and environmental service while the remainder were focused on efficient delivery of our plan. The bonus earned by each employee was dependent on the delivery of these company-wide objectives as well as their individual performance rating. The scheme aims to align the incentives for all employees with the interests of our customers.

Our executive remuneration policy closely links executive remuneration with overall company performance for customers, stakeholders and communities. For 2021–22, under our updated remuneration policy, at least 50% of variable pay was directly linked to customer outcomes (and in practice this will be significantly more). The key performance measures include performance on our ODIs, C-MeX and developer service performance D-MeX, health, safety and wellbeing, building our future environmental plan, employee engagement and cash flow.

The bonus arrangements for the coming years have been reviewed and new arrangements designed to deliver stretching levels of performance, delivering customer, environmental and stakeholder benefit, will be introduced for April 2022 onwards.

To ensure sustainable improvements in performance, it is our policy to defer 50% of the earned bonus of the executive, so performance can be measured over the long term. The scheme allows 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. Full details of our executive remuneration policy and details of its application in respect of 2021–22 are set out in our annual report **southernwater.co.uk/our-performance/reports/annual-reporting**.

As well as ensuring the right incentives are in place, it is important that we strike the right balance between providing a fair return to shareholders and investing for customers. Our dividend policy for the 2020–25 period incorporates a wide range of measures, including financial and customer performance measures. It also explicitly considers the financial resilience of the company and whether any financial outperformance should be re-invested to benefit our customers.

Ofwat Board Leadership, Governance and Transparency principles

In 2019 Ofwat published its Board leadership, transparency and governance principles ('Ofwat Principles'), which represented a major update of the principles published in 2014 and these incorporate many of the principles and provisions of the UK Corporate Governance Code published by the Financial Reporting Council (FRC) in July 2018. In addition, since July 2019, meeting the objectives of the Ofwat Principles has been a requirement under Southern Water's licence. Accordingly, we seek to apply both the Ofwat Principles and the relevant principles and provisions of the UK Corporate Governance Code.

We continue to make progress to strengthen our non-financial reporting; in particular we have had positive feedback from the EA in relation to our pollution reporting which they consider to be industry leading and setting best practice in pollution analysis and reporting for the sector. We have also had positive input from the EA in relation to our abstraction reporting.

In addition, we continue the work we do to satisfy Condition P of our Licence. This requires us to demonstrate that the Board has made appropriate diligent enquiry into the activities of the business and can evidence that the company will have sufficient financial resources and facilities, management resources and methods of planning and control in place to meet our statutory duties. The Condition P requirements are also a key part of our Section 19 Undertakings to Ofwat in connection with our historic misreporting (see below) and was subject to external assurance from our external auditors (Deloitte LLP).

Annual risk and compliance statement

The annual risk and compliance statement describes the steps we have taken to understand and meet our customers' expectations and to ensure we meet our statutory and regulatory obligations, as well as the expectations of our key regulators, Ofwat, the Environment Agency and the Drinking Water Inspectorate. It also sets out how we manage and mitigate any compliance risks identified.

Customer expectations

Our Business Plan for the period 2020–25 was based on the results of engagement with more customers than ever before (over 42,000 direct interviews). To drive a deeper understanding of customers we used innovative techniques such as ethnographic mobile apps and integrated 'willingness to pay' surveys to provide a single triangulated view of our customers' preferences.

We continue to engage extensively with customers to ensure that our plans and approach to delivery meet their needs and expectations. Through 2021–22 we have also begun working with customers for the next Business Plan for 2025–30, ensuring we have robust insight for understanding what our customers want from us now, and in the future.

Our Water Futures 2030 (household customers) and 2050 (young people) consumer groups have been central to our engagement with customers in the last year. The groups follow best practice guidance, as set out by the Consumer Council for Water (CCW), to provide a continuous dialogue on both our current delivery and future planning. We've also been collaborating closely with other water companies, especially in the South East, running joint projects and sharing the learning from our insight. These include the prioritisation of future water resources, working with customers on water efficiency and our communication approaches.

Following the pandemic, much more of our engagement now happens through online platforms as customers have become more comfortable with the technology. This has created opportunities to quickly bring consumer views closer to the teams at Southern Water through joint engagement events, where customers and decision makers come together in joint online workshops. At these events attendees have included our leadership team (including our Chief Customer Officer, Chief Environment Officer, Director of Asset Strategy and Planning and Regulation Director) as well as technical teams across projects. The topics for discussion are largely driven from areas of interest from our Water Futures groups and have helped us with developing our long-term strategy and our environmental ambition and addressing the challenges of combined sewer overflows. In October 2021 we even ran a live session with members from our household consumer group and over 100 managers and directors – focusing on the customer challenges they want Southern Water to focus on. The Southern Water teams then made individual commitments to go away and act on what we learnt within their area of the business.

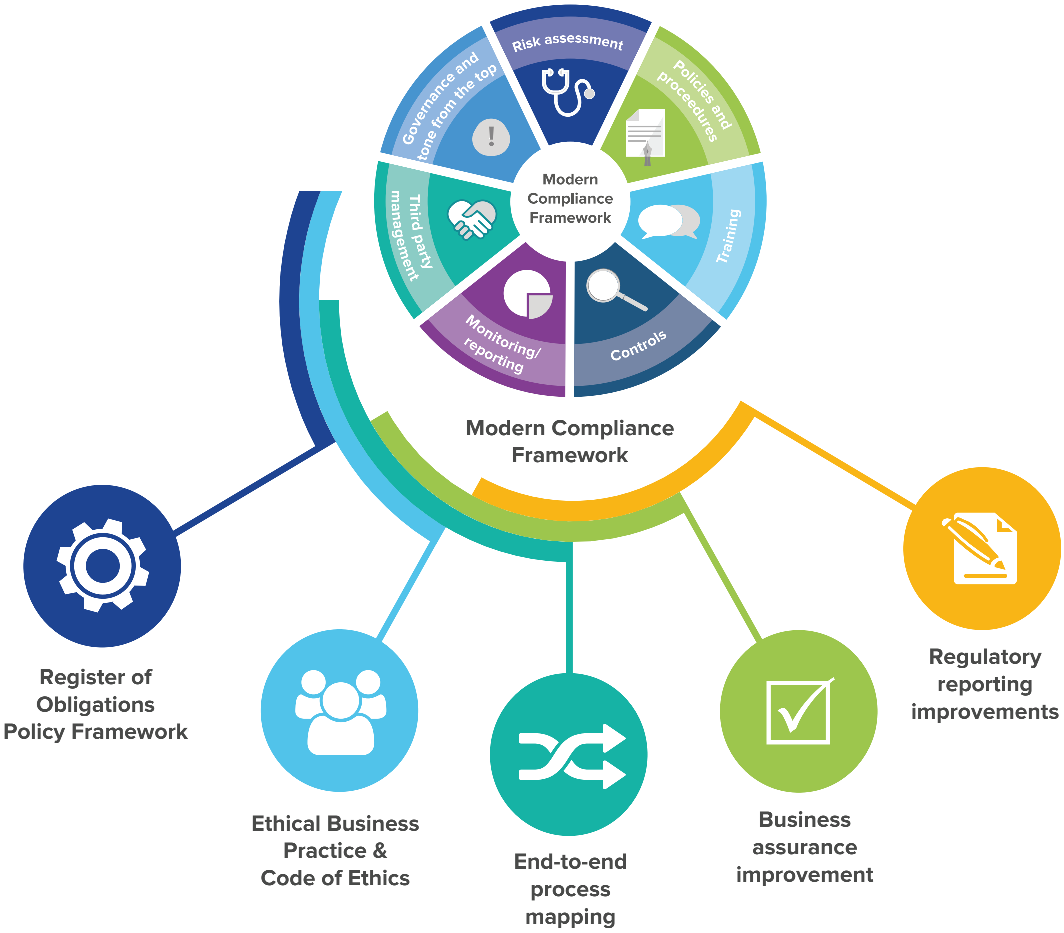
As we enter 2022–23 there is considerable concern about the impact of increases in the 'cost of living', alongside protecting the environment, ensuring resilient services for the future and protecting the most vulnerable in society. Our Water Futures programme is expanding to include panels from non-household customers, vulnerable audiences, stakeholders, and those from more diverse cultures where English might not be their first language. The additional groups will enable us to better listen to a more inclusive and range of views from the customers we serve. These groups then support our wider projects and joint work across the sector to continue to understand what matters to our customers and be able to act on that insight.

Statutory and regulatory obligations

Our purpose is to deliver water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy. In order to achieve this, we must deliver on our customers' expectations. As a regulated service provider, our primary obligations and duties are set out in the Water Industry Act 1991, the Drinking Water Regulations and our Instrument of Appointment (the Licence). These set the standards under which we must provide our services.

Southern Water is committed to driving structural and cultural change to support the development of a transparent and ethical compliance framework. We operate our Modern Compliance Framework (MCF) which was introduced five years ago and has become our 'Business as Usual' approach to managing compliance. The framework brings together key elements of our approach to risk and compliance (see Figure 1) including in relation to our regulatory obligations, our policy framework, ethical business practice and work to improve the quality and transparency of our regulatory reporting. This work is supported by strong governance in key areas of our operation (most notably in our monitoring and reporting programmes) backed up with strong training programmes to ensure good practice is embedded in all areas of the company. A key aspect of this work is embedding the approach as part of other training material we provide across the company.

Figure 1 – Performance Improvement under our Modern Compliance Framework



Our dedicated risk and compliance team have a clear role and responsibility to provide a separation of duties in monitoring key performance metrics of drinking water quality and wastewater performance. This function also provides 'second-line' internal assurance of our front-line teams

In the past the company has not met its own high expectations, and our performance has not been as good as our peers in the industry or as good as our customers might expect. We continue to work with our regulators, Ofwat, the Drinking Water Inspectorate (DWI) and the Environment Agency (EA) to implement improvements to our performance and reporting and to fully embed these changes.

As explained below, Ofwat and the Environment Agency continue to scrutinise our response to their joint sector-wide investigation into the management and operation of wastewater treatment works.

Ofwat

As reported previously, Ofwat undertook an investigation into our wastewater reporting that led to a decision to impose a financial penalty of £3 million. In addition, we agreed to make significant customer bill rebates, totalling £122.9 million (in 2017–18 prices), between 2020 and 2025. On 8 October 2019 we signed formal Undertakings pursuant to Section 19 of the Water Industry Act 1991 relating to the numerous changes we have put in place, and are putting in place, to ensure that the issues identified in the investigation have been stopped and cannot be repeated.

The Undertakings contain a wide range of corrective actions and interventions across seven themes:

A. Customer redress measures;

B. Technical review of Wastewater Treatment Works;

C. Organisational compliance process measures;

D. Organisational cultural change measures;

E. Ensuring Transparency;

F. Condition P Certificate Assurance Undertaking; and

G. Reporting on Compliance with the Undertakings.

Compliance with the Section 19 undertakings is subject to a formal assurance regime which is reported to both our Board and to Ofwat on a regular basis.

In our February 2022 update to Ofwat we were able to report that the actions arising to ensure compliance have either been completed or are on track to be fulfilled within the relevant time frame in the five-year period of the Undertakings. Our focus now moves to embedding the improvements and monitoring the effectiveness of that embedment. We reduced our wastewater charges payable by existing customers from April 2020 and have made payments to eligible former customers as part of our customer redress measures in Undertaking A.

On 18 November 2021 the Environment Agency and Ofwat announced that they had launched a joint investigation into the operation of wastewater treatment works across our industry. The investigation is looking into all water and sewerage companies, and more than 2,000 treatment works around the country. We will continue to be open and transparent and are committed to working with Ofwat and the Environment Agency constructively throughout the course of the investigation.

Ofwat has subsequently announced that following its assessment of the submissions six water companies are being considered for enforcement cases. Southern Water was not one of those companies, however Ofwat continues to monitor Southern Water's compliance with the package of commitments detailed in our Section 19 undertakings.

Our work to strengthen the management of permit and flow compliance has been a key focus for the company and is a key aspect of our Section 19 undertakings. We have been working hard since 2017 to strengthen our processes to ensure flow compliance, identifying and resolving permit compliance issues on our sites.

This has been through our focused work as part of the Section 19 undertakings, and as part of our AMP7 flow compliance investment programme. This programme of work was initially scoped out as part of PR19 and has been further refined with the addition of enhanced spill reporting data. We now have an AMP7 investment programme across our wastewater network totalling more than amounting to over £400 million.

Our strategic approach to flow management and compliance is now integrated into our business-as-usual activities. This includes an integrated approach that encompasses front-line operations, our front-line planning and improvement team, our asset management team, and our second-line environmental quality compliance team all working together to improve flow compliance.

In addition, the Section 19 Undertakings require us to provide additional assurance on Board compliance with Condition P (previously Condition I) of our Ofwat licence (please refer to page 16 for more detail).

The Environment Agency (EA)

Like other wastewater operators, in the normal course of operations we occasionally face investigations by the Environment Agency (EA) following incidents. In addition to those, the company was subject to a detailed investigation regarding permit breaches at some of our wastewater treatment works during the period 2010–15 which resulted in us being fined £90 million in July 2021.

Since Chief Executive Ian McAulay joined in 2017, he has driven thorough internal reviews of our wastewater business and led a major transformation programme which continues to deliver change as we address our historic failures. With the appointment of Lawrence Gosden as CEO from 1 July 2022, these improvements will continue to be delivered.

The EA is shortly due to release the The EA is shortly due to release the Environmental Performance Assessment for 2021, in its annual report on the environmental performance of the nine English water and sewerage companies. Our performance for the 2021 reporting year worsened from two-star in 2020 to one-star in 2021. Our one-star assessment is due to four red metrics; pollution, serious pollutions, supply demand balance index (SDBI) and treatment compliance.

As a company committed to protecting the environment and serving our customers, we were disappointed by the assessment but are working hard to continue to drive improvements.

Our SDBI has been assessed as red by the Environment Agency. The assessment highlighted a theoretical deficit in the peak deployable output scenario, associated with the outage of one of our bankside storage assets. The asset has now been returned to full operation and we expect the SDBI to return to green in 2022.

We are disappointed with the increase in significant pollution incidents within 2021 and have responded with extensive improvements in our operational control centre to identify more swiftly those incidents with the potential to become significant, enabling a more rapid response. This is in addition to our Pollution Incident Reduction Plan (see page 11).

Although our performance has deteriorated in the assessment, it is not an absolute deterioration in performance in all cases, with permit compliance and pollutions improving slightly on the 2020 performance, but still classed as red metrics. The number of pollutions reported in 2021 improved with a 7.5% reduction from 402 to 372 and the number of treatment failures reported in 2021 also improved from 10 to 7.

The challenge of improving bathing water quality seemed impossible 20 years ago. Today, all 83 of our bathing waters meet strict European standards, 80 are rated as excellent or good and none is poor. The evaluation of our Water Industry National Environment Programme (WINEP) delivery has improved to amber compared to the previous year and has been possible due to good collaboration with the EA.

The EA has recognised that we continue to make good progress in the area of self-reporting of pollution incidents and we are one of the leaders in the industry in this regard. They have also recognised that our pollution analysis, in particular of discharges during storm conditions, and reporting is leading the sector. This is helping to improve the transparency of how we identify and act when things go wrong. The continued good performance and EA feedback in this area is evidence of how embedded our pollution reporting improvements have become. The EA also recognised improvements in pollutions and treatment and overall reduction in risk across the assets. Continuation of work in these areas will support improved future performance.

The EA has commented positively on our improvement on abstraction compliance and in our data reporting improvement. These improvements are allowing us to identify issues earlier on in the process and intervene proactively to resolve items that previously would have become more serious issues.

In 2020 the EA expressed concerns about our performance in a number of areas, including pollution incidents in pumping stations and a deterioration of numeric treatment compliance. As a result, we implemented a programme of 'platinum health checks' in pumping stations this year which is reducing the number of incidents and we have applied better management processes to treatment compliance which is showing an improved trend for this year.

In 2020 we announced our Pollution Incident Reduction Plan (PIRP), working in partnership with the EA. As part of the plan we have analysed the challenge and developed a detailed set of interventions to resolve our pollution performance issues. The plan sets out the aim to achieve a reduction in pollution incidents to 80 per year by 2025, and zero pollution incidents by 2040. The second year of the PIRP was published online after consultation with the EA, and was assured as part of our previous Final Assurance Plan. The third iteration of the plan is being consulted on with the EA and it will be published as soon as we have their feedback. It includes a number of interventions including:

- Increased focus on pumping station health checks with a very deep review of the assets
- An extensive pro-active cleaning programme across pumping stations and network
- Control centre transformation and waste network digitalisation

We also recognise the concern among stakeholders with our abstractions, particularly from those from the sensitive chalk streams across the South East. We are actively working with government, regulators, Water UK and the water industry to ensure that we learn from others and share our experiences to ensure the most effective approaches are taken.

The Environment Act 2021, which was passed into law in November 2021, sets out the requirement for all water companies to 'secure a progressive reduction in the adverse impacts of discharges from storm overflows'. At the same time, the law also requires the government to publish a plan to reduce sewage discharges from storm overflows by September 2022 and report to Parliament on the progress towards implementing the plan. We welcome the strengthening of the Act's requirement, and are actively participating within the industry and proceeding with action and investment with an objective, subject to funding, of an 80% reduction in storm releases by 2030.

We know, like all water and wastewater companies, that we have challenges with our combined sewer outflows (CSOs). Our 'Beachbuoy' website provides near real-time information about releases of stormwater or wastewater for the public, demonstrating our commitment to transparency, and we are encouraging others in the sector to follow. It has been improved over the period and was used throughout the 2021 and into the 2022 bathing water seasons, raising awareness of and interest in CSOs. We have established a Storm Overflow Task Force that is taking a cross-sector approach, working with local stakeholders to find practical solutions to cut overflows. Its aim is to find innovative solutions, so we can go further and faster at tackling this issue collaboratively to help future proof against climate change.

The most efficient, cost effective and environmentally beneficial way of reducing storm releases is to separate surface water drainage from the sewer system. We know from some preliminary work in the summer of 2021 that reducing the amount of rainwater run-off from roads and roofs by around 40% would mean an 80% reduction in stormwater releases. It would also continue to protect homes, businesses and other properties from flooding, the vital role storm overflows currently provide.

The summer of 2021 in particular saw some very wet localised weather events. These types of events are likely to become for frequent as a result of the changing of the climate that we are already experiencing. In December 2021 we published our climate change adaptation report. We are on a journey to improve our resilience to climate change and this is a key focus for our work on the next five-year business plan for 2025–30 and beyond.

We are also committed to assisting the EA with its investigation into sampling compliance and reporting issues between 2013 and 2017 (inclusive). As the investigation is ongoing, we are not able to say any more about it at this time.

As referred to above, on 18 November 2021 the EA and Ofwat announced that they had launched a joint investigation into the operation of wastewater treatment works across the industry. We will continue to be open and transparent and are committed to working with the EA and Ofwat constructively throughout the course of the investigation.

The Drinking Water Inspectorate

We continue to progress the transformation of our drinking water quality performance. Our Compliance Risk Index (CRI) worsened in 2021.

We remain an outlier on this metric compared with the rest of the sector and further improvement is still required. We continue our transformation via a very ambitious capital maintenance programme with significant investment in improvements at strategic surface water works, reservoir cleaning and replacement, and targeted mains replacement. Operational improvements are focused on site hygiene, sampling environment improvements, dynamic risk management, grounds maintenance and chemical dosing enhancements. In addition, we are undertaking a programme of independent audits of our laboratory partner and strategic works.

Our provisional Event Risk Index (ERI) metric is our best result since 2015 and better than the industry average score, driven by improvements to our incident management process and improved reliability at our sites driven by our investment programme.

We have regular and close working arrangements with the DWI and report frequently on our performance and our transformation action plans including the delivery of the 'HazRev' review actions. This includes regular and open liaison with the DWI on our overall approach to providing wholesome drinking water. We have a varied programme of activity helping to improve our information management systems and process, including a risk-based review of monitoring, procedures, and manual interventions involved in all critical information systems. This package of work commenced in 2018, and a programme of asset and IT improvements designed in cooperation with the DWI has now begun and will continue through to 2025. This work is within the scope of our Section 19 Information Management Undertaking (IMU) with the DWI which formalises this element of our programme.

On 28 March 2022, the DWI issued a draft Final Enforcement Order (FEO) in relation to our treatment works at Burham for response. The draft FEO was accompanied by a new Regulation 28(4) Notice for the resilience related items (power and sludge handling).

On 25 May 2022 we were fined for an event in May 2018 when high chlorate levels were detected at High Park reservoir. The charge related to a breach of Regulation 31 Water Supply (Water Quality) Regulations 2016 in relation to the storage and use of Hypochlorite at the High Park booster station. At the sentencing hearing we were fined £16,000 plus costs. The operational issues that gave rise to the incident have now been addressed.

Reporting our performance

We provide a significant amount of data to the Environment Agency and Ofwat about the performance of our assets, and any wastewater or sewage discharges we make into the 'water environment' such as rivers, streams and coastal waters. We are committed to transparent reporting of high-quality data that can be trusted by our customers, stakeholders and regulators.

Following historic failings in the quality of our reporting to our regulators, we continue to embed our programme of improvements to ensure our regulators and other stakeholders can trust the data that we report. These improvements have been led by our Risk and Compliance directorate which is ensuring compliance reporting to our regulators is subject to sustained internal review and assurance. Further information on this programme can be found in our Data Assurance Summary 2021–22, which is available at: **southernwater.co.uk/our-reports**.

We regularly review performance information against a wide range of measures. Reporting to the Board and the Executive Leadership Team (ELT) focuses on delivery of our regulatory and statutory obligations. For the business plan period 2020–25, this information is provided to the Board by way of a detailed performance dashboard, including a selection of our business plan performance commitments and additional regulatory targets.

The Audit Committee has monitored the completion of a risk-based programme of assurance activities during the year, as part of a three-year rolling programme, covering the practices, procedures and systems used to secure compliance with our statutory obligations. This included a review of our compliance with our Instrument of Appointment which was presented to the Audit Committee in March 2022.

In response to new guidance from Ofwat in November 2020 we published, as part of our Annual Performance Report, a board assurance statement, stating that the data and information provided is accurate and complete and setting out any exceptions to this. This is embedded in our approach now and our latest statement is included on page 17.

Each year we engage with our customers, employees and stakeholders to help us identify any risks, strengths and weaknesses associated with our reporting. We published the findings of this exercise in November 2021, with an invitation to stakeholders to comment on the findings. The publication set out how we would respond to stakeholders' feedback and detailed how our corporate assurance practices would meet our reporting compliance obligations. Our Final Assurance Plan was published on 30 March 2022. It set out how we planned to assure the financial and non-financial information that we publish in our Annual Performance Report.

In line with the Final Assurance Plan, KPMG LLP, as our independent non-financial data assurer, completed the limited assurance under ISAE (UK) 3000 of selected Performance Commitments and Outcome Delivery Incentives (ODIs). KPMG LLP provided Southern Water with an unqualified ISAE (UK) 3000 opinion for 2021–22 over the selected Performance Commitments reported in Section 3 of the Annual Performance Report. This is the second year that KPMG LLP have been able to provide us with an unqualified ISAE (UK) 3000 opinion, reflecting their second year as our non-financial assurance partner.

A programme of process and control improvements has been worked through over the last five years and continues into the current year. These have been focused on key data returns to Ofwat, DWI and the EA and include improvements in our reporting control environment. Our work this year has begun to focus on the maturity of first-line controls; this reflects a maturing of our reporting capability.

In the Technical Audit report in June 2022, KPMG LLP reported that improvements to processes and controls in previous years had been maintained. Areas of further improvement have been identified, including to the first line control. For more detail see our Data Assurance Summary 2021–22.

As required by Ofwat, an audit was also performed on sections 1 and 2 of the Annual Performance Report by our auditor, Deloitte LLP together with agreed upon procedures in relation to sections 4 to 9.

In approving the Annual Report and Financial Statements, each director has confirmed that he or she has taken all the steps that he or she ought to have taken as a director in order to be aware of any relevant audit information and to establish that our auditor is aware of the information.
So far as the directors are aware, there is no relevant audit information of which the company's auditor is unaware.

Senior managers and ELT members are accountable for the provision and sign-off of non-financial information from their business areas. This includes ensuring adequate procedures and processes are in place for data collection and reporting. Data providers are accountable for submitting accurate data to set timescales. Subject matter experts within the relevant business areas are accountable for ensuring that this data, and the processes and procedures used in collating it, comply with Ofwat's reporting requirements. This process is managed through our Ofwat Compliance Framework (OCF) which is a system of controls that has been rolled out for data capture, collation and reporting within the business to make sure information used to measure compliance is complete, accurate and reliable. The OCF is in its second year of existence and follows on from the previous Regulatory Compliance Framework. The former is in place for business plan period (2020–25) the latter was in place during the previous business plan period (2015–20). Details of the assurance undertaken on our non-financial regulatory reporting by KPMG are provided in their audit opinion on page 66.

We have seen improvements in quality of our reporting to the DWI, the EA and Ofwat. These improvements are part of an on-going programme of improvements that will continue through the current business plan period and beyond.

All members of the ELT are required, every six months, to provide a declaration that they and their teams are fully compliant with our procedures and controls for areas of the business for which they are accountable. An action plan is required to address any areas of non-compliance. We have made improvements to this 'Statement of Compliance' process during the year. The updated process includes additional internal assurance and co-ordination of resulting action plans, and provides a compliance maturity assessment of each directorate. The Statement of Compliance is now in its ninth edition and is a key input into our reporting and control improvement plans.

Managing risks

The Board confirms that the company has appropriate systems and processes in place to identify, manage and mitigate its material risks.

Risk management is a core component of our wider governance and internal control framework, which provides the overarching structure through which the company conducts its business.

Risk is inherent in our business and we face a diverse range of risks and uncertainties that cannot be completely eliminated. The purpose of our approach to risk management is to support better decisions through an improved understanding of risk. Those risks that have the potential to have a material impact on our company and our ability to deliver on our strategic objectives are our Principal Risks. Our risk governance model ensures that we can manage, monitor and report on our Principal Risks to maintain a resilient business.

Southern Water's approach to risk management is designed to provide a clear and consistent framework for managing and reporting risks associated with our operations, to executive management and to the Southern Water Board.

The framework seeks to promote better decision making, avoid incidents and encourage the best outcome for the company and our customers by allowing us to:

1. understand the risk environment, identify the specific risks we face and assess the potential exposure for Southern Water;
2. determine how best to manage identified risks to balance overall potential exposure;
3. take action to manage the risks we do not want to be exposed to, ensuring our resources are effectively and efficiently prioritised and used;
4. report to the Audit Committee and to the Board on a periodic basis on how significant risks are being managed, monitored, assured and the improvements that are being made;
5. use our analysis to help the Board to define the company's appetite for the range of risks and monitor and report risks against the desired risk appetite.

Across the company our risk management approach is embedded within the business units and their business processes. We have established a risk management approach that provides a consistent basis for measuring risk to:

- establish a common understanding of risks on a like-for-like basis, taking into account potential impact and likelihood;
- report risks and their management to the appropriate levels of the company; and
- inform prioritisation of specific risk management activities and resource allocation.

All areas of the company review significant risks and business processes to help inform and enable risk-based decision making. As part of Southern Water's annual planning process, the Executive Leadership Team and Board review the business' principal risks.

Southern Water's approach to risk management adopts the 'three lines of defence' model in which risk ownership responsibilities are functionally independent from oversight and assurance.

- Primary responsibility for risk management lies with the business. The risk owner is the first line of defence. An important part of the role of all staff throughout Southern Water is to ensure they manage risks appropriately.
- The Risk Management function forms the second line of defence and provides independent and objective review and challenge, oversight, monitoring and reporting in relation to Southern Water's material risks.
- Independent external assurance and the Internal Audit function act as the third line and provide independent assurance on the business control environment and the effectiveness of the wider system of internal control.

Risk Oversight and Governance

To successfully embed risk management across Southern Water, the risk management process is supported by a governance structure that defines roles and responsibilities at each level of the company. The Board has overall accountability risk management but discharges this role through the Audit Committee, who oversee and advise on enterprise and corporate risks, and the newly formed Health and Safety and Operational Risk Committee who oversee and advise on operational risk.

Role of the Board

The role of the Board is to promote the long-term sustainability of Southern Water and its responsibilities to its shareholders, customers, employees, and the communities in which it operates and it has overall responsibility for risk management within the company.

The Board is responsible for maintaining an effective risk culture and is committed to:

- reviewing, endorsing and monitoring Southern Water's approach to risk culture and conduct;
- forming a view on Southern Water's risk culture and the extent to which it supports the ability of Southern Water to operate consistently within its risk appetite.

The Board defines our Risk Appetite, enabling us, in both quantitative and qualitative terms, to judge the level of risk we are prepared to take in achieving our overall objectives.

Our Risk Appetite is directly aligned to our Principal Risks. The Risk Appetite for each of our Principal Risks, underpins our governance and reporting framework and is subject to regular review by the Board. The alignment of Principal Risks with Risk Appetite allows for an informed analysis and discussion of our risk position and has provided the Board risk insight to key decisions.

The Board ensures the oversight and monitoring of our risk culture, risk appetite and risk management activities through the Audit Committee.

The Audit Committee is responsible for the review of our internal financial control systems that identify, assess, manage and monitor financial risks, and other internal control and risk management systems. They advise the Board on the company's overall risk appetite, tolerance culture and strategy, taking into account the current and prospective regulatory, legal, political, macroeconomic and financial environment with the Board retaining overall ownership and approval.

The Audit Committee oversees and advises the Board on the current risk exposure of the company and longer-term strategic risks to determine our future risk strategy. The Audit Committee has a key role in risk assessment, including:

- reviewing the company's overall risk assessment processes for the company's enterprise and corporate risks that inform the Board's decision making, ensuring both qualitative and quantitative metrics are used;
- reviewing regularly and approving the parameters used in these measures and the methodology adopted; and
- setting a standard for the accurate and timely monitoring of large exposures and corporate risk types of critical importance.

In addition, the Audit Committee reviews the company's capability to identify and manage new and emerging risk types and reviews reports on any material breaches of risk limits and the adequacy of proposed corrective actions.

The Health and Safety and Operational Risk Committee is responsible for the oversight and assessment of the overall adequacy and effectiveness, of the health, safety and wellbeing policies, strategies, processes and controls, operational risk management, and compliance with relevant legal and regulatory requirements. The Board retains overall ownership and approval.

The Health and Safety and Operational Risk Committee has a key role in:

- reviewing the areas of significant corporate and individual health, safety, wellbeing and operational risk and whether the executive is managing these risks effectively, including via the supply chain;
- reviewing the company's health, safety and wellbeing performance;
- reviewing operational risk and risk management of information security, information governance, water, wastewater and customer services;
- reviewing the scope, and results of any health, safety, wellbeing, information security, information governance, water, wastewater and customer operational risk audits; and
- considering the findings of internal and external investigations and executives' response.

Board risk and compliance statement

In making the risk and compliance statement, the Board confirms that the company:

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

Signed on behalf of the Board

Sebastiaan Boelen
Chief Financial Officer

15 July 2022

Regulatory matters

The following regulatory accounting statements and required regulatory information are provided to comply with Condition F of our Licence, which requires that regulatory accounts are prepared in accordance with the Regulatory Accounting Guidelines issued by Ofwat.

There are differences between statutory accounting reporting frameworks, International Financial Reporting Standards and the Regulatory Accounting Guidelines. Where different treatments are specified under each, the Regulatory Accounting Guidelines take precedence.

A particular point of definition is worth noting. Southern Water Services Limited is appointed by the Secretary of State to be a water and wastewater undertaker – the activities covered by the appointment are the 'Appointed Business'. Southern Water Services Limited has other functions and activities which are not covered by the appointment as a water and wastewater undertaker. These activities are termed the 'Non-Appointed Business'.

Assets, rights and resources (Condition P14)

Under paragraph 14 of Condition P of the Licence, the company is at all times required to ensure, so far as is reasonably practicable, that if a special administration order were made, the company would have available to it sufficient rights and resources (other than financial resources) to enable the special administrator to manage the affairs, business and property of the company. In the opinion of the directors, the company was in compliance with that requirement as at 31 March 2022.

Ring-fencing Certificate and statement (Condition P30)

In order to meet the Licence Condition P Certificate requirements as supplemented by the Ofwat Section 19 Undertakings, the Board needs to be able to clearly evidence the level of diligent enquiry that it has undertaken. To support this process the Southern Water Board signs off Condition P Assurance Statements demonstrating it has discharged its responsibilities and takes accountability for its diligent enquiry into the principal risks facing the business, and most importantly in the context of the Section 19 Undertakings, the wastewater business.

These statements were assured in June 2022 and were signed off by the Board as part of approvals for the Annual Performance Report to Ofwat.

To provide the Ring-fencing Certificate required by Licence Condition P30 and meet the Ofwat Section 19 undertakings the Southern Water Board needs to be able to clearly evidence the level of diligent enquiry that the Board has undertaken. This is outlined in detail in the Board Assurance statement (see Appendix 4).

In the Board Assurance Statement, the directors declare that, in their opinion:

i) The company will have available to it sufficient financial resources and facilities to enable it to carry out its regulated activities (including the investment programme necessary to fulfil its obligations under its appointments)

ii) The company will have available to it:

a) financial resources and facilities

b) management resources; and

c) methods of planning and internal control

which are sufficient to enable it to carry out those functions for a period of at least twelve months.

A specific paper on the Condition P statement is presented for sign off by the Southern Water Board and includes the finalised Board Assurance Statements as detailed in Appendix 4. The Board Assurance Statement will be subject to external assurance from our auditor, Deloitte. As part of our Section 19 commitments, their report will be provided separately to Ofwat. This sign-off process happens in parallel with the Board sign-off of an assurance statement on the accuracy and completeness of the data and information (financial and non-financial) submitted to Ofwat as part of our Annual Report and Annual Performance Report submission (see Appendix 3).

Directors' responsibilities for the preparation of the supplementary regulatory accounting statements and disclosure of information to auditors

In addition to their responsibilities to prepare accounts in accordance with the Companies Act 2006 and to disclose all relevant information to the auditor, described in the Corporate Governance section of the statutory accounts, the directors are also responsible under Condition F of the Licence for:

a) ensuring that proper accounting records are maintained by the company to enable compliance with the requirements of Condition F

b) preparing as set of regulatory accounting statements, in respect of the twelve- month period ending on 31 March in each year, which are in accordance with the Regulatory Accounting Guidelines published by Ofwat

c) complying with all other requirements that are set out in the Regulatory Accounting Guidelines published by Ofwat.

The directors approved the regulatory accounting statements (on pages 19 to 78) on 15 July 2022.

Board statement on accuracy and completeness of data and information

The Board confirms that the data and information provided to Ofwat during the reporting year, or published by the company in its role as a water and sewerage undertaker, was accurate and complete and is reflected in our Board Assurance Statement (see appendix 3).

The assurance statement includes a description of the activities which the Board has carried out to allow it to make the statement. The Board believe that our stakeholders deserve to have trust and confidence in the integrity of the information we provide in our annual reports. In order to achieve this, our performance reporting is subject to a system of checks to ensure that we meet the highest quality of reported information.

The Board has been fully aware of previous issues with the non-financial control environment of the company and has over the last four years worked with the executive management team to rebuild capability in this area. This work is on-going and is on track but will require further work in coming years.

The Board has actively engaged and challenged the assurance processes that have been adopted by the company. This covers assurance on both the financial and non-financial reporting. The Board has, over recent years, taken action to ensure that exceptions and weaknesses identified in the non-financial assurance have been addressed.
The Board is satisfied that the assurance approaches have appropriately identified and addressed the risks to the provision of accurate and complete data and information. This has been discharged through the Southern Water Services Board and its relevant committees (most notably the Audit Committee).

The Board Assurance Statement does not identify any specific exceptions.

Section 35A of the Water Industry Act 1991

The company is required under section 35A of the Water Industry Act 1991 to provide a statement that the remuneration paid to executive directors is linked to standards of performance. This statement is provided within the Directors' Remuneration Report section of the Annual Report and Financial Statements.

Long-term viability statement

In accordance with provision 31 of the UK Corporate Governance Code, 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 elected to conduct this review to 31 March 2030 and full details of the assessment and the viability statement are set out within the Strategic Report section on page 121 of the Annual Report and Financial Statements.

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) he/she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself 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.

Board statement

Save for those matters mentioned above where the company has identified shortcomings or potential shortcomings and where the company has set out the steps it is taking or will take to manage, mitigate and/or improve those), the Board confirms, that having taken all the steps that they ought to have taken as directors to make themselves aware of any relevant information, the company has:

1) a full understanding of, and is meeting, its obligations and has taken steps to understand and meet customer expectations
2) sufficient processes and internal systems of control to fully meet its obligations
3) appropriate systems and processes in place to allow it to identify, manage and review its risks.

K G Lough

Sebastiaan Boelen
Chief Financial Officer

Keith Lough
Chair

15 July 2022

Regulatory financial reporting

1A – Income statement for the 12 months ended 31 March 2022

	Note	Statutory £m	Adjustments: Differences between statutory and RAG definitions £m	Adjustments: Non-appointed £m	Adjustments: Total adjustments £m	Total appointed activities £m
Revenue		844.532	(47.369)	10.404	(57.773)	**786.759**
Operating costs		(830.266)	20.800	(8.398)	29.198	**(801.068)**
Other operating income		1.547	21.014	–	21.014	**22.561**
Operating profit		**15.813**	**(5.555)**	**2.006**	**(7.561)**	**8.252**
Other income		1.770	22.451	–	22.451	**24.221**
Interest income	3	4.789	–	–	–	**4.789**
Interest expense	3	(198.737)	(15.903)	–	(15.903)	**(214.640)**
Other interest expense	3	(2.300)	–	–	–	**(2.300)**
(Loss)/profit before tax and fair value movements		**(178.665)**	**0.993**	**2.006**	**(1.013)**	**(179.678)**
Fair value losses on derivative financial instruments		(668.997)	–	–	–	**(668.997)**
(Loss)/profit before tax		**(847.662)**	**0.993**	**2.006**	**(1.013)**	**(848.675)**
UK Corporation tax	4	–	–	–	–	**–**
Deferred tax		86.066	(0.249)	–	(0.249)	**85.817**
(Loss)/profit for the year		**(761.596)**	**0.744**	**2.006**	**(1.262)**	**(762.858)**
Dividends		–	–	–	–	**–**
Tax analysis						
Current year		–	–	–	–	**–**
Adjustments in respect of prior years		–	–	–	–	**–**
UK Corporation Tax		**–**	**–**	**–**	**–**	**–**

Analysis of non-appointed revenue	
Imported sludge	–
Tankered waste	6.631
Other non-appointed revenue	3.773
Revenue	**10.404**

Details of the differences between the statutory and regulatory definitions are shown in note 2.

Note: The signage convention for presentation of this table follows Ofwat guidance. Total adjustments comprise the difference between statutory and regulatory accounting definitions less the non-appointed activity.

1B – Statement of comprehensive income for the 12 months ended 31 March 2022

		Adjustments			
	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	Total adjustments £m	Total appointed activities £m
(Loss)/profit for the year	(761.596)	0.744	2.006	(1.262)	(762.858)
Actuarial losses on post-employment plans	(18.439)	–	–	–	(18.439)
Other comprehensive income	13.290	–	–	–	13.290
Total comprehensive income/(loss) for the year	**(766.745)**	**0.744**	**2.006**	**(1.262)**	**(768.007)**

1C – Statement of financial position for the 12 months ended 31 March 2022

	Statutory £m	Adjustments: Differences between statutory and RAG definitions £m	Adjustments: Non-appointed £m	Adjustments: Total adjustments £m	Total appointed activities £m
Non-current assets					
Fixed assets	6,712.389	(241.730)	0.518	(242.248)	**6,470.141**
Intangible assets	100.072	(3.654)	–	(3.654)	**96.418**
Investments – other	29.200	–	–	–	**29.200**
Financial instruments	45.576	–	–	–	**45.576**
Total non-current assets	6,887.237	(245.384)	0.518	(245.902)	**6,641.335**
Current assets					
Inventories	10.194	–	–	–	**10.194**
Trade and other receivables	528.949	(285.000)	1.488	(286.488)	**242.461**
Cash and cash equivalents	157.437	285.000	–	285.000	**442.437**
Total current assets	696.580	–	1.488	(1.488)	**695.092**
Current liabilities					
Trade and other payables	(198.435)	(2.810)	–	(2.810)	**(201.245)**
Capex creditor	(189.129)	–	–	–	**(189.129)**
Borrowings	(308.079)	–	–	–	**(308.079)**
Current tax liabilities	(13.124)	–	–	–	**(13.124)**
Provisions	(26.509)	–	–	–	**(26.509)**
Total current liabilities	(735.276)	(2.810)	–	(2.810)	**(738.086)**
Net current liabilities	**(38.696)**	**(2.810)**	**1.488**	**(4.298)**	**(42.994)**
Non-current liabilities					
Trade and other payables	(12.337)	–	–	–	**(12.337)**
Borrowings	(3,639.847)	–	–	–	**(3,639.847)**
Financial instruments	(2,188.894)	–	–	–	**(2,188.894)**
Retirement benefit obligations	(59.900)	–	–	–	**(59.900)**
Provisions	(58.799)	–	–	–	**(58.799)**
Deferred income – grants and contributions	(26.950)	(2.785)	–	(2.785)	**(29.735)**
Preference share capital	(69.829)	–	–	–	**(69.829)**
Deferred tax	(203.012)	62.745	–	62.745	**(140.267)**
Total non-current liabilities	(6,259.568)	59.960	–	59.960	**(6,199.608)**
Net assets	**588.973**	**(188.234)**	**2.006**	**(190.240)**	**398.733**
Equity					
Called up share capital	0.112	–	–	–	**0.112**
Retained earnings and other reserves	588.861	(188.234)	2.006	(190.240)	**398.621**
Total equity	**588.973**	**(188.234)**	**2.006**	**(190.240)**	**398.733**

Details of the differences between the statutory and regulatory definitions are shown in note 2.

1D – Statement of cash flows for the 12 months ended 31 March 2022

	Statutory £m	Adjustments: Differences between statutory and RAG definitions £m	Adjustments: Non-appointed £m	Adjustments: Total adjustments £m	Total appointed activities £m
Operating profit	15.813	(5.555)	2.006	(7.561)	8.252
Other income	1.770	22.451	–	22.451	24.221
Depreciation	324.142	(11.305)	0.004	(11.309)	312.833
Amortisation – grants and contributions	4.920	(6.587)	–	(6.587)	(1.667)
Changes in working capital	0.058	(5.594)	(1.902)	(3.692)	(3.634)
Pension contributions	(77.335)	–	–	–	(77.335)
Movement in provisions	(32.666)	–	–	–	(32.666)
Profit on sale of fixed assets	(1.547)	–	–	–	(1.547)
Cash generated from operations	**235.155**	**(6.590)**	**0.108**	**(6.698)**	**228.457**
Net interest paid	(150.511)	–	–	–	(150.511)
Tax paid	–	–	–	–	–
Net cash generated from operating activities	**84.644**	**(6.590)**	**0.108**	**(6.698)**	**77.946**
Investing activities					
Capital expenditure	(512.511)	–	(0.108)	0.108	(512.403)
Grants and contributions	–	6.590	–	6.590	6.590
Disposal of fixed assets	1.179	–	–	–	1.179
Other	(303.138)	285.000	–	285.000	(18.138)
Net cash used in investing activities	**(814.470)**	**291.590**	**(0.108)**	**291.698**	**(522.772)**
Net cash generated before financing activities	**(729.826)**	**285.000**	**–**	**285.000**	**(444.826)**
Cash flows from financing activities					
Equity dividends paid	–	–	–	–	–
Net loans paid	156.490	–	–	–	156.490
Cash inflow from equity financing	391.282	–	–	–	391.282
Net cash used in financing activities	**547.772**	**–**	**–**	**–**	**547.772**
Increase in net cash	**(182.054)**	**285.000**	**–**	**285.000**	**102.946**

Details of the differences between the statutory and regulatory definitions are shown in note 2.

1E – Net debt analysis at 31 March 2022

	Interest rate risk profile		
	Fixed rate £m	Index linked RPI £m	Total £m
Borrowings (excluding preference shares)	1,441.213	2,623.025	4,064.238
Preference share capital			69.829
Total borrowings			4,134.067
Cash			(157.437)
Short term deposits			(285.000)
Net debt			3,691.630
Gearing			65.51%
Adjusted gearing			63.43%
Full year equivalent nominal interest cost	(14.962)	226.002	211.040
Full year equivalent cash interest payment	(14.962)	74.497	59.535
Indicative interest rates			
Indicative weighted average nominal interest rate	(1.038%)	8.616%	5.193%
Indicative weighted average cash interest rate	(1.038%)	2.840%	1.465%
Weighted average years to maturity	12.878	8.448	11.545

Adjusted gearing excludes preference shares and includes debt at nominal values along with any unpaid accretion and the accrued accretion on our financial instruments.

The borrowings and full year equivalent interest cost reflect the impact of our financial derivatives, excluding fair value movements.

The calculation of the weighted average years to maturity is based on the designation of the underlying debt instruments and excludes the impact of swaps that we have in place.

A reconciliation between the borrowings reported in tables 1C and 1E is shown below, along with a reconciliation to the principal sum outstanding reported in table 4B, which is published separately alongside this report.

Reconciliation of borrowings between table 1C and tables 1E and 4B

	£m
1C – Current liabilities borrowings	308.079
1C – Non-current liabilities borrowings	3,639.847
Total Borrowings (table 1C)	3,947.926
Debt issue costs	8.429
Bond premium deferred	(6.886)
Deferred gilt lock proceeds	(4.393)
Accrued swap accretion	119.162
Borrowings (table 1E)	4,064.238
Preference shares	69.829
Difference between amortised cost and nominal value	30.694
Principal sum outstanding (table 4B)	4,164.761

The debt issue costs, bond premium, deferred gilt lock proceeds and deferred proceeds are amortised to the income statement and details are presented in note 20 to our statutory accounts.

The accrued swap accretion is an increase in the liability of the swap financial instruments which is presented within the financial instruments balance for statutory accounting purposes but included in borrowings as per table 1E guidance. This figure is also shown in table 4I.

1F – Financial Flows for the 12 months ended 31 March 2022 and for the price review to date (2017–18 financial year average CPIH)

	12 months ended 31 March 2022					
	%			£m		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Regulatory equity						
Regulatory equity	1,988.548	1,988.548	1,557.903	–	–	–
Return on regulatory equity						
Return on regulatory equity	3.86%	3.02%	3.86%	76.758	60.135	60.135
Financing						
Impact of movement from notional gearing	–	0.84%	0.45%	–	16.623	6.950
Cost of debt	–	1.78%	3.00%	–	35.450	46.715
Hedging instruments	–	2.14%	2.73%	–	42.574	42.574
Return on regulatory equity including Financing adjustments	**3.86%**	**7.78%**	**10.04%**	**76.758**	**154.782**	**156.374**
Operational performance						
Totex out/(under) performance	–	(3.04%)	(3.88%)	–	(60.399)	(60.399)
ODI out/(under) performance	–	(1.74%)	(2.23%)	–	(34.700)	(34.700)
C-MeX out/(under) performance	–	(0.25%)	(0.31%)	–	(4.906)	(4.906)
D-MeX out/(under) performance	–	(0.05%)	(0.07%)	–	(1.033)	(1.033)
Retail out/(under) performance	–	(1.18%)	(1.51%)	–	(23.557)	(23.557)
Other exceptional items	–	(4.33%)	(5.52%)	–	(86.010)	(86.010)
Operational performance total	**–**	**(10.59%)**	**(13.52%)**	**–**	**(210.605)**	**(210.605)**
RoRE (return on regulatory equity)	**3.86%**	**(2.81%)**	**(3.48%)**	**76.758**	**55.823**	**54.231**
RCV growth	**7.31%**	**7.31%**	**7.31%**	**145.363**	**145.363**	**113.883**
Total shareholder return	**11.17%**	**4.50%**	**3.83%**	**222.121**	**89.540**	**59.652**
Dividends						
Gross dividend	1.41%	–	–	28.039	–	–
Interest received on intercompany loans	–	–	–	–	–	–
Retained value	**9.76%**	**4.50%**	**3.83%**	**194.082**	**89.540**	**59.652**
Cash impact of 2015–20 performance adjustments						
Totex out/under performance	–	(0.04%)	(0.05%)	–	(0.730)	(0.730)
ODI out/under performance	–	0.02%	0.03%	–	0.459	0.459
Total out/under performance	–	(0.02%)	(0.02%)	–	(0.271)	(0.271)

Due to rounding, the figures presented above may not precisely reflect those calculated in accordance with Ofwat's methodology.

1F – Financial Flows for the 12 months ended 31 March 2022 and for the price review to date (2017–18 financial year average CPIH)

	Average 2020–22					
	%			£m		
	Notional returns and notional regulatory equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity	Notional returns and notional equity	Actual returns and notional regulatory equity	Actual returns and actual regulatory equity
Regulatory equity						
Regulatory equity	1,960.559	1,960.559	1,476.851	–	–	–
Return on regulatory equity						
Return on regulatory equity	3.86%	2.91%	3.86%	75.678	57.006	57.006
Financing						
Impact of movement from notional gearing	–	0.95%	0.49%	–	18.672	7.300
Cost of debt	–	(0.90%)	(0.71%)	–	(17.689)	(10.531)
Hedging instruments	–	3.31%	4.40%	–	64.946	64.946
Return on regulatory equity including Financing adjustments	**3.86%**	**6.27%**	**8.04%**	**75.678**	**122.935**	**118.721**
Operational performance						
Totex out/(under) performance	–	(2.53%)	(3.36%)	–	(49.657)	(49.657)
ODI out/(under) performance	–	(1.94%)	(2.57%)	–	(38.003)	(38.003)
C-MeX out/(under) performance		(0.13%)	(0.17%)		(2.453)	(2.453)
D-MeX out/(under) performance		(0.03%)	(0.04%)		(0.517)	(0.517)
Retail out/(under) performance		(1.34%)	(1.79%)		(26.363)	(26.363)
Other exceptional items	–	(2.19%)	(2.91%)	–	(42.929)	(42.929)
Operational performance total	**–**	**(8.16%)**	**(10.83%)**	**–**	**(159.922)**	**(159.922)**
RoRE (return on regulatory equity)	**3.86%**	**(1.89%)**	**(2.79%)**	**75.678**	**(36.987)**	**(41.201)**
RCV growth	**4.18%**	**4.18%**	**4.18%**	**81.951**	**81.951**	**61.733**
Total shareholder return	**8.04%**	**2.29%**	**1.39%**	**157.629**	**44.964**	**20.532**
Dividends						
Gross dividend	1.41%	0.10%	0.13%	27.644	1.895	1.895
Interest received on intercompany loans	–	(0.10%)	(0.13%)	–	(1.895)	(1.895)
Retained value	**6.63%**	**2.29%**	**1.39%**	**129.985**	**44.964**	**20.532**
Cash impact of 2015–20 performance adjustments						
Totex out/under performance	–	(0.04%)	(0.05%)	–	(0.730)	(0.730)
ODI out/under performance	–	0.02%	0.03%	–	0.459	0.459
Total out/under performance	–	(0.02%)	(0.02%)	–	(0.271)	(0.271)

Due to rounding, the figures presented above may not precisely reflect those calculated in accordance with Ofwat's methodology.

Commentary regarding table 1F – Financial Flows

- Table 1F Financial Flows aims to improve transparency and explain the elements that have the most significance on the financial flows to investors. As the analysis is designed to estimate the impact on equity return due to actual performance and capital structure, it includes some high-level approaches to estimate the impact of regulatory mechanisms. This results in regulatory rewards and penalties, earned in the current price review period 2020–25 but not realised by shareholders until the next price review period 2025–30, being included in the table. A simplified approach is also adopted for the cost of debt, and replicated in hedging instruments in order to ensure consistency of approach.

The above table provides information in a three-column format:

- 'notional returns and notional regulatory equity' (column 1) – equivalent to our allowance in the Final Determination for 2020–25.
- 'actual returns and notional regulatory equity' (column 2) – provides a representation of the variance in financial performance between the return allowed in the PR19 Final Determination and actual results.
- 'actual returns and actual regulatory equity' (column 3) – an extension of column 2, designed to show the impact on shareholder returns where their investment in the company is smaller or larger than the regulatory assumption (with debt being correspondingly larger or smaller, respectively).

Base return:

The base return on regulatory equity of 3.86%, plus inflation of 7.31% on the regulated equity, results in a total shareholder return of 11.17%. This is based on Ofwat's price review approach to determining returns, reflecting an efficient company with the regulatory notional gearing of 60.00%. The equivalent actual total shareholder return, reflecting our average gearing in 2021–22 of 68.66% and actual performance, was 3.83%

Our actual return of 3.83% differed from the notional return of 11.17% due to financing out-performance of 6.18% and operational under-performance of 13.52%.

Financing performance:

Our average actual gearing has decreased since last year, mainly due to the additional investment injected by Macquarie during 2021–22 (see page 105 of our Annual Report). Our average actual gearing of 68.66% is higher than the regulatory assumption of 60.00%, and has the effect of amplifying percentage returns to shareholders. This is partly because the same value of return is applied to a smaller shareholder equity base, representing a greater proportion. This increases the volatility of returns, in both out-performance and under-performance scenarios, with the risk being borne entirely by shareholders.

The price setting process also allows us a return on equity between the notional gearing of 60.00% and our average actual gearing of 68.66%, rather than the lower cost of debt. The impact of this relative cost of debt versus equity is estimated in the 'Impact of movement from notional gearing' returns adjustment of 0.45%.

Our 'Comparison between tax charge and allowance in price limits' (see page 36) provides a detailed narrative on our corporation tax charge and approach to using group relief. In summary, our PR19 determination includes no funding from customers for corporation tax and, having excluded the cashflows relating to the inter-company loan to Southern Water Services Group (SWSG), we incurred no tax charge in the current year. The net impact on shareholder returns of corporation tax and group relief is 0.0%.

Our cost of debt (excluding the impact of swap instruments), measured by reference to an implied real rate of interest, was lower than the amount allowed in our PR19 determination (updated for the cost of debt reconciliation mechanism) increasing returns by 3.00%.

We have a portfolio of inflation linked swaps that match the cost we pay under our debt instruments to the cash flow we receive from customer bills. We have calculated the impact of these hedging instruments in a manner consistent with the prescribed calculation for cost of debt, by deflating to an implied real rate of net interest. This creates a positive impact for the year of 2.73%, reflecting benefits to our interest cashflows from the capital restructuring carried out in 2018.

Operational performance:

For AMP7 we will retain approximately 64% of wholesale totex overspends, but only 36% of wholesale totex cost savings, with the remainder being returned to customers. Some types of wholesale totex are not subject to customer sharing, with any out-performance or under-performance remaining entirely with the company. To account for any timing differences in our totex delivery, such as slippage or acceleration in our capital programme, we adjust for this in Table 4C. In 2021–22, having excluded expenditure relating to the Innovation Fund, we experienced a retained overspend of £60.4 million, equivalent to a decrease of 3.88% in returns.

The company share of retail cost under-performance represents the amount by which we are overspending against the PR19 price determination. There is no sharing with customers of the retail expenditure variance, with the result that the £23.6 million over-spend for 2021–22 reduces returns by 1.51%.

The impact of our performance on Outcome Delivery Incentives (ODIs) is £34.7 million for 2021–22, decreasing returns by 2.23%. Penalties or rewards are included even if they are not payable or receivable until later in the current AMP or the next AMP. Tables 3A and 3B provide further details.

For 2021–22 we include a £4.9 million penalty for the Customer Measure of Experience (C-MeX) ODI in our Retail business, and a £1.0 million penalty for the Developer Measure of Experience (D-MeX) ODI in Developer Services. These are equivalent to a 0.31% and 0.07% reduction to returns, respectively.

The exceptional item entry of £86.0 million, equivalent to a 5.52% decrease in returns, relates mainly to the fine and associated court and legal costs of the prosecution by the Environment Agency (see page 10). This is marginally offset by the company share of land sales, which we include under the 'exceptional items' to ensure consistency with Ofwat guidance for this table. The values for the land sales are immaterial, and not reported as exceptional items elsewhere in the financial statements.

Other:

The inflationary RCV return of 7.31% is long-term in nature and cannot be immediately realised.

No dividends were paid in 2021–22, including those historically paid as part of the SWSG intercompany loan (see notes below).

AMP7 annual average returns

Over the first two years of the AMP7 regulatory period, and including the 4.18% average annual inflationary growth of the RCV, the total shareholder return averages 1.39%. Excluding the inflationary RCV return, which is long-term in nature and cannot be immediately realised, the average annual return potentially available to shareholders is -2.79%, 6.65% lower than the 3.86% return allowed by Ofwat in the price determination.

The main driver of the shortfall on returns is our operational performance, which reduces returns by 10.83%. Our wholesale business comprises 8.84% of this difference, with 3.36% relating to cost overruns, 2.57% to our performance against Performance Commitments and resulting ODI penalties, and 2.91% to the exceptional item – almost entirely comprising the fine and costs of the Environment Agency prosecution. It should be noted that the EA prosecution, while being recognised in 2021–22, relates to historical performance over a number of years. The remaining 1.99% of our operational performance mainly relates to cost overruns and C-MeX performance in the Retail business.

The 4.18% increase to returns due to our financing performance, driven mainly by the impact of our hedging instruments, partially offsets the impact of our operational performance.

During AMP7 we have retained shareholder value in the business and made no dividends.

Cash impact of 2015–20 performance adjustments

The impact of 2015–20 performance adjustments has been removed from the main calculation of shareholder return for 2021–22 reporting. The cash impact is now reported as a memo note at the foot of the table and, consistent with Ofwat table guidance, we show the impact for wholesale totex and wholesale ODIs.

Other adjustments relating to 2015–20 performance are no longer reported. The most material of these are the regulatory settlement following the Ofwat investigation into our wastewater treatment compliance (discussed on page 9) and the Service Incentive Mechanism (SIM) in the Retail business, which was the AMP6 equivalent of C-MeX. For 2021–22 these penalties reduce returns by £24.2 million (1.55%) and £6.4 million (0.41%) respectively.

Notes:

To ensure consistency with treatment in the PR19 determination, the cashflows relating to the SWSG intercompany loan have been excluded from the above analysis. The interest income on the intercompany loan is excluded from net interest costs; no group relief payments for the interest loss at SWSG were made in 2021–22, and the payments in 2020–21 are not reflected in the corporation tax and group relief sections for the cumulative AMP-to-date; no dividends were made in 2021–22, and the gross dividend for 2020–21 was reduced by the amount of dividend paid to SWSG under this arrangement, also correctly stating the cumulative AMP-to-date. This ensures that these items do not distort the reporting of returns to shareholders.

We believe that our RCV for 2021–22 published by Ofwat is understated by approximately £23.3 million, due to the approach taken to convert from year-average prices to March 2022 to prices for the proportion of our RCV which remains linked to RPI. For our reporting we have used the value published by Ofwat, which translates to a lower regulatory equity value, amplifying the impact of out-performance and under-performance in the Financial Flows table. We are engaging with Ofwat to determine the correct treatment.

Notes to the regulatory financial statements
For the year ended 31 March 2022

1 Accounting policies

a) Basis of preparation

The regulatory accounting statements have been prepared in accordance with Condition F of the Appointment and the Regulatory Accounting Guidelines (RAGs) published by Ofwat, the accounting policies set out in the statement of accounting policies and under the historical cost convention.

The accounting policies used in the regulatory accounting statements are the same as those adopted in the statutory historical cost accounts, except as set out below.

The regulatory accounting statements are separate from the statutory financial statements of the company. The statutory financial statements are prepared under FRS 101 'Reduced Disclosure Framework'. There are differences between International Financial Reporting Standards under FRS 101 and the basis of preparation of information provided in the regulatory accounts because the Regulatory Accounting Guidelines specify alternative treatment or disclosure in respect of:

- revenue recognition
- capitalisation of borrowing costs.

Where the Regulatory Accounting Guidelines do not specifically address an accounting issue, then they require the company's statutory accounting framework to be followed. Financial information other than that prepared wholly on the basis of IFRS, FRS 101 or FRS 102 may not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 2006.

b) Fixed assets

Interest – To meet the requirements of RAG 1.09 the interest capitalised within the statutory accounts under IAS 23 'Borrowing Costs' has been reversed and charged through the income statement.

Capitalisation policy – Costs that are either directly attributable to bringing an asset into working condition or subsequent expenditure that provides an enhancement of the economic benefits of a fixed asset are treated as capital expenditure. In order to aid classification of expenditure the following rules are applied:

Non-infrastructure assets

- Expenditure on a single item of equipment, including installation costs, exceeding £3,000 is treated as capital expenditure. Individual items purchased for less than £3,000 are charged to operating costs unless they form part of a capital scheme
- All repairs, replacements and improvements to non-infrastructure fixed assets costing in excess of £3,000 and which extend the life of the asset are charged to capital.

Infrastructure assets

- All repairs and maintenance to infrastructure assets will generally be treated as operating expenditure.
- Large repairs, involving the replacement of a significant length of pipe, are treated as capital expenditure after review with the Finance Team.
- Planned renewals to replace significant lengths of pipe in relation to a specific asset are treated as capital expenditure.

Private sewers – The ownership of and responsibility for private sewers in Southern Water's region were transferred to the company on 1 October 2011.

Following the adoption of FRS 101, expenditure in relation to private sewers has been treated as an expense and charged to the income statement.

c) Revenue recognition

Revenue represents the income receivable in the ordinary course of business (excluding value added tax) for goods and services provided in the year by the regulated activities of the business.

Revenue relates to charges due in the year and includes charges billed to customers for water and sewerage services, which are recognised in the period in which they are earned, and an accrual in respect of unbilled charges. Revenue excludes payments received in advance which are recorded as deferred revenue.

Unmetered bills for water and wastewater services are based on either the rateable value of the property, an assessed volume of water supplied or on a Fixed Licence Fee.

Metered bills for water and wastewater services are based on actual or estimated water consumption. Metered revenue is dependent upon the volumes supplied and includes an estimate of the consumption between the date of the last meter reading and the period end. Meters are read on a cyclical basis and the company recognises revenue for unbilled amounts based on estimated usage from the last meter reading date through to the end of the reporting period. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff. Where there is insufficient historical information, estimation is based on average consumption for defined levels of occupancy.

Within the accrual, adjustments to billing are made for changes to occupancy dates and where consumption levels are in excess of certain tolerances. No other amendments are made between revenue and billing.

Charges on income arising from court, solicitors and debt recovery agency fees are credited to operating costs and added to the relevant customer account. They are not recognised within revenue.

In the statutory accounts, reported under IFRS 15 – 'Revenue from Contracts with Customers', revenue is only recognised when it is probable that economic benefits will result to the company. RAG 1.09 requires that no judgment is applied to the probability of collection. Following a review of the collectability of revenue for the bad debt provision charge for 2019–20, revenue has been recognised in full in the statutory accounts and therefore there is no difference this year between the revenues reported for statutory and regulatory purposes.

Charging policy

Water and sewerage charges fall into the following three categories:

1) Charges which are payable in full

2) Charges which are payable in part

3) Not chargeable (void properties)

The circumstances in which each of the above applies are set out below. All of the charges covered in categories 1) and 2) are included in revenue.

Charges payable in full

Charges are payable in full in the following circumstances:

i) Occupied and furnished

Water (and sewerage) charges are payable in full from the date of connection or change of customer on all properties which are recorded as occupied and furnished.

ii) Unoccupied and furnished

Water (and sewerage) charges are payable in full on unoccupied, furnished premises. These include properties:

- left with bedding, a desk or other furniture
- used for multiple occupation with shared facilities
- used as holiday, student, hostel or other accommodation
- used for short-term occupation or letting where the occupation or terms of tenancy is less than six months.

Exceptions to this, where water (and sewerage) charges are not payable, include where the customer is:

- in a care home
- in long-term hospitalisation
- in prison
- overseas long term
- deceased.

iii) Unoccupied and unfurnished

Water (and sewerage) charges are payable in full on unoccupied, unfurnished premises where water is being consumed. This includes:

- premises where renovation, redecoration or building work is being undertaken
- premises being used as storage
- premises not normally regarded as being occupied such as cattle troughs and car parks
- non-household agricultural properties.

Charges payable in part

The following charges only are payable in certain circumstances:

- Metered standing charges – Payable on unoccupied, metered properties which are still connected.
- Surface water charge – Payable on unmeasured properties which are temporarily disconnected.
- Sewerage unmeasured tariff – Payable on unmeasured, occupied properties where the water supply is disconnected but sewerage is still provided.
- Surface water and highway drainage – Payable on furnished properties where the water supply is disconnected.

Not chargeable

Properties which are unoccupied, unfurnished and disconnected are not chargeable for water and sewerage therefore no billing is raised, and no revenue recognised in respect of these properties.

Definition and treatment of properties

Occupied properties

The occupier is any person who owns a premises or who has agreed with us to pay water and sewerage services in respect of the premises. The property management process is followed to identify whether the property is occupied or not and, if occupied, to identify the chargeable person and raise a bill.

The property management process may comprise some or all the following:

- Physical inspection
- Mailings
- Customer contacts
- Meter readings for metered properties
- Checks with third parties, e.g. credit agencies.

When a new customer is identified, the company process aims to establish the date that they became responsible for water and sewerage charges at the property. This is normally the date at which they moved into the property. The new customer will be charged retrospectively from the date at which they became responsible for water and sewerage charges of the premises.

Where evidence exists that a property is occupied the property management process is followed until occupancy details are obtained. Bills are not issued in the name of 'The Occupier' to try to generate confirmation of occupancy and therefore there is no billing in the name of 'The Occupier' within revenue.

Unoccupied properties

A property is deemed to be unoccupied when the company has completed the property management process and not identified the property as occupied. To be classified as unoccupied a property must meet at least one of the following criteria:

- A new property has been connected but is empty and unfurnished.
- The company has been informed that the customer has left the property, it is unfurnished and not expected to be reoccupied immediately.
- It has been disconnected following a customer request.
- The identity of the customer is unknown.
- The company has been informed that the customer is in a care home, long-term hospitalisation, prison, overseas long term or deceased.

If the property management process confirms that the property is unoccupied, the property may be declared void and the supply turned off.

New properties

All new properties are metered. Charges accrue from the date at which the meter is installed. The developer is billed between the date of connection and first occupancy and this is recognised as revenue.

If the developer is no longer responsible for the property and no new occupier has been identified, the property management process referred to above is followed to identify the new occupier. Until the new occupier has been identified the property is treated as unoccupied and is not billed.

d) Revenue disclosures

In accordance with RAG 3.13 we highlight the following comments in respect of turnover for the year:

(i) The value of household billings raised in the year ended 31 March 2022 for consumption in prior years was £227.9 million. The value of these billings was greater than the metered income accrual made at 31 March 2021. The estimation difference was £13.4 million and this has been recognised in the current year's turnover. This difference is larger than we would normally expect and reflects much greater levels of consumption than anticipated from COVID-19 and the impact this had on customer consumption patterns.

(ii) No changes have been made to the overall accrual methodology in the year although we have taken into consideration the experience from March 2021

e) Social tariffs

We provide a number of schemes and tariffs to improve affordability and accessibility for vulnerable customers. These include:

- **Essentials** – for customers whose household income is less than £21,000, or for those in receipt of pension credit.
- **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.

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).

Further details can be found in our Annual Report and on our website at: **southernwater.co.uk/account/help-paying-your-bill.**

f) Bad and doubtful debts

The bad debt provision is calculated by applying estimated recovery rates, based on the past collection experience of other customers who share similar characteristics.

Higher provisioning percentages are applied to customers which are, based on their characteristics, considered to be of greater risk. These include those with a poor payment history as well as to those of with older debts. Bad debt provisioning rates are updated annually to reflect the latest collection performance data from the company's billing system. Actual amounts recovered may differ from the estimated levels of recovery, which could impact on operating results.

The company operates a comprehensive debt recovery process and bad debt is only written off when the recovery of such debt has been exhausted through routine collection, debt recovery or litigation processes or where it would be uneconomical to undertake further recovery action.

Situations where this may arise and where debt may be written off are as follows:

- Where the customer has absconded without paying and strategies to trace their whereabouts and collect outstanding monies have been fully exhausted,
- Where the customer has died without leaving an estate or has left an insufficient estate from which to recover the debt,
- Where the age and/or value of the debt makes it uneconomical to pursue,
- Where county court proceedings and attempts to recover the debt using debt collection agencies have proved unsuccessful,
- Where the customer has been declared bankrupt, is in liquidation or is subject to insolvency proceedings or a debt relief order and no dividend has been or is likely to be received.

Write-off rules apply primarily to customers to whom the company has ceased to supply a service. Only in exceptional circumstance or as part of specific debt recovery assistance programmes is debt relating to continuing customers considered for write-off.

For debt to be written off there must be a legitimate charge against the debtor. If it is considered that part or all of the debt is incorrect or unsubstantiated, then such elements are dealt with through the issue of a credit note.

The company's bad debt provisioning and write-off policies have remained unchanged and have been consistently applied during the year. The value of debt written off over the past year has remained low due to the continuation of projects aimed at reducing bad debt before the point of write-off.

The value of trade and other receivables of the appointed business increased to £242.5 million (2021: £213.4 million). This increase largely results from an increase in the balance on our inter-company debtor with Southern Water Services (Finance) Limited of £18.1 million, which is used to pay the interest on our loans. In addition, following the relaxation of COVID-19 restrictions during 2022, the value of the accrual for non-household revenue increased by £2.7 million at March 2022.

g) Price control units

The notes to the regulatory accounting statements analysing revenues, operating costs and fixed assets by price control segment have been drawn up in accordance with the guidance provided by Ofwat in RAG 2.09 and our accounting separation methodology statement which is published separately on our website.

The methods for undertaking cost allocations to produce this information are summarised below:

Operating expenditure

Most direct costs are specific either to water, wastewater or retail services. Where costs cannot be directly attributed to a sub-function an apportionment has been made on an appropriate basis, using the most accurate allocation method available. Examples of allocation methods include the use of time recording devices, headcount, operational site data and management estimates.

The allocation methods adopted have been agreed following review meetings held across the business with management and technical experts.

The information relating to non-appointed business, including an allocation of overhead cost, has been excluded in line with the guidance

Fixed assets

The fixed asset data has predominantly been directly attributed to the price control segments based on an assessment of the overall nature of each scheme.

Where a scheme relates to more than one price control segment it has been allocated to the price control unit where the principal use occurs. For corporate assets, the price control of principal use is wholesale wastewater as this is our largest price control and recharges to the other price control units are made for the use of these assets.

New expenditure incurred during the year is allocated to business units within each price control based on an analysis of the scheme design.

Revenues

Revenue streams have been directly attributed to price control segments where they have been recorded as such in our systems. Classification of household and non-household revenues has been made in line with the classifications in place when the business plan was completed in accordance with the guidance from Ofwat.

Revenues that could not be directly attributed to a price control segment have been assessed and allocated to the appropriate price control segment based on the nature of the income.

h) Provisions

Environment Agency – wastewater sites

The company was subject to a detailed investigation regarding permit breaches at some of our wastewater treatment works during the period 2010–15.

On 9 July 2021, the company was sentenced and fined £90.0 million plus £2.5 million of costs for these historic offences against the previous provision of £1.0 million made in the year to 31 March 2020, giving rise to a charge to the income statement in the period of £91.5 million. As a result, provisions for liabilities relating to this Environment Agency investigation are now £nil (31 March 2021: £1.0 million).

The company is seeking to work proactively with the Environment Agency to resolve its separate investigation into sampling compliance and reporting issues 2013 and 2017 (inclusive). The Board has concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from this separate investigation and further details are provided in within the contingent liability disclosures in our Annual Report.

i) Havant Thicket

In February 2021 the company entered into a contractual arrangement with Portsmouth Water, under which Portsmouth Water will obtain planning permission, design, build, finance, and operate a reservoir in Havant. Once the construction is complete, Portsmouth Water will supply, on the request of Southern Water up to 21 million litres of treated water per day from 1 April 2029.

Following a detailed review of the complex contractual arrangement, and with a better understanding of the contractual terms of the agreement, which require both parties to complete certain activities to enable the water to be provided, we have formed the judgment that this contract should be accounted for as an executory contract until such time that both parties have fulfilled their obligations and the right to water can be met.

As a result, the Balance Sheet for the prior year has been restated, the intangible asset and associated liability of £124.6 million, recorded in 2020–21, have been reversed in the prior year and the payments made during 2020–21 of £6.5 million have been reclassified from intangible assets to prepayments as disclosed in our Annual Report and Financial Statements for March 2022. There is no impact on the profit and loss account for 2020–21 or retained earnings.

There is no change to our overall totex reported, which included the payments made to Portsmouth Water last year. The opening balance of intangible assets has been restated, to reflect the changes described above, in table 2O.

2 Differences between statutory and regulatory reporting

Statutory reporting reflects the financial performance of Southern Water Services which comprises appointed and non-appointed activities. The appointed business relates to those activities which are necessary for the company to fulfil its function and duties as a water and sewerage undertaker. The non-appointed business relates to activities we undertake that are not covered by our Licence but are related to our business. For regulatory reporting the activities of the non-appointed business have been separated from those of the appointed business.

In addition, there are differences between regulatory accounting definitions and those applied for statutory reporting under FRS 101. These are summarised below:

Income statement – differences between statutory and RAG definitions

	Revenue £m	Operating costs £m	Other operating income £m	Other income £m	Interest expense £m
i) CHP income	(3.6)	3.6	–	–	–
ii) Grants and contributions	(21.8)	–	–	21.8	–
iii) Contribution amortisation	(0.9)	–	–	0.9	–
iv) Regulatory settlement amortisation	(21.0)	–	21.0	–	–
v) Borrowing costs	–	11.3	–	–	(15.9)
vi) Innovation costs	–	5.9	–	(0.3)	–
Total	(47.3)	20.8	21.0	22.4	(15.9)

i) Income generated from Combined Heat and Power (CHP) processes, which convert methane into electricity, is recorded as revenue within the statutory accounts. For regulatory reporting this income is reported as a negative operating cost. As a result, £3.6 million of revenue has been re-classified as a negative operating cost.

ii) As required by RAG 1.09 section 4.11, grants and contributions received and recognised in the income statement are reported under other income in the Annual Performance Report financial tables. As a result, £21.8 million has been transferred from revenue to other income in the income statement. See table 2E for further information.

iii) Certain contributions received are held on the Balance Sheet before amortisation or release to the income statement. Those released to the income statement through revenue totalling £0.9 million have been reclassified as other income along with the grants and contributions mentioned above.

iv) In 2018–19 we made a provision for rebates to be made to customers during the period from 2020–25 as a result of the investigation undertaken by Ofwat into wastewater reporting as set out on page 9. For regulatory purposes, the amortisation of this provision is reclassified from revenue to other operating income.

v) For statutory reporting, borrowing costs associated with capital expenditure are capitalised. Regulatory reporting does not permit interest to be capitalised. As a result, operating costs are reduced by £11.3 million, reflecting the removal of depreciation on interest capitalised and the interest charge has been increased by £15.9 million reversing the element of interest capitalised in the year.

vi) As required by Ofwat we have removed the costs paid and accrued in relation to the innovation fund from our operating costs. The value paid into the fund and for administration the fund of £0.3 million has been reclassified within other income in order to reflect this transaction through reserves and the accrual of £5.6 million has been reversed in accordance with IN-2201 Expectations for monopoly company annual performance reporting 2021–22 as published by Ofwat.

The tax impact of the changes detailed above have been recognised through an adjustment to deferred tax.

Statement of financial position – differences between statutory and RAG definitions

	Fixed Assets £m	Intangible Assets £m	Trade and other receivables £m	Cash and cash equivalents £m	Current trade and other payables £m	Deferred income – grants and contributions £m
i) Borrowing costs	(241.7)	(3.7)	–	–	–	–
ii) Grants and contributions	–	–	–	–	2.8	(2.8)
iii) Innovation costs	–	–	–	–	(5.6)	–
iv) Short-term deposits	–	–	(285.0)	285.0		
Total	(241.7)	(3.7)	(285.0)	285.0	(2.8)	(2.8)

i) As borrowing costs cannot be capitalised under regulatory reporting, fixed and intangible assets have been reduced by £241.7 million and £3.7 million respectively, reflecting the removal of cumulative borrowing costs capitalised. There is a corresponding reduction to retained earnings.

ii) Grants and contributions relating to requisitions of £2.8 million classified within current trade and other payables in the statutory accounts have been transferred to deferred income for regulatory reporting.

iii) Removal of the innovation cost accrual as mentioned in note (vi) to the income statement above.

iv) The balance of £285.0 million held on short-term deposit and reported in the statutory accounts as a current investment has been reclassified to cash and cash equivalents for the regulatory accounts.

Statement of cash flows – differences between statutory and RAG definitions

	Operating profit £m	Other income £m	Depreciation £m	Amortisation – grants and contributions £m	Changes in working capital £m	Grants and contributions £m	Investing activities – other £m
i) Grants and contributions – income statement	(22.7)	22.7	–	–	–	–	–
ii) Depreciation	11.3	–	(11.3)	–	–	–	–
iii) Grants and contributions – cash	–	–	–	(6.6)	–	6.6	–
iv) Innovation fund	5.9	(0.3)	–	–	(5.6)	–	–
v) Short-term deposits	–	–	–	–	–	–	285.0
Total	(5.5)	22.4	(11.3)	(6.6)	(5.6)	6.6	285.0

i) The re-classification of grants and contributions received in the income statement of £22.7 million from operating profit to other income.

ii) There is a £11.3 million adjustment made to both operating profit and depreciation relating to the removal of capitalised borrowing costs.

iii) In the statutory accounts for 2021–22, cash contributions received and held on the Balance Sheet have been presented as operating cashflows. These have been included within the statutory amortisation of grants and contributions row of table 1D. For regulatory purposes £6.6 million, reflecting the cash received for specific capital assets, has been reclassified to grants and contributions within investing activities.

iv) Innovation fund – reclassification of payments made from operating costs to other income of £0.3 million and removal of the accrual made in the statutory accounts of £5.6 million.

v) Short-term deposits – reclassification of short-term deposits from current investments to cash and cash equivalents.

3 Interest

	£m
Interest income	
Interest revenue from Southern Water Services Group Limited	4.0
Deposit income on short-term bank deposits	0.8
	4.8
Interest income	
Interest payable on other loans	(2.1)
Interest paid to Southern Water Services (Finance) Ltd	(159.6)
Indexation	(46.5)
Fair value adjustment on contractual obligations	(6.2)
Amortisation of issue costs	(1.5)
Amortisation of gilt lock proceeds	0.1
Amortisation of bond premium	0.7
Finance lease interest	(0.8)
Dividends on preference shares	(4.9)
	(220.8)
Other interest expense	
Pension financing charge	(2.3)
	(2.3)

4 Corporation tax reconciliation

The tax assessed for the year is different to the standard rate of corporation tax in the UK and the reconciliation is shown in the table below.

	Appointed £m	Non-appointed £m
Profit before tax and fair value movement	(179.7)	2.0
Tax at the UK corporation tax rate of 19%	(34.1)	0.4
Permanent differences	20.7	–
Fixed asset timing differences	29.3	(0.4)
Other short-term timing differences	(9.3)	–
Pension cost relief in excess of pension charge	(6.6)	–
Group relief received for nil payment	–	–
Adjustment in respect of prior years – current tax	–	–
Tax charge for year	–	–

Details of factors affecting future tax charges:

The Finance Bill 2021 was substantively enacted in May 2021 and the main rate of UK corporation tax will change from 19% to 25%, effective 1 April 2023. The majority of our deferred assets and liabilities will reverse after 1 April 2023 and therefore deferred tax has been calculated at the 25% rate. There is a small value of deferred liabilities which are calculated at 19%.

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.

A comparison of the current appointed tax charge with the allowance in price limits is shown in the table and associated notes below:

Comparison between tax charge and allowance in final determination

	Current tax charge £m	Current tax charge (excluding SWSG loan) £m
i) Final determination allowance	–	–
ii) Price determination – tax not charged on forecast tax losses	(3.8)	(3.8)
iii) Earnings before interest and tax	(37.2)	(37.2)
iv) Regulatory settlement	3.6	3.6
v) EA prosecution – Court fine and costs	15.6	15.6
vi) Net finance costs, including taxable fair value movements	(16.2)	(16.9)
vii) Depreciation and capital allowances claimed	42.9	43.6
viii) Pensions	(4.4)	(4.4)
ix) Group relief claimed	–	–
x) Change in tax rate	–	–
Other	(0.5)	(0.5)
Current tax before payments for group relief and prior year adjustments	–	–
xi) Payments for group relief	–	–
Appointed current tax charge	–	–

i) In the price review process for the current regulatory period, 2020–25, there was no corporation tax forecast to be paid in the wholesale business and therefore there is no allowance for corporation tax in customer bills.

ii) For 2021–22 the price determination included tax losses of £3.8 million and no allowance was provided for these in price limits.

iii) Actual earnings before interest and tax are lower than those in the Final Determination. This is mainly driven by additional operating expenditure in both the wholesale and retail businesses.

iv) In 2018–19 we made a provision for the regulatory settlement on revenues, and did not reflect a reduction to our tax charge due to the reduced revenues in that year. During AMP7 this provision is released to the income statement, increasing revenues. We do not reverse this for tax purposes, instead recognising an increased tax charge due to the regulatory settlement.

v) The fine and Court costs associated with the EA prosecution, totalling £91.5 million in 2021–22, have not been treated as a deductible cost for tax purposes. This increases our tax charge by £15.6 million.

vi) Net finance costs increased, reducing our tax charge, due to higher interest costs, higher inflation on index-linked debt instruments, and taxable fair value losses relating to debt indexation. This is partially offset by the interest receivable on our derivative financial instruments, and interest income on the inter-company loan to Southern Water Services Group (SWSG), prior to its repayment in September 2021.

The cash flows relating to the inter-company loan to SWSG were designed to be neutral to Southern Water and its customers as we received interest and paid an equal amount of dividend and group tax relief back to SWSG. In the prior year (2020–21) we claimed approximately half of these losses, and used additional capital allowances to offset the full amount of interest income. In the current year (2021–22) we claimed no losses relating to the SWSG loan and used capital allowances to offset the full amount of the interest income. The effect of removing this loan (consistent with the treatment in the price determination) is shown in the table above.

vii) Lower capital allowances were claimed as a result of lower taxable profits.

viii) We are making pension contributions in excess of those in the price determination. These additional contributions reduce our tax charge. For tax purposes the lump sum payment of £59.6 million in 2021–22, covering agreed contribution payments to March 2025, has been subject to pension spreading, with some of the additional tax deduction being spread over future years.

ix) Historically we have used losses from other companies within the Greensands group to reduce the current tax charge for Southern Water. Capital allowances not claimed, in favour of group losses, were then available to Southern Water as a deduction against future taxable profits.

In 2020–21 we limited use of group relief to the tax losses received on the inter-company interest income from SWSG. In 2021–22 we further extended this approach, claiming no group losses at all.

x) The Final Determination assumed that corporation tax would be payable at a rate of 17%. The actual tax rate of 19% would, all other things being equal, increase our current tax charge. Historically we have shown a small value in this reconciliation for the impact of the change in tax rate, applied to the current tax charge prior to the use of group relief. As we are no longer claiming group relief and are instead fully offsetting taxable profits using capital allowances, the reported value for this year is zero.

xi) As described above at (ix), we claimed no group relief in the year and have therefore made no payments.

Taxation policy and strategy

We manage our tax affairs in an open and transparent way and contribute materially to the Exchequer each year.

Our tax policy is consistent with the overall values and strategy of the company and will consider 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 using 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. 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 approach to tax management is compliant with tax laws, rules, regulations and reporting requirements in all of its operations. 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. Management of our tax affairs is carried out by an experienced internal tax team with the support of professional tax advisers and specialist tax support. Professional tax advisers are used in circumstances when additional advice is deemed appropriate (for example, to ensure compliance with new legislation and tax planning). We use specialist tax support in the preparation of our capital allowances.

Risk is managed by ensuring there are sufficient processes, systems, governance and appropriate controls in place. Internal assurance for the company is carried out by our Internal Audit team and we have also used the services of professional tax advisers to assist us with our tax compliance. Our tax policy extends to the wider group and ensures all companies within the Southern Water and Greensands groups are subject to UK tax, and all companies are UK tax resident irrespective of their place of incorporation.

A key factor in managing tax 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, such as internal audit findings. HMRC share our view of our low-risk approach to the management of our tax affairs with an assessment of us as a 'low-risk' company.

Further information is available in our Annual Report and Financial Statements on page 98.

5 Innovation Fund

For the period from 2020–25 Ofwat has introduced a series of innovation competitions. We are collecting monies from customers through our revenue across this regulatory period to fund these innovation competition activities. Ofwat held the first "Innovation in Water Challenge" during 2021–22 for which we have paid the administration fees and a contribution totalling £0.3 million. As disclosed above this payment has been re-classified through other income in the regulatory financial statements to exclude it from operating costs, as required by Ofwat, and ensure that it is reflected in retained earnings.

No further cash payments have been made during 2021–22 for the subsequent "Breakthrough" challenges and the accrual made for these has been removed from the regulatory accounting statements in accordance with IN-2201 Expectations for monopoly company annual performance reporting 2021–22 as published by Ofwat.

Price control and other segmental reporting

2A – Segmental income statement for the 12 months ended 31 March 2022

	Retail		Wholesale				
	Retail household £m	Retail non-household £m	Water resources £m	Water network + £m	Wastewater network + £m	Bioresources £m	Total £m
Revenue – price control	54.035	–	27.504	179.457	466.433	51.978	779.407
Revenue – non price control	–	–	5.046	0.295	1.967	0.044	7.352
Operating expenditure – excluding PU recharge impact	(70.625)	–	(13.990)	(100.170)	(287.489)	(21.338)	(493.612)
PU opex recharge	(1.182)	–	(1.417)	(12.234)	17.192	(2.359)	–
Operating expenditure – including PU recharge impact	**(71.807)**	**–**	**(15.407)**	**(112.404)**	**(270.297)**	**(23.697)**	**(493.612)**
Depreciation – tangible fixed assets	(2.654)	–	(8.979)	(64.809)	(195.981)	(19.484)	(291.907)
Amortisation – intangible fixed assets	(2.707)	–	(0.248)	(0.546)	(17.425)	(0.001)	(20.927)
Other operating income	–	–	0.952	6.944	13.483	1.182	22.561
Operating profit	**(23.133)**	**–**	**8.868**	**8.937**	**(1.820)**	**10.022**	**2.874**
Surface water drainage rebates							0.149

PU = Principal Use

Operating costs reported for retail are linked directly to table 2C and include the pension deficit repair costs of £5.378 million which do not get charged to operating expenditure in the income statement.

2B – Totex analysis for the 12 months ended 31 March 2022 – Wholesale

	Water resources £m	Water network + £m	Wastewater network + £m	Bioresources £m	Total £m
Base operating expenditure					
Power	3.704	12.767	35.370	(3.244)	48.597
Income treated as negative expenditure	–	(0.016)	–	(3.611)	(3.627)
Abstraction charges/discharge consents	3.665	0.099	4.030	–	7.794
Bulk supply/bulk discharge	–	0.335	–	–	0.335
Renewals expensed in year (Infrastructure)	–	19.652	32.585	–	52.237
Renewals expensed in year (Non-Infrastructure)	–	–	–	–	–
Other operating expenditure	6.354	58.039	181.969	28.794	275.156
Local authority and Cumulo rates	0.999	11.289	13.392	1.758	27.438
Total base operating expenditure	14.722	102.165	267.346	23.697	407.930
Other operating expenditure					
Enhancement operating expenditure	0.131	6.867	–	–	6.998
Growth operating expenditure	–	1.488	2.951	–	4.439
Total operating expenditure excluding third party services	14.853	110.520	270.297	23.697	419.367
Third party services	0.554	1.884	–	–	2.438
Total operating expenditure	15.407	112.404	270.297	23.697	421.805
Grants and contributions					
Grants and contributions – operating expenditure	–	–	–	–	–
Capital expenditure					
Base capital expenditure	5.186	128.781	235.726	23.994	393.687
Enhancement capital expenditure	29.584	21.351	107.249	0.056	158.240
Growth capital expenditure	–	11.340	23.868	–	35.208
Total gross capital expenditure excluding third party services	34.770	161.472	366.843	24.050	587.135
Third party services	1.307	5.204	2.404	–	8.915
Total gross capital expenditure	36.077	166.676	369.247	24.050	596.050
Grants and contributions					
Grants and contributions – capital expenditure	1.366	5.536	13.197	–	20.099
Net totex	50.118	273.544	626.347	47.747	997.756
Cash expenditure					
Pension deficit recovery payments	0.826	21.787	45.646	3.699	71.958
Totex including cash items	50.944	295.331	671.993	51.446	1,069.714

2C – Cost analysis for the 12 months ended 31 March 2022 – Retail

	Household £m	Total £m
Operating expenditure		
Customer services	20.738	20.738
Debt management	6.283	6.283
Doubtful debts	29.964	29.964
Meter reading	3.210	3.210
Other operating expenditure	5.033	5.033
Local authority and Cumulo rates	0.019	0.019
Total operating expenditure excluding third party services	65.247	65.247
Depreciation		
Depreciation on tangible fixed assets existing at 31 March 2015	0.980	0.980
Depreciation on tangible fixed assets acquired after 1 April 2015	1.674	1.674
Amortisation on intangible fixed assets existing at 31 March 2015	1.030	1.030
Amortisation on intangible fixed assets acquired after 1 April 2015	1.677	1.677
Recharges		
Recharge from wholesale for legacy assets principally used by wholesale (assets existing at 31 March 2015)	0.066	0.066
Income from wholesale for legacy assets principally used by retail (assets existing at 31 March 2015)	–	–
Recharge from wholesale assets acquired after 1 April 2015 principally used by wholesale	1.116	1.116
Income from wholesale assets acquired after 1 April 2015 principally used by retail	–	–
Net recharges costs	1.182	1.182
Total retail costs excluding third party and pension deficit repair costs	71.790	71.790
Third party services operating expenditure	–	–
Pension deficit repair costs	5.378	5.378
Total retail costs including third party and pension deficit repair costs	77.168	77.168
Debt written off		
Debt written off	1.674	1.674
Capital expenditure		
Capital expenditure	10.983	10.983
Other operating expenditure includes the net retail expenditure for the following household retail activities which are part funded by wholesale		
Demand-side water efficiency – gross expenditure	(0.003)	
Demand-side water efficiency – expenditure funded by wholesale	–	
Demand-side water efficiency – net retail expenditure	(0.003)	
Customer-side leak repairs – gross expenditure	–	
Customer-side leak repairs – expenditure funded by wholesale	–	
Customer-side leak repairs – net retail expenditure	–	
Comparison of actual and allowed expenditure		
Cumulative actual retail expenditure to reporting year end	151.682	
Cumulative allowed expenditure to reporting year end	102.409	
Total allowed expenditure 2020–25	261.689	

Movement in costs from 2020–21

Household retail operating expenditure has decreased by £3.0 million to £65.2 million (2021: £68.2 million).

This is principally due to a reduction in the bad debt charge by £3.8 million to £30.0 million (2021: £33.8 million). The prior year bad debt charge included assessment of the collectability of our outstanding debt in light of the anticipated impact of the COVID-19 pandemic. The 2022 bad debt provision includes an additional £10.3 million to reflect the impact of high inflation on the cost-of-living and on customers' ability to pay.

Debt management costs have increased by £1.2 million to £6.3 million (2021: £5.1 million) due to the resumption of debt collection activities that were suspended during the period of the first national COVID-19 lockdown during 2020.

There have been small movements in other costs with customer services costs reducing by £0.2 million, meter reading costs reducing by £0.3 million and other operating expenditure increasing by £0.2 million.

Comparison to the final determination

Household

Total household retail costs excluding recharges totalling £76.0 million are £24.4 million higher than allowed in the final determination (£51.6 million). The increase is due to the following factors:

- The bad debt charge is £17.8 million higher than assumed in the business plan. This is due to a worsening in our assessment of the recoverability of debt that has reached the end of the recovery process largely as a result of the impact of high inflation on the cost-of-living together with the enduring impact of the COVID-19 pandemic.
- Debt management costs are £0.7 million higher than the business plan, and customer services costs are £5.6 million higher than the business plan, both due to transformational activities taking longer than planned. This is offset by £4.0 million lower allocated overheads due to the outsourcing of customer services.
- Meter reading costs are £1.0 million over the business plan due to additional costs incurred as a result of increasing volumes of failed automatic reads.
- The charge for depreciation and amortisation of tangible and intangible assets for the household retail business is £2.3 million higher than the allowance in the final determination. This all relates to the charge for depreciation and amortisation on assets acquired after March 2015.
- Pension deficit repair costs are £4.1 million above that assumed in the business plan due to additional lump sum deficit payments, covering the period to 2025, made into our final salary pension scheme in the year.

Non-household

On 1 April 2017 we exited the non-household retail business and our customers transferred to a specialist retail company, Business Stream.

2D – Historic cost analysis of tangible fixed assets – Wholesale and retail

	Wholesale				Retail	
	Water resources £m	Water network + £m	Wastewater network + £m	Bioresources £m	Household £m	Total £m
Cost						
At 1 April 2021	223.283	1,997.942	6,488.941	607.982	35.023	9,353.171
Disposals	(1.388)	(4.372)	(11.287)	(0.255)	–	(17.302)
Additions	35.434	166.664	320.630	24.030	(0.028)	546.730
Adjustments	–	–	(16.574)	16.574		–
Assets adopted at nil cost	–	0.048	9.857	–	–	9.905
At 31 March 2022	**257.329**	**2,160.282**	**6,791.567**	**648.331**	**34.995**	**9,892.504**
Depreciation						
At 1 April 2021	(69.921)	(634.252)	(2,127.407)	(290.610)	(25.568)	(3,147.758)
Disposals	1.388	4.372	11.287	0.255	–	17.302
Adjustments	–	–	0.632	(0.632)	–	–
Charge for year	(8.979)	(64.809)	(195.981)	(19.484)	(2.654)	(291.907)
At 31 March 2022	**(77.512)**	**(694.689)**	**(2,311.469)**	**(310.471)**	**(28.222)**	**(3,422.363)**
Net book amount at 31 March 2022	**179.817**	**1,465.593**	**4,480.098**	**337.860**	**6.773**	**6,470.141**
Net book amount at 1 April 2021	153.362	1,363.690	4,361.534	317.372	9.455	6,205.413
Depreciation charge for year						
Principal services	(7.300)	(62.946)	(195.603)	(19.483)	(2.654)	(287.986)
Third party services	(1.679)	(1.863)	(0.378)	(0.001)	–	(3.921)
Total	**(8.979)**	**(64.809)**	**(195.981)**	**(19.484)**	**(2.654)**	**(291.907)**

The net book value of tangible assets includes £626.5 million in respect of assets in the course of construction.

During the year we have reclassified £16.6 million of assets relating to our treatment works at Woolston from wastewater network+ to bioresources.

In order to present the intangible asset information alongside the fixed asset information Table 2O is presented on page 43.

20 – Historic cost analysis of intangible assets – Wholesale and retail

	Wholesale				Retail	
	Water resources £m	Water network + £m	Wastewater network + £m	Bioresources £m	Household £m	Total £m
Cost						
At 1 April 2021	13.866	5.058	114.824	0.276	28.994	163.018
Additions	0.643	0.012	48.617	0.020	11.011	60.303
At 31 March 2022	14.509	5.070	163.441	0.296	40.005	223.321
Depreciation						
At 1 April 2021	(8.445)	(2.381)	(81.148)	(0.093)	(13.909)	(105.976)
Charge for year	(0.248)	(0.546)	(17.425)	(0.001)	(2.707)	(20.927)
At 31 March 2022	(8.693)	(2.927)	(98.573)	(0.094)	(16.616)	(126.903)
Net book amount at 31 March 2022	5.816	2.143	64.868	0.202	23.389	96.418
Net book amount at 1 April 2021	5.421	2.677	33.676	0.183	15.085	57.042
Depreciation charge for year						
Principal services	(0.236)	(0.538)	(17.425)	(0.001)	(2.707)	(20.907)
Third party services	(0.012)	(0.008)	–	–	–	(0.020)
Total	(0.248)	(0.546)	(17.425)	(0.001)	(2.707)	(20.927)

The net book value of intangible assets includes £45.0 million in respect of assets in the course of construction.

In 2020–21 we signed an agreement with Portsmouth Water for the construction of a new reservoir at Havant Thicket. The agreement requires us to make capacity charge payments to Portsmouth Water over an 80-year period to fund the construction of the reservoir as well as entitling us to a bulk supply from them.

As described in accounting policy note (i) we have restated the opening balance of the water resources intangible assets to remove the asset of £124.6 million recorded in the prior year for this agreement along with the payments of £6.5 million made to Portsmouth Water which have been reclassified to prepayments.

2E – Analysis of 'grants and contributions' for the 12 months ended 31 March 2022 – water resources, water network+ and wastewater network+

	Fully recognised in income statement £m	Capitalised and amortised (in the income statement) £m	Total £m
Grants and contributions – water resources			
Diversions – s185	–	–	–
Other contributions (price control)	–	1.366	1.366
Price control grants and contributions	–	1.366	1.366
Diversions – NRSWA	–	–	–
Diversions – other non-price control	–	–	–
Other contributions (non-price control)	–	–	–
Total	–	1.366	1.366
Value of adopted assets	–	–	–
Grants and contributions – water network+			
Connection charges	4.053	–	4.053
Infrastructure charge receipts	(0.138)	–	(0.138)
Requisitioned mains	(0.078)	1.606	1.528
Diversions – s185	0.672	–	0.672
Other contributions (price control)	–	2.142	2.142
Price control grants and contributions before deduction of income offset	4.509	3.748	8.257
Income offset	3.266	–	3.266
Price control grants and contributions after deduction of income offset	1.243	3.748	4.991
Diversions – NRSWA	0.545	–	0.545
Diversions – other non-price control	–	–	–
Other contributions (non-price control)	–	–	–
Total	1.788	3.748	5.536
Value of adopted assets	0.048	–	0.048
Grants and contributions – wastewater network+			
Receipts for on-site work	0.474	–	0.474
Infrastructure charge receipts	11.347	–	11.347
Diversions – s185	–	–	–
Other contributions (price control)	0.942	–	0.942
Price control grants and contributions before deduction of income offset	12.763	–	12.763
Income offset	2.759	–	2.759
Price control grants and contributions after deduction of income offset	10.004	–	10.004
Diversions – NRSWA	0.110	–	0.110
Diversions – other non-price control	–	–	–
Other contributions (non-price control)	–	3.083	3.083
Total	10.114	3.083	13.197
Value of adopted assets	9.857	–	9.857

IFRS 15'Revenue from Contracts with Customers' became effective for financial period commencing on or after 1 January 2018.

The effect of applying IFRS 15 results in the immediate recognition, on completion of the performance obligation, of developer related revenue relating to diversions, requisitions and adoptions, previously treated as deferred revenue. Until the performance obligation is completed the revenue for these activities will be deferred on the Balance Sheet.

Grants and contributions recognised in the statutory income statement as revenue have been reclassified to other income for regulatory purposes in table 1A. These include the amounts of £1.8 million and £10.1 million disclosed above for water and wastewater respectively together with £9.9 million of adopted assets.

2E – Analysis of 'grants and contributions' for the 12 months ended 31 March 2022 – water resources, water network+ and wastewater network+ – continued

	Water resources £m	Water network+ £m	Wastewater network+ £m	Total £m
Movements in capitalised grants and contributions				
Brought forward	4.134	8.782	11.210	**24.126**
Capitalised in year	1.366	3.748	3.083	**8.197**
Amortisation (in income statement)	(0.153)	(1.780)	(0.655)	**(2.588)**
Carried forward	**5.347**	**10.750**	**13.638**	**29.735**

2F – Residential retail

	Revenue £m	Number of customers 000's	Average residential revenues £
Residential revenue			
Wholesale charges	602.140		
Retail revenue	54.035		
Total residential revenue	**656.175**		
Retail revenue			
Revenue Recovered ('RR')	54.035		
Revenue sacrifice	–		
Actual revenue (net)	**54.035**		
Customer information			
Actual customers ('AC')		1,966.557	
Reforecast customers		1,974.289	
Adjustment			
Allowed revenue ('R')	50.127		
Net adjustment	**(3.908)**		
Other residential information			
Average residential retail revenue per customer			27.48

As we have exited the retail market and in accordance with the guidance in RAG 4.10, we are not required to report tables 2G and 2H.

2I – Revenue analysis for the 12 months ended 31 March 2022

	Household £m	Non-household £m	Total £m	Water resources £m	Water network+ £m	Total £m
Wholesale charge – water						
Unmeasured	17.473	1.069	18.542	2.473	16.069	18.542
Measured	148.721	38.794	187.515	25.008	162.507	187.515
Third party revenue	–	0.904	0.904	0.023	0.881	0.904
Total wholesale water revenue	166.194	40.767	206.961	27.504	179.457	206.961

	Household £m	Non-household £m	Total £m	Wastewater network+ £m	Bioresources £m	Total £m
Wholesale charge – wastewater						
Unmeasured – foul charges	79.689	2.763	82.452	73.219	9.233	82.452
Unmeasured – surface water charges	5.566	0.123	5.689	5.689	–	5.689
Unmeasured – highway drainage charges	3.178	0.065	3.243	3.243	–	3.243
Measured – foul charges	306.355	75.371	381.726	338.981	42.745	381.726
Measured – surface water charges	24.925	2.373	27.298	27.298	–	27.298
Measured – highway drainage charges	16.233	0.752	16.985	16.985	–	16.985
Third party revenue	–	1.018	1.018	1.018	–	1.018
Total wholesale wastewater revenue	435.946	82.465	518.411	466.433	51.978	518.411
Wholesale total	602.140	123.232	725.372	493.937	231.435	725.372
Retail revenue						
Unmeasured	7.836	–	7.836			
Measured	46.199	–	46.199			
Other third party revenue	–	–	–			
Retail total	54.035	–	54.035			
Third party revenue – non-price control						
Bulk supplies – water			4.235			
Bulk supplies – wastewater			1.251			
Other third party revenue			1.844			
Principal services – non-price control			0.022			
Other appointed revenue						
Total appointed revenue			786.759			

2J – Infrastructure network reinforcement costs for the 12 months ended 31 March 2022

	Network reinforcement capex £m	On site / site specific capex (memo only) £m
Wholesale water network+ (treated water distribution)		
Distribution and trunk mains	–	5.922
Pumping and storage facilities	0.734	–
Total	**0.734**	**5.922**
Wholesale wastewater network+ (sewage collection)		
Foul and combined systems	16.338	5.204
Pumping and storage facilities	0.422	(0.014)
Total	**16.760**	**5.190**

2K – New connections – infrastructure charges reconciliation for the 12 months ended 31 March 2022

	Water £m	Wastewater £m	Total £m
Impact of infrastructure charge discounts			
Infrastructure charges	(0.138)	11.347	11.209
Discounts applied to infrastructure charges	0.169	–	0.169
Gross infrastructure charges	**0.031**	**11.347**	**11.378**
Comparison of revenue and costs			
Variance brought forward	4.307	(4.921)	(0.614)
Revenue	(0.138)	11.347	11.209
Costs	(0.734)	(16.760)	(17.494)
Variance carried forward	**3.435**	**(10.334)**	**(6.899)**

Infrastructure charges are received when new connections are made to the network and represent a contribution to the incremental impact additional connections have on the overall network. Network reinforcement costs represent the capital expenditure undertaken generally on our network to allow for the increased flows as a consequence of new connections/ developments.

In order to be in a position to accept the flows as new connections are made, it is necessary to complete the infrastructure enhancement in advance of the new connections, meaning construction normally precedes income. As an example, £8.4 million has been expended in the year on providing a new 6.5 km rising main to support an ongoing development at Chilmington Green near Ashford. This is a development of up to 7,500 new properties to be built over the coming years.

The table above compares infrastructure charges received in the year with the level of general network reinforcement work. The variance in the year relates to the timing difference of completing these activities and is expected to even out over time.

2L – Analysis of land sales for the 12 months ended 31 March 2022

	Water resources £m	Water Network+ £m	Wastewater Network+ £m	Total £m
Proceeds from disposals of protected land	–	–	0.886	0.886

2M – Revenue reconciliation for the 12 months ended 31 March 2022 – wholesale

	Water resources £m	Water network+ £m	Wastewater network+ £m	Bioresources £m	Total £m
Revenue recognised					
Wholesale revenue governed by price control	27.504	179.457	466.433	51.978	725.372
Grants and contributions (price control)	1.366	4.991	10.004	–	16.361
Total revenue governed by wholesale price control	**28.870**	**184.448**	**476.437**	**51.978**	**741.733**
Calculation of the revenue cap					
Allowed wholesale revenue before adjustments (or modified by CMA)	28.109	170.867	452.946	49.085	701.007
Allowed grants and contributions before adjustments (or modified by CMA)	0.382	18.191	19.394	–	37.967
Revenue cap	**28.491**	**189.058**	**472.340**	**49.085**	**738.974**
Calculation of the revenue imbalance					
Revenue cap	28.491	189.058	472.340	49.085	738.974
Revenue recovered	28.870	184.448	476.437	51.978	741.733
Revenue imbalance	**(0.379)**	**4.610**	**(4.097)**	**(2.893)**	**(2.759)**

Overall wholesale price control revenue was £2.8 million (0.4%) higher than allowed in the final determination.

We over-recovered by £0.4 million (1.2%) in water resources. In water network+ we under-recovered by £4.6 million (2.4%). This under-recovery reflects the decision of the Board to purposefully defer some revenues to later years to ensure that the increase in water supply bills faced by our customers was not excessive.

In wastewater network+ we over-recovered by £4.1 million, or less than 1%. In bioresources the allowed wholesale revenue is as set out in Ofwat's final determination; the revenue imbalance of £2.9 million (5.9%) is due to the actual volume of sludge being lower than forecast in our business plan and reflected in the Final Determination from Ofwat. The revenue imbalance will be reconciled through a revenue adjustment to bills in year four of the AMP.

In total grants and contributions were £22.5 million below the allowed level. Contributions received for water resources were £1 million higher than our allowance, but this was offset by water and wastewater network+, which were both £12 million lower than the Ofwat assumption. Under Ofwat's 'single till' approach grants and contributions and wholesale revenues are treated as a single allowance; due to the forecast shortfall in grants and contributions we recovered more of the allowed revenues from wholesale water and wastewater charges than forecast in the final determination.

The shortfall in grants and contributions results primarily from reduced developer related activities in relation to requisitions, diversions and new connections. In addition, we have experienced increasing numbers of New Appointment Variations and water self-lay activity, resulting in much lower requisition volumes.

2N – Residential retail – social tariffs

	Revenue £m	Number of customers 000s	Average amount of customers £
Number of residential customers on social tariffs			
Residential water only social tariffs		1.821	
Residential wastewater only social tariffs		57.398	
Residential dual service social tariffs		45.180	
Number of residential customers not on social tariffs			
Residential water only no social tariffs		91.116	
Residential wastewater only no social tariffs		862.903	
Residential dual service no social tariffs		908.140	
Social tariff discount			
Average discount per water only social tariffs customer			38.440
Average discount per wastewater only social tariffs customer			55.681
Average discount per dual service social tariffs customer			82.094
Social tariff cross-subsidy – residential customers			
Total customer funded cross-subsidies for water only social tariffs customers	0.070		
Total customer funded cross-subsidies for wastewater only social tariffs customers	3.196		
Total customer funded cross-subsidies for dual service social tariffs customers	3.709		
Average customer funded cross-subsidy per water only social tariffs customer			0.753
Average customer funded cross-subsidy per wastewater only social tariffs customers			3.473
Average customer funded cross-subsidy per dual service social tariffs customer			3.891
Social tariff cross-subsidy – company			
Total revenue forgone by company to fund cross-subsidies for water only social tariffs customers	–		
Total revenue forgone by company to fund cross-subsidies for wastewater only social tariffs customers	–		
Total revenue forgone by company to fund cross-subsidies for dual service social tariffs customers	–		
Average revenue forgone by company to fund cross-subsidy per water only social tariffs customer			–
Average revenue forgone by company to fund cross-subsidy per wastewater only social tariffs customer			–
Average revenue forgone by company to fund cross-subsidy per dual service social tariffs customer			–
Social tariff support – willingness to pay			
Level of support for social tariff customers reflected in business plan			6
Maximum contribution to social tariffs supported by customer engagement			6

Independent auditor's report

Independent auditor's report to the Water Services Regulation Authority ('WSRA') and directors of Southern Water Services Limited.

Report on the audit of the Regulatory Accounting Statements

Opinion

We have audited the sections of Southern Water Services Limited's ("the Company") Annual Performance Report for the year ended 31 March 2022 ("the Regulatory Accounting Statements") which comprise:

- the regulatory financial reporting tables comprising the income statement (table 1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D), the net debt analysis (table 1E), lines 1F.1 to 1F.3, 1F.5 to 1F.6, 1F.8, 1F.12 to 1F.14, 1F.18 and 1F.23 to 1F.24 of the statement of financial flows (table 1F) and the related notes; and
- the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of grants and contributions and land sales for wholesale (table 2E), the household water revenues by customer type (table 2F), the non-household water revenues by customer type (table 2G), the non-household wastewater revenues by customer type (table 2H), the revenue analysis and wholesale control reconciliation (table 2I), the infrastructure network reinforcement costs (table 2J), the infrastructure charges reconciliation (table 2K), the analysis of land sales (table 2L), the revenue reconciliation for wholesale (table 2M), residential retail social tariffs (table 2N) and historical cost analysis of intangible assets (table 2O) and the related notes.

We have not audited lines 1F.4, 1F.7, 1F.9 to 1F.11, 1F.15 to 1F.17, 1F.19 to 1F.22 and 1F.25 of the statement of financial flows (table 1F), the Outcome performance table (tables 3A to 3I) and the additional regulatory information in tables 4A to 4R, 5A to 5B, 6A to 6D, 7A to 7E, 8A to 8D and 9A.

In our opinion, Southern Water Services Limited's Regulatory Accounting Statements have been prepared, in all material aspects, in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.09, RAG 2.09, RAG 3.13, RAG 4.10 and RAG 5.07) and the accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.13, appendix 2), set out on page 28.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800, and applicable law, except as stated in the section on Auditors' responsibilities for the audit of the Regulatory Accounting Statements below, and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales.

Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the Regulatory Accounting Statements within the Annual Performance Report section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit, including the Financial Reporting Council's (FRC's) Ethical Standard as applied to public interest entities, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter – special purpose basis of preparation

We draw attention to the fact that the Regulatory Accounting Statements have been prepared in accordance with a special purpose framework, Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.13, appendix 2) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. As a result, the Regulatory Accounting Statements may not be suitable for another purpose. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly, we make no such assessment. In addition, we are not required to assess whether the methods of cost allocation set out in the accounting methodology statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA.

The Regulatory Accounting Statements are separate from the statutory financial statements of the Company and have not been prepared under the basis of international accounting standards in conformity with the requirements of the Companies Act 2006 ("UK IASs"). Financial information other than that prepared on the basis of UK IASs does not necessarily represent a true and fair view of the financial performance or financial position of a Company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

The Regulatory Accounting Statements on pages 19 to 78 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from IASs. A summary of the effect of these departures in the Company's statutory financial statements is included in the tables within section 1.

Our opinion is not modified in respect of this matter.

Conclusions relating to going concern

In auditing the Regulatory Accounting Statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the Regulatory Accounting Statements is appropriate.

Our evaluation of the directors' assessment of the Company's ability to continue to adopt the going concern basis of accounting included:

- Obtained an understanding of relevant controls related to the management assessment of going concern;
- Obtained third party bank confirmation for the group's bank accounts, which confirmed cash balances and borrowings;
- Inspected the revolving credit facility agreement;
- Assessed the reasonableness of the cash flows projections;
- Performed integrity checks of management's going concern model, including checking for mathematical and clerical accuracy;
- Recalculated debt covenants and assessed compliance over the forecasted period, including consideration of the waiver from its Lenders in February 2021;
- Evaluated and challenged management's stress tests;
- Evaluated the appropriateness of management's identified mitigating actions;
- Evaluated the company's ability to raise debt finance in light of similar transactions in the market place; and
- Assessed the appropriateness of the disclosures over going concern included within the financial statements.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Other information

The other information comprises all of the information in the Annual Performance Report other than the Regulatory Accounting Statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the Regulatory Accounting Statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the Regulatory Accounting Statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Regulatory Accounting Statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the Regulatory Accounting Statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report based on these responsibilities.

Responsibilities of the Directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 17, the directors are responsible for the preparation of the Annual Performance Report in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the Company's accounting policies (including the Company's published accounting methodology statement(s), as defined in RAG 3.13, appendix 2).

The directors are also responsible for such internal control as they determine is necessary to enable the preparation of the Annual Performance Report that is free from material misstatement, whether due to fraud or error.

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

Auditors’ responsibilities for the Audit of the Regulatory Accounting Statements

Our objectives are to obtain reasonable assurance about whether the Regulatory Accounting Statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors’ 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 the Regulatory Accounting Statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

We considered the nature of the company’s industry and its control environment, and reviewed the company’s documentation of their policies and procedures relating to fraud and compliance with laws and regulations. We also enquired of management about their own identification and assessment of the risks of irregularities.

We obtained an understanding of the legal and regulatory framework[s] that the company operates in, and identified the key laws and regulations that:

- Had a direct effect on the determination of material amounts and disclosures in the Regulatory Accounting Statements. These included Regulatory Accounting Guidelines as issued by the WSRA, UK Companies Act, pensions legislation and tax legislation; and
- Do not have a direct effect on the Regulatory Accounting Statements but compliance with which may be fundamental to the company’s ability to operate or to avoid a material penalty. These included the company’s operating licence, regulatory solvency requirements and environmental regulations.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override. In addressing the risk of fraud through management override of controls, we tested the appropriateness of journal entries and other adjustments; assessed whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluated the business rationale of any significant transactions that are unusual or outside the normal course of business.

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

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

A further description of our responsibilities for the audit of the Regulatory Accounting Statements is located on the Financial Reporting Council’s website at **frc.org.uk/auditorsresponsibilities.** This description forms part of our auditor’s report.

Use of this report

This report is made, on terms that have been agreed, solely to the Company and the WSRA in order to meet the requirements of Condition F of the Instrument of Appointment granted by the Secretary of State for the Environment to the Company as a water and sewage undertaker under the Water Industry Act 1991 ("Condition F"). Our audit work has been undertaken so that we might state to the Company and the WSRA those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under Condition F to procure such a report and (b) to facilitate the carrying out by the WSRA of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the WSRA, for our audit work, for this report or for the opinions we have formed.

Our opinion on the Regulatory Accounting Statements is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2022 on which we reported on 15 July 2022, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our "Statutory audit") was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the

Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our Statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Deloitte LLP

Deloitte LLP

Chartered Accountants and Statutory Auditors

Cardiff, United Kingdom

15 July 2022

Performance Summary

Assurance

KPMG LLP were engaged to provide independent limited assurance over the selected annual performance data highlighted in this section marked with the symbol △ for the calendar year ended 31 December 2021 and the information marked with the symbol* for the financial year ended 31 March 2022 using the assurance standard ISAE (UK) 3000. KPMG LLP has provided assurance only over the performance level reported for 2021–22. KPMG LLP has issued an unqualified opinion over the selected annual performance data. KPMG LLP's full assurance statement is available on page 66.

3A – Outcome performance – Water common performance commitments

Common performance commitments – Water (Financial)	Status	Unit	Performance level – actual	PCL met?	Outperformance or underperformance payment	Forecast of total 2020–25 outperformance or underperformance payment
Water quality compliance (CRI)△	✗	number	6.69	No	(2.945)	(8.126)
Water supply interruptions*	–	hh:mm:ss	00:09:22	No	(0.789)	(3.473)
Leakage*	–	%	5.0	No	(0.265)	(2.411)
Per capita consumption*	✗	%	(4.4)	No	–	(9.790)
Mains repairs*	✓	number per 1,000 km of main	101.5	Yes	0.924	(0.104)
Unplanned outage*	✓	%	7.19	Yes	–	(0.152)
Bespoke performance commitments – Water and Retail (Financial)						
Drinking water appearance△	–	nr	0.87	No	(0.601)	(2.680)
Drinking water taste and odour△	✓	nr	0.23	Yes	–	(0.416)
Abstraction Incentive Mechanism*	✓	nr	(16)	Yes	0.511	2.044
Access to daily water consumption data	–	nr	–	No	–	0.102
Void properties*	–	%	3.12	No	(0.600)	(2.760)
Replace lead customer pipes	–	nr	–	No	–	0.159
Properties at risk of receiving low pressure*	✓	nr	210	Yes	–	(0.417)
Long term supply demand schemes	✗	months	23	No	–	–
Impounding reservoirs	✓	%	–	Yes	–	(1.314)
Financial water performance commitments achieved	%	–		40		
Overall performance commitments achieved (excluding C-MeX and D-MeX)	%	–		50		

Notes:
Each performance commitment is shown with the assessed performance status (red, amber or green) which indicates performance against expectations. An explanation of each performance commitment, the definitions and the criteria for assessment is given in appendix 2.

3B – Outcome performance – Wastewater common performance commitments

Common performance commitments – Wastewater (Financial)	Status	Unit	Performance level – actual: Current reporting year	PCL met?	Outperformance or underperformance payment	Forecast of total 2020–25 outperformance or underperformance payment
Internal sewer flooding*	✗	Number of incidents per 10,000 sewer connections	3.04	No	(7.835)	(5.946)
Pollution incidents△	⊖	Number of incidents per 10,000 km of sewer	93.63	No	(7.960)	(30.753)
Sewer collapses*	⊖	Number of sewer collapses per 1,000 km of all sewers	7.87	No	(4.110)	(11.390)
Treatment works compliance△	⊖	%	97.94	No	(10.600)	(30.000)
Bespoke performance commitments – Wastewater (Financial)						
Effluent re-use	✓	nr	127	Yes	–	0.001
Renewable generation	✗	%	15.85	No	(1.326)	(6.630)
Satisfactory bioresources recycling△	✓	%	100.00	Yes	–	–
River water quality*	✓	nr	82.50	Yes	–	–
Maintain bathing waters at 'Excellent'△	✓	nr	60	Yes	–	–
Improve the number of bathing waters to at least 'Good' (Cost Adjustment Claim)△	✓	nr	–	–	–	(3.704)
Improve the bathing waters at 'Excellent' quality (Cost Adjustment Claim)△	✓	nr	–	–	–	(1.700)
Surface water management	⊖	m^3	–	No	(0.052)	(0.239)
External sewer flooding*	✓	nr	3,944	Yes	0.948	6.070
Thanet sewers	✓	months	–	Yes	–	–
Financial wastewater performance commitments achieved	%	–		50		

Key

✓ Ofwat target met or exceeded

⊖ Ofwat target missed but performance improved in relation to prior year outcome

✗ Ofwat target missed and performance worse than prior year outcome

– Not applicable

3C – Customer measure of experience (C-MeX) table

Item	Unit	Value
Annual customer satisfaction score for the customer service survey	Number	69.33
Annual customer satisfaction score for the customer experience survey	Number	74.66
Annual C-MeX score*	Number	72.00
Annual net promoter score	Number	0.50
Total household complaints	Number	60,235
Total connected household properties	Number	2,036,142
Total household complaints per 10,000 connections	Number	295.829
Confirmation of communication channels offered	True or False	True

Notes:
Each performance commitment is shown with the assessed performance status (red, amber or green) which indicates performance against expectations. An explanation of each performance commitment, the definitions and the criteria for assessment is given in appendix 2.

3D – Developer services measure of experience (D-MeX) table

Item	Unit	Value
Qualitative component annual results	Number	62.24
Quantitative component annual results	Number	93.33
D-MeX score*	Number	77.78
Developer services revenue (water)	£m	9.654
Developer services revenue (wastewater)	£m	24.110

Calculating the D-MeX quantitative component

Water UK performance metric	Unit	Reporting period (1 April to 31 March)	Quantitative score (annual)
W1.1 Pre-development enquiry – reports issued within target	%	100.00%	
W3.1 s45 quotations – within target	%	99.93%	
W4.1 s45 service pipe connections – within target	%	97.84%	
W6.1 Mains design	%	88.54%	
W7.1 Mains design >500 plots – quotations within target	%	93.33%	
W8.1 Mains construction within target	%	98.90%	
W17.1 Mains diversions (without constraints) – quotations within target	%	89.66%	
W17.2 Mains diversions (with constraints) – quotations within target	%	20.00%	
W18.1 Mains diversions – construction/commissioning within target	%	–	
W20.1 Self lay Point of Connection report < 500 plots etc – reports issued within target	%	100.00%	
W21.1 Self lay Point of Connection reports >500 plots etc – reports issued within target	%	100.00%	
W23.1 Self lay design and terms request	%	92.00%	
W24.1 Self lay design and terms request >500 plots etc – quotations within target	%	100.00%	
W26.1 Self lay water for pressure/bacteriological testing – provided within target	%	100.00%	
W27.1 Self lay permanent water supply– provided within target	%	100.00%	
W30.1 Self lay plot references and costing details – issued within target	%	–	

Calculating the D-MeX quantitative component (continued)

Water UK performance metric	Unit	Reporting period (1 April to 31 March)	Quantitative score (annual)
S1.1 Pre-development enquiry – reports issued within target	%	96.66%	
S3.1 Sewer requisition design – offers issued within target	%	90.00%	
S4.1 Sewer requisition – constructed and commissioned within agreed extension	%	100.00%	
S7.1 Adoption legal agreement – draft agreements issued within target	%	100.00%	
SN2.2 % Bulk discharge offer letters issued to the applicant within target period	%	83.87%	
SN4.1 % of main laying schemes constructed and commissioned within the target period	%	–	
WN1.1 % of confirmations issued to the applicant within target period	%	–	
WN2.2 % Bulk supply offer letters issued to the applicant within target period	%	80.00%	
WN4.1 % of main laying schemes constructed and commissioned within the target period	%	–	
WN4.2 % of testing supplies provided within target period	%	100.00%	
WN4.3 % of permanent supplies made available within the target period	%	100.00%	
SAM – 3/1 Update draft agreement	%	–	
SAM – 4/1 Inspections and construction period	%	100.00%	
D-MeX quantitative score (for the relevant reporting period)	%	93.33%	
D-MeX quantitative score (annual)	Number		0.93

3E – Outcome performance – Non financial performance commitments

Common	Status	Unit	Performance level – actual: Current reporting year	PCL met?
Risk of severe restrictions in a drought*	✓	%	–	Yes
Priority services for customers in vulnerable circumstances – PSR reach*	✗	%	2.9	No
Priority services for customers in vulnerable circumstances – Attempted contacts*	✓	%	72.5	Yes
Priority services for customers in vulnerable circumstances – Actual contacts*	✓	%	32.6	Yes
Risk of sewer flooding in a storm	✓	%	11.50	Yes

Bespoke performance commitments	Status	Unit	Current reporting year	PCL met?
Target 100*	–	%	35	No
Water saved from water efficiency visits	–	m^3/day	359	No
Effectiveness of financial assistance	–	%	67	No
Customer satisfaction with vulnerability support*	–	%	73	No
Community engagement	✗	rank	–	No
Schools visited and engagement with children	–	%	85	No
Water supply resilience*	✓	nr	131,201	Yes
Combined Sewer Overflows (CSO) monitoring	–	%	87.80	No
Natural capital	✓	nr	–	Yes
Gap sites*	–	nr	33	No
Distribution input*	–	Ml/day	556	No
Value for money	✗	%	67	No
WINEP delivery*	–	text	Not met	No

Non-financial water performance commitments achieved	%		33%

3F – Underlying calculations for common performance commitments – water and retail

Performance commitments set in standardised units – Water	Status	Unit	Standardising data indicator	Standardising data numerical value	Performance level – Actual (current reporting year)	Performance level – Calculated (i.e. standardised)
Mains repairs – Reactive	✔	Mains repairs per 1000 km	Mains length in km	13,865.70	909	65.56
Mains repairs – Proactive	✔	Mains repairs per 1000 km	Mains length in km	13,865.70	499	35.99
Mains repairs	✔	Mains repairs per 1000 km	Mains length in km	13,865.70	1,408	101.55
Per capita consumption (PCC)	✘	l/p/d	Total household population (000s) and household consumption (Ml/d)	2,580.20	345	133.64

Performance commitments measured against a calculated baseline	Status	Unit	Performance level – actual (2017–18)	Performance level – actual (2018–19)	Performance level – actual (2019–20)	Baseline	Performance level – actual (2020–21)	Performance level 3 year average	Calculated performance level to compare against PCLs
Leakage	–	Ml/d	102.6	102.9	94.1	99.9	93.8	94.9	5.0
Per capita consumption (PCC)	✘	l/p/d	126.2	129.6	128.1	128.0	139.0	133.6	-4.4

Water supply interruptions	Status	Unit	Standardising data indicator	Standardising data numerical value	Total minutes lost	Number of properties supply interrupted	Calculated performance level
Water supply interruptions	–	Average number of minutes lost per property per year	Number of properties	1,137.9	10,657,248	192,532	00:09:22

Unplanned or planned outage	Status	Current company level peak week production capacity (PWPC) Ml/d	Reduction in company level PWPC Ml/d	Outage proportion of PWPC %
Unplanned outage	✔	877.87	63.10	7.19%

Priority services for customers in vulnerable circumstances	Status	Total residential properties	Total number of households on the PSR (as at 31 March)	PSR reach	Total number of households on the PSR over a 2 year period	Number of attempted contacts over a 2 year period	Attempted contacts %	Number of actual contacts over a 2 year period	Actual contacts %
Priority services for customers in vulnerable circumstances	✘	1,976	56,487	2.9%	22,495	16,315	72.5%	7,336	32.6%

3G – Underlying calculations for common performance commitments – wastewater

Performance commitments set in standardised units	Status	Units	Standardising data indicator	Standardising data numerical value	Performance level – actual current reporting year	Calculated performance level
Internal sewer flooding – customer proactively reported	✖	Number of incidents per 10,000 sewer connections	Number of sewer connections	2,019.69	603	2.99
Internal sewer flooding – company reactively identified (i.e. neighbouring properties)	✖	Number of incidents per 10,000 sewer connections	Number of sewer connections	2,019.69	11	0.05
Internal sewer flooding	✖	Number of incidents per 10,000 sewer connections	Number of sewer connections	2,019.69	614	3.04
Pollution incidents	–	Number of incidents per 10,000 km of sewer	Sewer length in km	39,729.00	372	93.63
Sewer collapses	–	Number of sewer collapses per 1,000 km of all sewers	Sewer length in km	39,900.00	314	7.87

3H – Summary information on outcome delivery incentive payments

	Initial calculation of performance payments (excluding C-MeX and D-MeX) £m (2017–18 prices)
Initial calculation of in period revenue adjustment by price control	
Water resources	0.511
Water network+	(3.715)
Wastewater network+	(29.610)
Bioresources (sludge)	(1.286)
Residential retail	(0.600)
Business retail	–
Dummy control	–
Initial calculation of end of period revenue adjustment by price control	
Water resources	(1.460)
Water network+	–
Wastewater network+	–
Bioresources (sludge)	–
Residential retail	–
Business retail	–
Dummy control	–
Initial calculation of end of period RCV adjustment by price control	
Water resources	–
Water network+	–
Wastewater network+	–
Bioresources (sludge)	–
Residential retail	–
Business retail	–
Dummy control	–

3I – Supplementary outcomes information

Unplanned or planned outage	Status	Current company level peak week production capacity (PWPC) Ml/d	Reduction in company level PWPC Ml/d	Outage proportion of PWPC %
Unplanned outage	✓	877.87	22.58	2.57%

Risk of severe restrictions in drought	Status	Deployable output Ml/d	Outage allowance Ml/d	Dry year demand Ml/d	Target headroom Ml/d	Total population supplied	Customers at risk
Risk of severe restrictions in drought	✓	773.72	94.73	555.53	38.30	2,632,356.00	No

Risk of sewer flooding in a storm	Status	Total pe served	Total pe in excluded catchments	Percentage of total pe in excluded catchments
Risk of sewer flooding in a storm	✓	4,766,366.17	0.00	0.00%

Risk of sewer flooding in a storm	Status	Total pe Option 1a	Percentage of total pe Option 1a	Total pe Option 1b	Percentage of total pe Option 1b	Vulnerability risk grade Percentage of total population served Low	Medium	High
Risk of sewer flooding in a storm	✓	239,469.23	5.02%	4,526,896.93	94.98%	88.50%	3.84%	7.66%

Sewer collapses	Status	Number of patch repairs or relining undertaken on sewer and not included in reported sewer collapses
Sewer collapses	–	734

2021–22 performance against performance commitments

2021–22 saw some improved performance in a number of areas, compared to 2020–21, and we met or exceeded 18 of our 47 wholesale performance commitments. This represents a significant improvement compared with 2020–21 when we only met 14 of our performance commitments.

This improvement is also reflected in the fact that we earned outperformance payments totalling £2.5 million for beating the Ofwat targets for three of our performance commitments – external sewer flooding (£1.0 million), mains repairs (£0.9 million) and abstraction incentive mechanism (£0.5 million).

Overall, we incurred a net ODI underperformance payment for wholesale services of £34.7 million, lower than that incurred in 2020–21 (£40.7 million).

Notably, just five ODIs contribute more than 90% of the value of this net penalty. The overall level of penalties incurred reflect the significant level of performance challenge in Ofwat's PR19 final determination.

For Ofwat's C-MeX and D-MeX measures of customer experience, which are based on comparative performance, we also forecast lower penalties than for 2021–22 at £4.5 million and £0.6 million respectively (2020–21: £4.9 million and £1.0 million).

The impact of these penalties and rewards will be reflected in customers' bills from 2023–24.

We comment here on the wholesale performance commitments associated with the largest underperformance payments[3]. A full description of performance against all of our performance commitments is provided in our Annual Report and Financial Statements.

[3]Comment is provided for all performance commitments with an underperformance penalty of greater than £1 million for 2021–22. In addition, we provide a brief commentary on leakage performance, due to the level of stakeholder interest in this area and on long term supply demand schemes.

Wastewater treatment works compliance (underperformance payment: £10.6 million)

During the 2021 calendar year seven (2.06%) of our treatment works were classified as failed works by the Environment Agency. While this resulted in the largest of our ODI underperformance payments for this year, performance was improved on the previous year, where we had ten failed works and incurred a penalty of £19.4 million.

This improvement is principally a result of enhanced management processes at our wastewater treatment works, including implementation of a new organisational design for our wastewater directorate from April 2021 to enable closer working relationships between maintenance, process support and field teams. We continue to review all compliance breaches and near misses to understand the root causes and drive improvement actions across the region.

Pollution incidents (penalty: £8.0 million)

Despite delivering a 7.5% reduction in pollution incidents in the 2021 calendar year we remain well above our Ofwat target. We know this is an area that we must do better in. However, we are proud that our level of self-reporting increased further with 90% of all incidents being identified and reported by the company – one of the highest proportions in the sector.

During the year we updated our Pollution Incident Reduction Plan, which sets out how we will aim to reduce the annual number of pollutions to 98 by 2024 and aim for zero by 2040. There are five areas of focus for our year three PIRP; the most immediately impactful of which will be the ‘Top 250 Wastewater Pumping Station Upgrade’ and network cleaning programmes. The upgrade programme focuses on any site that has had a pollution incident in the past three years, with associated investment spend of £15 million.

While not taking focus off our drive to improve performance, we would support moves by Ofwat and the EA to ensure that there is a level playing field for reporting of pollution incidents and storm overflow releases. Our pollutions reporting approach uses additional information from our EDM telemetry to assess pollutions arising from spills not observed directly by the company or public, giving a more comprehensive view on performance and going above and beyond the traditional observational approach used by the rest of the industry in their reporting. In 2021–22, 115 of our 372 wastewater pollutions arose from this approach, that would otherwise not have been reported under the traditional reporting method. We look forward to Ofwat and the EA harmonising this approach across all companies to ensure transparency and true comparability of performance.

Internal sewer flooding (underperformance payment: £7.8 million)

As in 2020–21, we beat our target for external sewer flooding, but we fell short of our target for internal sewer flooding and the number of internal flooding incidents increased significantly from 393 in 2020–21 to 614 in 2021–22.

The increase was primarily related to an exceptionally high number of internal sewer flooding incidents recorded in July and August 2021. This was due to intense rainfall over the summer, including a one in one-hundred-and-fifty-year rainstorm which caused severe flooding in Herne Bay.

Improving our performance in this area is a key focus for us. We have a dedicated Pollution and Flooding Resilience team and our Zero Flooding project aims to eliminate sewer flooding incidents in key hotspots across our regions. We are also continuing our fat, oil and grease (FOG) and Unflushables campaign to explain to customers what can go down the toilet or the sink, as well as improving our incident response.

We have clear improvement plans in place which we forecast will result in us being better than our target level from 2023, in the absence of further severe weather events.

Sewer collapses (underperformance payment: £4.1 million)

As with pollution incidents, while we missed our target for sewer collapses, we successfully reduced the number of incidents for the second year running, with a 9% reduction compared with 2020–21. We forecast that we will continue to reduce the number of collapses each year; performance will, however, remain above target to the end of AMP7.

Compliance Risk Index (underperformance payment: £2.9 million)

Disappointingly, our water quality measure Compliance Risk Index (CRI) score has risen to 6.69, (2020–21: 4.53), as a result of an increased score at service reservoirs and consumer taps, as well as failures at our Burham Treatment Works in November 2021. Nonetheless, 99.97% of water quality samples met all of the required DWI standards and we forecast that by year five of AMP7 we will have improved our performance on the CRI measure to below Ofwat’s ODI penalty threshold.

Renewable generation (underperformance payment: £1.3 million)

The percentage of our energy that we generated from renewable sources remained similar to 2020–21 at 15.85%. This is below our target of 21.3% but during the year we purchased Renewable Energy Guarantees of Origin (REGOs) through to April 2024, ensuring that even though we are generating less renewable energy than we planned, 100% of the energy we use is green.

We are committed to increasing the proportion of our energy that we generate from renewable sources and are investing in solar arrays at more of our sites as well as maximising the amount of biogas we generate from sludge.

Leakage (underperformance payment: £0.3 million)

During 2021–22, we achieved leakage levels of 94.9 megalitres per day (Ml/d) on a three-year rolling average basis, (2021: 98.5 Ml/d). This is marginally higher than Ofwat's target of 93.9 Ml/d.

To deliver these improvements, during the year we increased the size of our leakage team during the year, identifying and fixing a record 12,000 leaks. In addition, the Board approved additional investment in measures to reduce leakage, including the accelerated roll out of an advanced pressure management system, in order to achieve our target of halving leakage by 2050.

Per capita consumption (underperformance payment: n/a)

The COVID-19 pandemic resulted in significant changes to patterns of water consumption with much more consumption in the home and reduced business usage. The notional underperformance payment associated with this performance commitment has been included in the tables above, but Ofwat has determined that the per capita consumption performance commitment for all companies should be assessed as an end-of-period ODI. There will therefore be no in-period effect from our performance in this area.

Long term supply demand schemes

Within our PR19 final determination, we have an ODI to ensure that we remain on track to deliver a number of supply demand schemes by no later than 31 March 2027. ODI penalties are incurred for every month of delay to the schemes.

Delivery of these schemes has commenced, but a number have experienced unavoidable delays which has meant progress is currently up to 23 months behind the original delivery schedule, which is reflected in the table above. We are currently working on plans to mitigate the delays that have been experienced to date; for this reason, we are forecasting an ODI delay penalty of zero.

Forecasts of future years' performance

As required by Ofwat, we have provided a forecast of total 2020–25 outperformance or underperformance payments for all performance commitments. These represent a current best estimate based on our latest internal delivery plan. This delivery plan will be updated throughout the AMP to reflect ongoing performance and thus forecasts of outperformance or underperformance payments. We will continue to strive to meet the targets set in the final determination and thus reduce the level of underperformance payments incurred.

Reporting to customers

Ofwat requires us to describe how the information reported in the Section 3 of this Annual Performance Report relates to the information on outcome performance it has published and reported to its customer challenge group or similar body and customers more generally. We can confirm that the performance commitment information reported here is fully consistent with the information we have reported to our customers in our Annual Report and Financial Statements. We recently established our Customer & Community Challenge Panel to help inform our next business plan. The new group will be updated regularly on our performance, including the results for 2021–22 reported here.

Independent Limited Assurance Report of KPMG LLP to Southern Water Services Limited

KPMG LLP ('KPMG' or 'we') were engaged by Southern Water Services Limited ('Southern Water') to provide limited assurance over the Selected Information described below in respect of the year ended 31 March 2022 and the calendar year ended 31 December 2021.

Our conclusion

Based on the work we have performed and the evidence we have obtained, nothing has come to our attention that causes us to believe that the Selected Information has not been properly prepared, in all material respects, in accordance with the Reporting Criteria.

This conclusion is to be read in the context of the remainder of this report, in particular the inherent limitations explained below and this report's intended use.

Selected Information

The scope of our work includes only the information included within the Southern Water Annual Performance Report ('the Report') in respect of the year ended 31 March 2022 marked with the symbol * and in respect of the calendar year ended 31 December 2021 marked with the symbol △ (together 'the Selected Information').

We have not performed any work, and do not express any conclusion, over any other information that may be included in the Report or displayed elsewhere on Southern Water's website for the current year or for previous periods unless otherwise indicated.

Reporting Criteria

The Reporting Criteria we used to form our judgements are the Southern Water Reporting Criteria 2021–22 as set out at **southernwater.co.uk/our-performance/reports/annual-reporting** ('the Reporting Criteria').

The Selected Information needs to be read together with the Reporting Criteria.

Inherent limitations

The nature of non-financial information; the absence of a significant body of established practice on which to draw; and the methods and precision used to determine non-financial information, allow for different, but acceptable evaluation and measurement techniques and can result in materially different measurements, affecting comparability between entities and over time.

The Reporting Criteria has been developed to assist Southern Water in detailing the methodology applied in their reporting obligations under the PR19 price review as prescribed by Ofwat. As a result, the Selected Information may not be suitable for another purpose.

Directors' responsibilities

The Directors of Southern Water are responsible for:

- designing, operating and maintaining internal controls relevant to the preparation and presentation of the Selected Information that is free from material misstatement, whether due to fraud or error;
- selecting and/or developing objective Reporting Criteria;
- measuring and reporting the Selected Information in accordance with the Reporting Criteria; and
- the contents and statements contained within the Report and the Reporting Criteria.

Our responsibilities

Our responsibility is to plan and perform our work to obtain limited assurance about whether the Selected Information has been properly prepared, in all material respects, in accordance with the Reporting Criteria and to report to Southern Water in the form of an independent limited assurance conclusion based on the work performed and the evidence obtained.

Assurance standards applied

We conducted our work in accordance with International Standard on Assurance Engagements (UK) 3000 *Assurance Engagements other than Audits or Reviews of Historical Financial Information* ('ISAE (UK) 3000') issued by the UK Financial Reporting Council.

That standard requires that we obtain sufficient, appropriate evidence on which to base our conclusion.

Independence, professional standards and quality control

We comply with the ICAEW Code of Ethics issued by the Institute of Chartered Accountants in England and Wales and we apply International Standard on Quality Control (UK) 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements. Accordingly, we maintain a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements and professional standards (including independence, and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour) as well as applicable legal and regulatory requirements.

Summary of work performed

A limited assurance engagement involves planning and performing procedures to obtain sufficient appropriate evidence to obtain a meaningful level of assurance over the Selected Information as a basis for our limited assurance conclusion. Planning the engagement involves assessing whether the Reporting Criteria are suitable for the purposes of our limited assurance engagement. The procedures selected depend on our judgement, on our understanding of the Selected Information and other engagement circumstances, and our consideration of areas where material misstatements are likely to arise.

The procedures performed included:

- assessing on a sample basis whether the Selected Information has been collected and reported in accordance with the applicable criteria;
- conducting interviews with Southern Water's management to obtain an understanding of the key processes, systems and controls in place over the preparation of the Selected Information;
- selected limited substantive testing, including agreeing a selection of the Selected Information to corresponding supporting information, including to independent databases and monitoring systems such as Waternet, Prism, SAP BI, Qlikview, CSM and to regulatory returns from Water UK, the Drinking Water Inspectorate (DWI) and the Environment Agency (EA);
- performing analytical procedures over the aggregated Selected Information, including a comparison to the prior period's amounts having due regard to changes in business volume; and
- reading the Report and narrative accompanying the Selected Information in the Report with regard to the Reporting Criteria, and for consistency with our findings.

The work performed in a limited assurance engagement varies in nature and timing from, and is less in extent than for, a reasonable assurance engagement. Consequently, the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed.

This report's intended use

This assurance report is made solely to Southern Water in accordance with the terms of the engagement contract between us. Those terms permit disclosure to other parties, solely for the purpose of Southern Water showing that it has obtained an independent assurance report in connection with the Selected Information.

We have not considered the interest of any other party in the Selected Information. To the fullest extent permitted by law, we accept no responsibility and deny any liability to any party other than Southern Water for our work, for this assurance report or for the conclusions we have reached.

KPMG LLP

KPMG LLP

Chartered Accountants

London,

15 July 2022

The maintenance and integrity of Southern Water's website is the responsibility of the Directors of Southern Water; the work carried out by us does not involve consideration of these matters and, accordingly, we accept no responsibility for any changes that may have occurred to the reported Selected Information, Reporting Criteria or Report presented on Southern Water's website since the date of our report.

Additional regulatory information

4A – Water bulk supply information for the 12 months ended 31 March 2022

	Volume Ml	Operating costs £m	Revenue £m
Bulk supply exports			
Affinity	4.414	–	–
Wessex	69.298	–	–
South East Water	9,782.121	3.134	3.899
Total bulk supply exports	**9,855.833**	**3.134**	**3.899**

	Volume Ml	Operating costs £m
Bulk supply imports		
Affinity Water	4.288	–
Sutton and East Surrey Water	78.193	0.081
Portsmouth Water	1,690.283	0.254
Total bulk supply imports	**1,772.764**	**0.335**

Bulk exports to New Appointment Variation (NAV) customers are not included in the table.

We do not show cost information for the bulk exports to Affinity Water and Wessex Water. These supplies are made via our distribution network and the costs are therefore not separately identifiable. Operating costs are included for the exports to South East Water. These agreements are based on a sharing of specific costs, thus the relevant costs are agreed as part of the charging process.

4B – Analysis of debt

As permitted by RAG 3.13 section 2.7, table 4B is excluded from this APR document and is published alongside this document and can be found at **southernwater.co.uk/our-reports**.

4C – Impact of price control performance to date on RCV

	12 months ended 31 March 2022			
	Water resources £m	Water network+ £m	Wastewater network+ £m	Bioresources £m
Totex (net of business rates, abstraction licence fees and grants and contributions)				
Final determination allowed totex (net of business rates, abstraction licence fees and grants and contributions)	16.805	180.171	446.364	41.744
Actual totex (net of business rates, abstraction licence fees and grants and contributions)	28.454	244.775	612.974	45.989
Transition expenditure	–	–	–	–
Disallowable costs	–	–	92.784	–
Total actual totex (net of business rates, abstraction licence fees and grants and contributions)	**28.454**	**244.775**	**520.190**	**45.989**
Variance	11.649	64.604	73.826	4.245
Variance due to timing of expenditure	(0.469)	18.028	15.066	2.461
Variance due to efficiency	**12.118**	**46.576**	**58.760**	**1.784**
Customer cost sharing rate – outperformance	63.55%	63.55%	63.92%	–
Customer cost sharing rate – underperformance	36.45%	36.45%	36.08%	–
Customer share of totex overspend	4.417	16.977	21.201	–
Company share of totex overspend	7.701	29.599	37.559	1.784
Totex – business rates and abstraction licence fees				
Final determination allowed totex – business rates and abstraction licence fees	5.853	11.214	12.787	1.331
Actual totex – business rates and abstraction licence fees	4.664	11.388	13.392	1.758
Variance – business rates and abstraction licence	**(1.189)**	**0.174**	**0.605**	**0.427**
Customer cost sharing rate – business rates and abstraction licence fees	75.00%	75.00%	75.00%	75.00%
Customer share of totex over/underspend – business rates and abstraction licence fees	(0.892)	0.131	0.454	0.320
Company share of totex over/underspend – business rates and abstraction licence fees	(0.297)	0.043	0.151	0.107
Totex not subject to cost sharing				
Final determination allowed totex – not subject to cost sharing	13.652	25.456	9.076	–
Actual totex – not subject to cost sharing	17.000	17.381	(0.019)	–
Variance – 100% company allocation	**3.348**	**(8.075)**	**(9.095)**	**–**
Total customer share of totex over/underspend	**3.525**	**17.107**	**21.654**	**0.320**
RCV				
Total customer share of totex over/underspend	3.525	17.107	21.654	0.320
PAYG rate	56.13%	44.96%	49.01%	59.64%
RCV element of totex over/underspend	**1.547**	**9.416**	**11.042**	**0.129**

4C – Impact of price control performance to date on RCV – continued

	Price control period to date			
	Water resources £m	Water network+ £m	Wastewater network+ £m	Bioresources £m
Totex (net of business rates, abstraction licence fees and grants and contributions)				
Final determination allowed totex (net of business rates, abstraction licence fees and grants and contributions)	33.345	354.477	778.785	77.517
Actual totex (net of business rates, abstraction licence fees and grants and contributions)	56.766	419.087	986.284	80.880
Transition expenditure	1.721	0.980	–	–
Disallowable costs	–	–	96.447	–
Total actual totex (net of business rates, abstraction licence fees and grants and contributions)	**58.487**	**420.067**	**889.837**	**80.880**
Variance	25.142	65.590	111.052	3.363
Variance due to timing of expenditure	(0.469)	(0.567)	(11.751)	1.938
Variance due to efficiency	**25.611**	**66.157**	**122.803**	**1.425**
Customer cost sharing rate – outperformance	63.55%	63.55%	63.92%	–
Customer cost sharing rate – underperformance	36.45%	36.45%	36.08%	–
Customer share of totex overspend	9.335	24.114	44.307	–
Company share of totex overspend	16.276	42.043	78.496	1.425
Totex – business rates and abstraction licence fees				
Final determination allowed totex – business rates and abstraction licence fees	11.498	22.031	25.121	2.616
Actual totex – business rates and abstraction licence fees	9.357	20.548	26.638	3.495
Variance – business rates and abstraction licence	**(2.141)**	**(1.483)**	**1.517**	**0.879**
Customer cost sharing rate – business rates and abstraction licence fees	75.00%	75.00%	75.00%	75.00%
Customer share of totex over/underspend – business rates and abstraction licence fees	(1.606)	(1.112)	1.138	0.659
Company share of totex over/underspend – business rates and abstraction licence fees	(0.535)	(0.371)	0.379	0.220
Totex not subject to cost sharing				
Final determination allowed totex – not subject to cost sharing	22.128	42.224	18.122	–
Actual totex – not subject to cost sharing	26.251	33.284	3.802	–
Variance – 100% company allocation	**4.123**	**(8.940)**	**(14.320)**	**–**
Total company share of totex over/underspend	**7.729**	**23.002**	**45.445**	**0.659**
RCV				
Total customer share of totex over/underspend	7.729	23.002	45.445	0.659
PAYG rate	48.93%	49.49%	38.27%	52.30%
RCV element of totex over/underspend	**3.947**	**11.618**	**28.053**	**0.314**
Adjustment for ODI outperformance payment or underperformance payment	–	–	–	–
RCV determined at FD at 31 March	114.157	1,228.010	4,073.306	219.707
Projected 'shadow' RCV	**118.104**	**1,239.628**	**4,101.359**	**220.021**

Wholesale totex analysis

Our total expenditure (totex) for 2021–22 was higher than the allowance in the PR19 final determination for both water and wastewater. We set out below the principal reasons for the variances within each wholesale price control and each cost category shown above. It is important to note that the final determination from Ofwat does not explicitly show the totex allowance at a granular level. The variances described therefore represent a best estimate of the reasons for the variances.

The principal totex variances to the final determination have been allocated between timing and efficiency within the table on page 69. The following rules have been applied in making these allocations:

- All operating expenditure variances are allocated to efficiency on the basis that these are recurring costs that cannot typically be shifted between years.
- Variances related to renewals and capital maintenance expenditure have been allocated to timing, with the exception of enhanced maintenance expenditure forming part of the agreed £230 million of additional investment in excess of the final determination, that the Board has committed to. This is because over the five-year period, with the exception of additional expenditure on these projects which the Board has approved, we currently forecast that we will spend in line with the final determination allowance.
- Enhancement costs have been compared with a notional allocation of each category of expenditure to each year of the AMP using Ofwat's final determination profiling assumptions. All identified variances have been allocated to timing.
- Any enhancement costs incurred in relation to schemes which were not funded within the final determination (for example carryover of AMP6 expenditure) has been allocated to the efficiency category.

Totex variance to final determination

Water totex variance over/(under) £m	12 months ended 31 March 2022		Price control period to date	
	Water resources	Water network+	Water resources	Water network+
Net totex	11.6	64.6	25.1	65.6
Business rates and abstraction licences	(1.2)	0.2	(2.1)	(1.5)
Not subject to cost sharing	3.3	(8.1)	4.1	(8.9)
Total totex variance	**13.7**	**56.7**	**27.1**	**55.2**

Water

Water resources totex is £11.6 million higher than the final determination allowance for 2021–22 and is £25.1 million over the final determination for the AMP to date.

The variance of £11.6 million in 2021–22 reflects an overspend of £12.1 million, offset by timing variances of £0.5 million.

The principal reason for the overspend is the completion of some Eels Regulations schemes from the previous regulatory period (AMP6), representing £12.4 million in the year and £22.9 million cumulatively together with an increase in the provision made for ecological work, associated with the section 20 agreement in relation to the Rivers Test and Itchen and the Candover Stream, of £1.7 million in 2021–22 and £2.5 million cumulatively. These variances have been included within the (in)efficiency category.

The favourable timing variance of £0.5 million is a combination of a slower start than assumed on a number of enhancement projects, including schemes related to raw water deterioration (£2.5 million) and WINEP investigations (£2.6 million) offset by higher levels of capital maintenance expenditure in the year than the notional final determination allowance.

Water network+ expenditure is £64.6 million above the final determination in 2021–22. This variance consists of timing variances of £18.0 million and an overspend of £46.6 million.

The timing variance mainly relates to an additional £43.6 million of expenditure on advancing capital maintenance and renewals during the year, £64.8 million cumulatively, offset by an underspend in the year of £28.8 million on supply demand balance schemes during the year, £56.5 million cumulatively. These schemes are expected to be delivered later in the AMP.

The remaining efficiency variance of £46.6 million in 2021–22 includes £13.8 million of additional capital maintenance to address water quality risks at our supply works and operating expenditure which is significantly higher than the final determination assumption. This overspend largely reflects additional contract costs and efficiencies not delivered in line with expectations, and this is also the main driver for the cumulative variance to date.

Business rates for water resources and water network+ are £1.0 million lower than the final determination allowance overall, reflecting lower abstraction charges for water resources. Cumulatively the total variance is £3.6 million lower than the determination, reflecting the impact of a one-off business rates rebate in 2020–21 of £2.4 million.

Within the 'costs not subject to sharing' category water resources expenditure is £3.3 million higher than the final determination allowance, while water network+ is £8.1 million below the allowance. The largest element of expenditure within this category is related to the strategic water resources development schemes which form our Water for Life Hampshire programme.

Overall expenditure on these schemes is £2.8 million below the final determination allowance, with an underspend of £5.8 million within the water network+ price control being offset by an overspend of £3.1 million within the water resources control.

The remaining variance is principally associated with the income offset (relating to developer-led schemes) which is £2.4 million lower than allowed reflecting a lower level of development activity during the year.

Pension deficit repair costs, which are not subject to cost sharing, are excluded from both the final determination allowed totex and the actual totex.

Totex variance to final determination

Wastewater totex variance over/(under) £m	12 months ended 31 March 2022		Price control period to date	
	Wastewater network+	Bioresources	Wastewater network+	Bioresources
Net totex	73.8	4.2	111.1	3.4
Business rates and abstraction licences	0.6	0.4	1.5	0.9
Not subject to cost sharing	(9.1)	–	(14.3)	–
Total totex variance	**65.3**	**4.6**	**98.3**	**4.3**

Wastewater

Bioresources totex is £4.2 million higher than the final determination allowance for 2021–22 and is £3.4 million over the final determination for the AMP to date.

The variance of £4.2 million in 2021–22 reflects an overspend of £1.8 million and a timing variance of £2.5 million.

The timing element of this variance consists of £3.3 million of additional capital maintenance in the year, £0.6 million cumulatively, offset by expenditure on sludge growth schemes which was £0.8 million below the notional final determination allocation for the year but for which we have spent £1.4 million more than the notional determination allowance cumulatively. The efficiency variance is driven by higher operating expenditure in relation to sludge transport costs and materials and chemicals.

Wastewater network+ totex is £73.8 million higher the final determination representing timing differences of £15.1 million, and an overspend of £58.7 million.

The timing variance relates to an additional £107.1 million of expenditure on capital maintenance and renewals during the year, £143.7 million cumulatively, and this is largely driven by significant schemes to improve our wastewater treatment works compliance and pumping station performance. The increased capital maintenance activity is offset by an underspend in the year of £92.1 million on enhancement schemes, £155.5 million cumulatively. Within the enhancement schemes the largest areas of underspend to date, compared with the implied final determination profile, are in relation to Flows to Full Treatment schemes £38.9 million in year and £60.7 million cumulatively, storage schemes at treatment works £21.9 million in year and £35.4 million cumulatively and phosphorous removal schemes £12.6 million in year and £27.4 million cumulatively.

The efficiency variance of £58.7 million in year, £122.8 million cumulatively, relates principally to higher operating expenditure than was allowed for within the final determination, in particular in relation to non-routine tankering to protect customers from flooding and avoid pollutions, and higher operational maintenance costs to help improve compliance and operational performance, as well as anticipated cost reductions not being achieved in line with expectations.

Business rates for bioresources and wastewater network+ are £1.0 million higher than the final determination allowance but are in line with previous years' business rates expenditure.

Within the 'costs not subject to sharing' category actual expenditure is £9.1 million less than the final determination allowance for the year and £14.1 million lower for the AMP to date. This variance is largely driven by the income offset (relating to developer-led schemes) which is £4.3 million lower than the determination in 2021–22, £9.8 million cumulatively reflecting a lower level of developer activity than anticipated together with lower expenditure on third party services.

Pension deficit repair costs, which are not subject to cost sharing, are excluded from both the final determination allowed totex and the actual totex.

Atypicals/Exceptionals

The atypical costs shown in table 4E relate to the court fine and costs associated with the EA prosecution. These have been classified as disallowable costs in table 4C and do not form part of the variances that are highlighted above.

Link to the final determination outcomes

With the exception of performance commitments that relate to specific capital delivery schemes, it is generally not possible to directly associate expenditure with the delivery of the final determination outcomes. This is because the vast majority of outcomes are delivered through base operating and capital maintenance expenditure, rather than specific funded schemes. We note that despite both water and wastewater totex being significantly higher than the final determination allowance, we have nonetheless incurred significant Outcome Delivery Incentive underperformance payments, in particular in relation to internal drinking water quality, sewer flooding and pollution incidents. These remain key areas of focus and investment for the business.

Disallowable costs

When comparing our actual totex to that allowed in the final determination we are required to make adjustments for certain disallowable costs, including fines and investigation costs. We have identified disallowable costs for 2021–22 of £92.8 million, all within the wastewater network plus price control. These comprise the court fine and costs associated with the EA prosecution.

Recharges between business units

Details of our process for allocating costs between business units can be found in our Methodology Statement.

4D – Totex analysis for the 12 months ended 31 March 2022 – water resources and water network+

		Network+				
	Water resources £m	Raw water transport £m	Raw water storage £m	Water treatment £m	Treated water distribution £m	Total £m
Operating expenditure						
Base operating expenditure	14.722	0.351	0.267	47.965	53.582	116.887
Enhancement operating expenditure	0.131	0.006	0.006	5.735	1.120	6.998
Developer services operating expenditure	–	–	–	–	1.488	1.488
Total operating expenditure excluding third party services	14.853	0.357	0.273	53.700	56.190	125.373
Third party services	0.554	–	–	1.228	0.656	2.438
Total operating expenditure	15.407	0.357	0.273	54.928	56.846	127.811
Grants and contributions						
Grants and contributions – operating expenditure	–	–	–	–	–	–
Capital expenditure						
Base capital expenditure	5.186	0.125	–	85.766	42.890	133.967
Enhancement capital expenditure	29.584	1.599	–	17.298	2.454	50.935
Developer services capital expenditure	–	–	–	–	11.340	11.340
Total gross capital expenditure (excluding third party)	34.770	1.724	–	103.064	56.684	196.242
Third party services	1.307	–	–	4.837	0.367	6.511
Total gross capital expenditure	36.077	1.724	–	107.901	57.051	202.753
Grants and contributions						
Grants and contributions – capital expenditure	1.366	–	–	1.986	3.550	6.902
Net totex	50.118	2.081	0.273	160.843	110.347	323.662
Cash expenditure						
Pension deficit recovery payments	0.826	–	0.100	10.415	11.272	22.613
Totex including cash items	50.944	2.081	0.373	171.258	121.619	346.275
Atypical expenditure						
N/A						
Total atypical expenditure	–	–	–	–	–	–

Note – developer services operating costs exclude non-price control diversion costs of £0.367 million, disclosed in table 4P, as we treat these costs as capital expenditure.

4E – Totex analysis for the 12 months ended 31 March 2022 – wastewater network+ and bioresources

	Network+ Sewage collection			Network+ Sewage treatment		Bioresources			
	Foul £m	Surface water drainage £m	Highway drainage £m	Sewage treatment and disposal £m	Imported sludge liquor treatment £m	Sludge transport £m	Sludge treatment £m	Sludge disposal £m	Total £m
Operating expenditure									
Base operating expenditure	61.043	11.602	11.602	178.091	5.008	4.656	12.780	6.261	291.043
Developer services operating expenditure	2.055	0.448	0.448	–	–	–	–	–	2.951
Total operating expenditure excluding third party services	63.098	12.050	12.050	178.091	5.008	4.656	12.780	6.261	293.994
Third party services	–	–	–	–	–	–	–	–	–
Total operating expenditure	63.098	12.050	12.050	178.091	5.008	4.656	12.780	6.261	293.994
Grants and contributions									
Grants and contributions –	–	–	–	–	–	–	–	–	–
Capital expenditure									
Base capital expenditure	56.963	12.416	12.416	153.931	–	–	23.994	–	259.720
Enhancement capital expenditure	3.854	0.839	0.839	101.717	–	–	0.056	–	107.305
Developer services capital expenditure	16.618	3.622	3.622	0.006	–	–	–	–	23.868
Total gross capital expenditure (excluding third party)	77.435	16.877	16.877	255.654	–	–	24.050	–	390.893
Third party services	0.197	0.043	0.043	2.121	–	–	–	–	2.404
Total gross capital expenditure	77.632	16.920	16.920	257.775	–	–	24.050	–	393.297
Grants and contributions									
Grants and contributions – capital expenditure	7.049	1.537	1.537	3.074	–	–	–	–	13.197
Net totex	133.681	27.433	27.433	432.792	5.008	4.656	36.830	6.261	674.094
Cash expenditure									
Pension deficit recovery	14.858	2.478	2.478	23.269	2.563	–	3.699	–	49.345
Totex including cash items	148.539	29.911	29.911	456.061	7.571	4.656	40.529	6.261	723.439
Atypical expenditure									
Fine and Legal Defence costs	–	–	–	92.784	–	–	–	–	92.784
Total atypical expenditure	–	–	–	92.784	–	–	–	–	92.784

Note – developer services operating costs exclude non-price control diversion costs of £0.283 million, disclosed in table 4P, as we treat these costs as capital expenditure.

4F – Major project expenditure for wholesale water by purpose 12 months ended 31 March 2022

	Expenditure in report year					
		Water network+				
	Water resources £m	Raw water transport £m	Raw water storage £m	Water treatment £m	Treated water distribution £m	Total £m
Major project capital expenditure by purpose						
Otterbourne to Andover Pipeline	–	–	–	–	0.166	0.166
Crabwood to Micheldever Pipeline	–	–	–	–	0.206	0.206
Testwood to Otterbourne Pipeline	–	–	–	–	0.167	0.167
Western Grid SRO Common costs	9.932	–	–	–	–	9.932
Fawley Desalination	–	–	–	2.301	–	2.301
River Itchen effluent re-use	–	–	–	3.822	–	3.822
West Country Sources North	0.125	–	–	–	–	0.125
Havant Thicket – Pipeline	3.421	–	–	–	–	3.421
Total major project capital expenditure	**13.478**	**–**	**–**	**6.123**	**0.539**	**20.140**

The totals shown for the Strategic Resource Option Schemes (Fawley desalination, Havant Thicket Pipeline and Itchen Water re-use) are the amounts incurred in the financial year 2021–22. They include some costs that were subsequently excluded by Ofwat on the recommendation of RAPID in its Gate 2 final decision of 17 May 2022, on the grounds that some of the costs were not appropriate for inclusion in the ring-fenced funding provided.

4G – Major project expenditure for wholesale wastewater by purpose for the 12 months ended 31 March 2022

We have no projects classed as major projects to report within wholesale wastewater.

4H – Financial metrics for the 12 months ended 31 March 2022

	Units	Metric	AMP to date
Financial Indicators			
Net debt	£m	3,691.630	
Regulatory equity	£m	1,943.550	
Regulatory gearing	%	65.51%	
Post tax return on regulatory equity	%	(10.62%)	
RORE (return on regulatory equity)	%	(2.81%)	(1.89%)
Dividend yield	%	–	
Retail profit margin – Household	%	(2.63%)	
Retail profit margin – Non Household	%	–	
Credit rating – Fitch	n/a	BBB+ (Negative)	
Credit rating – Moody's	n/a	Baa3 (Stable)	
Credit rating – Standard and Poor's	n/a	BBB+ (Stable)	
Return on RCV	%	0.60%	
Dividend cover	dec	–	
Funds from operations (FFO)	£m	81.580	
Interest cover (cash)	dec	1.46	
Adjusted interest cover (cash)	dec	(0.33)	
FFO/Debt	dec	0.02	
Effective tax rate	%	–	
Retained cash flow (RCF)	£m	81.580	
RCF/Net debt	dec	0.02	
Borrowings			
Proportion of borrowings which are fixed rate	%	36.55%	
Proportion of borrowings which are floating rate	%	–	
Proportion of borrowings which are index linked	%	63.45%	
Proportion of borrowings due within 1 year or less	%	0.09%	
Proportion of borrowings due in more than 1 year but no more than 2 years	%	7.36%	
Proportion of borrowings due in more than 2 years but no more than 5 years	%	10.76%	
Proportion of borrowings due in more than 5 years but no more than 20 years	%	69.37%	
Proportion of borrowings due in more than 20 years	%	12.42%	

The interest cover and adjusted interest cover ratios quoted above are based on the cash interest payable for the financial year rather than the cash interest paid in the financial year.

Interest Cover Ratios reconciliation

	ICR (cash) £m	Adj ICR (cash) £m
Funds from operations	81.580	81.580
Add back cash interest paid in year	159.457	159.457
Less regulatory depreciation	–	(294.708)
	241.037	(53.671)
Cash interest paid in year	159.457	159.457
Less interest paid in prior year	(38.579)	(38.579)
Add interest payable re current year	47.070	47.070
Less interest prepaid	(3.001)	(3.001)
Interest payable for 2021–22	164.947	164.947
Ratio (dec)	1.461	(0.325)

4I – Financial derivatives for the 12 months ended 31 March 2022

	Nominal value by maturity (net) at 31 March			Total value at 31 March		Total accretion at 31 March	Interest rate (weighted average for 12 months to 31 March)	
	1 to 2 years	2 to 5 years	Over 5 years	Nominal value (net)	Mark to Market		Payable	Receivable
	£m	£m	£m	£m	£m	£m		
Interest rate swap (sterling)								
Fixed to index-linked	–	–	1,316.608	1,316.608	2,143.318	119.162	2.21%	9.51%
Total	–	–	**1,316.608**	**1,316.608**	**2,143.318**	**119.162**		

Floating to index-linked derivatives are intended to expose interest cash flows, and the nominal value of debt outstanding, to short-term movement in RPI inflation. This ensures a proportion of our interest cost is a match against the nature of our inflation-linked cash flows and our inflation-linked RCV. Our inflation-linked financial instruments have a long maturity in order to finance the long life of our assets and the long-term nature of our investment decisions.

The value of the Mark to Market represents forecast future cash flows for the duration of the derivatives and discounted by prevailing interest rates. This value is extremely volatile given that market interest rates are constantly moving. The liability shown in the table above of £2,143.3 million associated with the Mark to Market valuations of our derivatives is very high at present given the current low interest rate environment. The risk of this Mark to Market value crystallising is extremely remote given that it can only crystallise under certain conditions of a default of our financing covenants, in which case operations of the company are protected and will continue. Further details are available on page 238 of our Annual Report and Financial Statements.

Additional regulatory tables

As permitted by RAG 3.13 section 2.9, the remaining regulatory tables which form the Annual Performance Report are excluded from this document and are published as an appendix at **southernwater.co.uk/our-reports**

Data assurance summary

We take full responsibility for the information we publish on our performance. We seek to provide confidence to customers and stakeholders through a transparent approach to data assurance. This assurance provides confidence in our reported performance and the delivery of performance commitments made in our 2020–25 business plan.

Whilst assurance is rarely able to provide absolute certainty over the quality of reported information, we aim for the assurance that we perform and commission to provide our internal and external stakeholders with sufficient comfort over the robustness and quality of the information that we report.

The assurance activity we undertake around the information that we provide is one of the critical elements we have put in place to build and secure the trust and confidence of our regulators, stakeholders and customers.

Our technical assurance framework agreement in place for our five-year Business Plan period (AMP7) allows us to appoint the most suitable assurance partners to different technical assurance projects. KPMG and Jacobs are now completing their second year in this role.

We have published a separate document that details the completed assurance work performed on our reported information for the 2021–22 financial year. The results, both positive and improvement areas are published in the document entitled 'Data Assurance Summary' which is available on our Southern Water website **southernwater.co.uk/our-reports**.

The main assurance areas for the annual reports are:

Significant areas for assurance	Assurance results for 2021–22
The Annual Report including the Statutory and Regulatory Accounts, cost allocation and segmental reporting	The Annual Report and Financial Statements were audited by Deloitte LLP. Their opinion is included on page 252 of that report. The Annual Performance Report (APR), sections 1 and 2, excluding table 1F, were audited by Deloitte LLP. Their assurance statement is included on page 50. Deloitte LLP also performed assurance activities agreed with us on the financial information presented in table 1F and sections 4 to 9 of the APR and the financial information published in the cost assessment tables alongside this report. No issues were identified.
Additional assurance undertaken	Deloitte LLP also undertook assurance procedures on the following statements made in the Annual Report and APR: • Viability statement • Ring-fencing Certificate and statement (Licence Condition P)
Ofwat Performance Commitments and Outcome Delivery Incentives (ODIs)	Our technical assurers KPMG LLP have issued us with an unqualified limited assurance ISAE (UK) 3000 opinion over the reported performance against our high and medium risk Performance Commitments for the Business Plan period 2020–25 in the APR.
Specific assurances related to other regulators' required information (i.e. The Drinking Water Inspectorate and The Environment Agency)	Each specified requirement is detailed in our Data Assurance Summary

Appendices

The information in the appendices has not been audited.

Appendix 1. Transactions with associates and the non-appointed business

Services supplied to the associated companies by the appointee

Greensands Holdings Limited (GSH) is the ultimate parent of Greensands Investments Limited (GSI), which is an intermediate parent of Southern Water Services Limited (SWS), the appointee. The purpose of GSH and GSI is to act as holding companies for SWS. As such they do not trade and have no turnover.

During the year, recharges for group-related management services, for example legal, treasury, governance and financial services, supplied by Southern Water Services Limited were as follows:

Services supplied to associated companies by the appointee

	Company	Turnover of associate	Terms of supply	Value £m
Management charges	Greensands Investments Limited	–	Cost/market price	1.000

Services received by the appointee from associated companies

There were no services supplied by associate companies to SWS.

Group relief received by the appointee

Service	Company	Turnover of associate	Terms of supply	Value £m
Corporation tax group relief	Southern Water Services Group	–	Cost	–

Allocation of costs between regulated and non-regulated businesses

Each non-appointed activity is treated separately within the company's financial records. Examples of non-appointed activities include non-monopoly rechargeable works, property searches and services for waste tankering. Revenues, costs, assets and liabilities are generally directly allocated to particular business activities. Administrative overheads have been apportioned from the appointed business to the non-appointed business on an activity cost basis.

Service provided by non-appointed business	Basis of recharge made by the appointed business	Value £m
Treatment of imported sludge	Not applicable	–
Treatment of tankered waste	The Mogden Formula was used to calculate the income for tankered waste and the costs were derived from this calculation	6.274
Other	Headcount (FTE) was used to calculate administrative overhead for property searches, accommodation rental and Homeserve costs	0.128

Details of intercompany loans

Loans granted to Southern Water Services Limited

Company	Loan type	Interest rate %	Repayment date	Balance at 31 March 2022 £m
Southern Water Services (Finance) Limited	Fixed rate	6.202	2029	348.933
	Index linked	3.716	2034	250.119
	Index linked	3.716	2034	66.985
	Fixed rate	6.650	2026	349.278
	Index linked	3.826	2023	257.155
	Fixed rate	5.010	2041	147.266
	Fixed rate	4.510	2052	197.315
	Fixed rate	5.135	2056	292.826
	Fixed rate	2.385	2028	370.797
	Fixed rate	3.010	2037	443.789
	Fixed rate	1.626	2027	295.294
	Fixed rate	2.790	2031	174.216
	Fixed rate	2.970	2036	74.614
	Index linked	4.086	2033	283.025
	Index linked	3.645	2032	261.900
	Fixed rate	0.000	On demand	30.250
Total				**3,843.762**

Loans granted by Southern Water Services Limited

Company	Loan type	Interest rate %	Repayment date	Balance at 31 March 2022 £m
Southern Water Services (Finance) Limited	Fixed rate	0.000	On demand	35.013
Total				**35.013**

Dividends paid by Southern Water Services Limited to group companies

Company	2022 £m	2021 £m
Southern Water Holdings (ordinary dividend)	–	–
Southern Water Holdings (for SWSG loan agreement)	–	3.968

No ordinary dividend was declared for payment to Southern Water Holdings Limited (SWH) in 2022 (2021: £nil).

No dividends were paid to SWS Holdings Limited (2021: £3.968 million) to allow SWSG to service part of its interest obligations on the Southern Water Services Limited/SWSG loan agreement.

Dividend policy

Our dividend policy is formulated to ensure a fair balance of reward between investors and customers. To deliver on our vision for the successful delivery of our Business Plan for 2020–25, all stakeholders must share in success: customers benefitting through enhanced service and lower bills, and shareholders earning a fair return on the 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 our financial and non-financial performance. This would reflect our overall financial performance as compared to the final Business Plan for 2020–25 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 our customers. This consideration will also 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

Comparison of dividend to the PR19 Final Determination

The Board has not approved the payment of preference share dividends for 2021–22 (2021: £nil million). Preference share dividends are disclosed as interest in the financial statements and a cumulative accrual of £12.2 million in relation to this liability is included within the financial statements.

Asset transfers

There were no asset transfers during the year.

Appendix 2. KPI definitions and status assessment rules

Performance Commitment Definitions RAG status

✓	Ofwat target met or exceeded
– (amber)	Ofwat target missed but performance improved in relation to prior year outcome
✗	Ofwat target missed and performance worse than prior year outcome
–	Not applicable

Performance Commitment Definitions

Deliver great service

Water quality compliance (Compliance Risk Index)	**Definition:** The definition for this performance commitment is set by the Drinking Water Inspectorate (DWI) in collaboration with the industry. This is published as DWI Compliance Risk Index (CRI), August 2018: **ofwat.gov.uk/publication/dwi-compliance-risk-index-cri-definition/**.
Drinking water appearance	**Definition:** The number of times the company is contacted by consumers due to the drinking water not being clear, reported per 1,000 population. Calculation is the number of contacts for appearance multiplied by 1,000 divided by the resident population as reported to the Drinking Water Inspectorate (DWI).
Drinking water taste and odour	**Definition:** The number of times the company is contacted due to the taste and odour of drinking water, reported per 1,000 population. Calculation is the number of contacts for all taste/odour contacts multiplied by 1,000 divided by the resident population as reported to the Drinking Water Inspectorate (DWI).
Replace lead customer pipes	**Definition:** The number of residential properties receiving grants from the company towards removing lead pipes in the home in the 2020–25 period. This is a co-delivery measure with the company's customers to reduce the amount of lead in customer pipes. The performance commitment will apply only in the company's Deal, Kent, water supply zone, where it is trialling this approach to eliminating lead pipes and fittings.
Water supply interruptions	**Definition:** Reducing interruptions to water supply is defined in the reporting guidance for PR19 – Supply Interruptions, published on 27 March 2018: **ofwat.gov.uk/publication/reporting-guidance-supply-interruptions/** It is calculated as the average number of minutes lost per customer for the whole customer base for interruptions that lasted three hours or more.
C-MeX	**Definition:** The customer measure of experience (C-MeX) is a measure of customer satisfaction. A company's C-MeX score is calculated as the weighted average of customer satisfaction (CSAT) scores from customer service (CS) and customer experience (CE) surveys. Standard and higher performance payments under C-MeX depend on a company's performance relative to those of other companies. Higher performance payments are available if the company passes each of the following three 'gates': • the company is one of the top three performers by C-MeX score; • the company is at or above a cross-sector threshold of customer satisfaction performance based on the all-sector upper quartile (ASUQ) of the UK Customer Satisfaction Index (UKCSI); and • the company has lower than the industry average number of household complaints (per 10,000 connections).

Deliver great service

Void properties	**Definition:** The number of household properties classified as void as a percentage of the total number of household properties served by the company. Void properties are defined as properties, within the company's supply area, which are connected for either a water service only, a wastewater service only or both services but do not receive a charge, as there are no occupants. Additionally a property connected for both services that is not occupied, only counts as one void property.
Gap sites	**Definition:** The number of household gap sites identified by the company and brought into charge annually. A gap site is identified as a property that is not recorded on the company's billing database. To add one more site requires the company to add one property to its billing database.
Internal sewer flooding	**Definition:** The internal sewer flooding measure is defined in the reporting guidance for PR19 – Sewer Flooding, published on 27 March 2018: **ofwat.gov.uk/publication/reporting-guidance-sewer-flooding/** The measure is calculated as the number of internal sewer flooding incidents normalised per 10,000 sewer connections including sewer flooding due to severe weather events.
External sewer flooding	**Definition:** The performance commitment will be reported as the absolute number of the company's external sewer flooding incidents per year including incidents caused by severe weather. The external sewer flooding measure is defined in the reporting guidance for PR19 – Sewer Flooding, updated on 28 April 2018: **ofwat.gov.uk/publication/reporting-guidance-sewer-flooding/**
Customer Satisfaction with Vulnerability Support	**Definition:** Percentage of customers that have received non-financial support who believe Southern Water's support addresses their specific requirements and needs. Non-financial support is defined as any support that is provided by the company to a customer with specific requirements or needs which affects the customer for reasons that are not specific to their financial position. This support is provided through the Priority Services Register (PSR) e.g. braille bills or talking bills. Performance will be measured through a survey of customers that have received PSR support. Customers will be asked whether the support provided addresses their specific requirements and needs in relation to their water and wastewater service. Customers will be provided information about the support the company provides as part of the questionnaire so they clearly understand the premise of the question. The questionnaire used will be consistent with that used in the company's baseline survey for 2017–18. Customers will be able to respond with a 'Yes' or 'No' answer and provide additional comments to give the company feedback on any improvements that could still be made to improve support. The performance will be measured as the total number of yes responses divided by the total number of responses. The company will not include in the survey PSR customers who have not received a service from the company in the reporting period. The survey should be planned and carried out following social research best practice (example any applicable sections of a relevant code such as that published by the Market Research Society). The sample size should be selected to give a reasonable statistical significance for the purpose of the performance commitment.

Deliver great service

Effectiveness of financial assistance	**Definition:** The percentage of customers that pay their bills in the immediate twelve months following the receipt of financial assistance. The measure includes residential customers who have received support through the Essentials social tariff, WaterSure, Water Direct, NewStart Debt Matching scheme and any new financial assistance schemes the company implements. Any new financial schemes introduced by the company for inclusion in this performance commitment should be subject to assurance from the Customer Challenge Group. Customers 'paying their bills' is defined as customers either having paid in ten distinct months (of twelve) or having paid 90% of the billed value.
Priority services for customers in vulnerable circumstances	**Definition:** This common performance commitment is defined in the reporting guidance: 'Reporting guidance – Common performance commitment for the Priority Service Register'. This performance commitment consists of the following criteria: • The PSR reach: percentage of households that the company supplies with water and/or wastewater services that are registered on the company's PSR; • Attempted contact: percentage of distinct households on the PSR that the company has attempted to contact over a two-year period; • Actual contact: percentage of distinct households on the PSR that the company has actually contacted over a two-year period. To achieve compliance with this performance commitment the reach, attempted contact and actual contact targets should be achieved.
Properties at risk of receiving low pressure	**Definition:** The number of properties receiving or at risk of receiving pressure below the low pressure reference level. This measure is calculated as the total number of properties receiving pressure below standard, minus the number of those properties that are covered by the predetermined allowable exclusion categories as detailed in the reporting guidance. Low pressure reference level is defined in the reporting guidance published 11 December, 2017 'Properties at risk of receiving low pressure': **ofwat.gov.uk/publication/properties-at-risk-of-receiving-low-pressure/**
Value for money	**Definition:** Percentage of customers that state they are satisfied with the value for money of water and sewerage services in their area. This performance commitment will be measured through an annual survey of customers that is run by CCWater (Water Matters). The measure will take the results for Southern Water customers only. The proportion of customers that state either 'very' or 'fairly' satisfied on a five-point scale, as measured by CCWater's annual tracking report 'Water Matters'. It combines a mean average score of the ratings: • Satisfaction with value for money for water services; and • Satisfaction with value for money for sewerage services CCWater will interview 200 of Southern Water's customers each year in this survey. The measurement of the survey will be conducted in a consistent way over the 2020 to 2025 period. If, during the period, CCWater cease measurement of the relevant data set, the company will replace the source data and measurement for this performance commitment with an appropriate equivalent confirmed and assured by an appropriately qualified independent third party.

Fit for the future

Long term supply demand schemes	**Definition:** The expected number of months delay to deliver long term supply-demand capacity benefit of 182.5 Ml/d which is expected to be delivered by 31 March 2027. The capacity benefit (Ml/d) target represents the total of the stated average capacities for the individual schemes, both treatment and transfer, identified by the company within the business plan and the revised draft WRMP. The following schemes are expected to be delivered: • Ford Wastewater Treatment Works (WwTW) indirect potable water reuse (20 Ml/d); • Utilise full existing transfer capacity (3 Ml/d); • East Woodhay Water Supply Works (WSW) (1 Ml/d); • Bournemouth Water supply from Knapp Mill (20 Ml/d); • Coastal desalination – Shoreham Harbour (10 Ml/d); • Sussex Coast – Lower Greensand (2 Mld); • Hardham winter transfer: Stage 2 (2 Ml/d); • Aylesford WwTW indirect potable water reuse – Eccles Lake (18 Ml/d); • Sandown WwTW indirect potable water reuse (8.5 Ml/d); and • Internal interconnections (98 Ml/d).
Sewer collapses	**Definition:** Sewer collapse: A sewer collapse is considered to be where a structural failure has occurred to the pipe that results in a service impact to a customer or the environment and where action is taken to replace or repair the pipe to reinstate normal service. The measure intentionally does not refer to the magnitude of the collapse. The measure includes rising mains. Collapses on the entire network are to be reported. Sewer length: Include the length of the entire network, including sewers that transferred to their responsibility under the Transfer of Public Sewers Regs 2011. The company should separately record the length of transferred sewers, the calculation of this measure should be based on the latest measurements of the length.
Surface water management	**Definition:** Reduction in volume (m^3) of surface water entering the surface or combined sewer network as a result of sustainable urban drainage approaches. Solutions include sustainable urban drainage approaches to slow down and reduce the volume of water entering the network. These include, but are not limited to: • Provision of a soakaway, either through providing a grant to the customer or through installation by Southern Water. • Provision of a sustainable drainage system which does not connect to a combined sewer network or which materially attenuates the flow of surface water to the combined network (e.g. a rain garden).
Community engagement	**Definition:** The percentile performance of Southern Water compared to other utility companies in the B4S1 annual report The company has engaged B4SI, a company that measures corporate community investment and philanthropy, to measure the company's performance in line with organisations both within and outside the sector. The measure will be based on the company's annual ranking of utilities companies in the B4SI annual report, which will be influenced by the company's ongoing commitment to increase hours volunteered, partnering with charities, raising money for charities, community and outreach events and administering community grants. Each year the company will convert the ranking into a percentile using the excel function 'PERCENTRANK.INC' multiplied by 100 and report this. The data will be organised so that the best company will receive the highest percentile.

Fit for the future

Schools visited and engagement with children

Definition:

The measure is the percentage of feedback the company receives, from schools that have been visited in the year, which the schools have rated as 'good' or 'excellent', based on a survey completed after the visit.

It is measured annually on a reporting year basis.

A 'visit' is defined as any activity involving a school, either at the school premises or other venue, which has as its aim the education of pupils in relation to the company's core activities, including the value of water, water efficiency, 'unflushables' and the water cycle.

'Schools' includes any establishment involved in the education of children under the age of 18.

The survey should be planned and carried out following social research best practice (e.g. any applicable sections of a relevant code such as that published by the Market Research Society).

The sample size should be selected to give a reasonable statistical significance for the purpose of the performance commitment.

Impounding reservoirs

Definition:

This performance commitment measures the progress that the company makes against its programme of work for enhancing the safety of four named reservoir assets, measured as the percentage completion of the schemes. The company must increase the drawdown rates for four of its largest impounding reservoirs to at least the basic levels as set out in the below table for the purposes of measuring delivery under this performance commitment.

The company must comply with the Reservoirs Act 1975.

Statutory reservoir name	Basic drawdown standard rate (metres per day at 50 percentile inflow)	Latest timing of statutory inspection	% completion allocation	Target completion date of the works
Bewl	1.00	2018	48.8	11 Nov 2022
Darwell	0.83	2024	14.8	11 Nov 2024
Powdermill	0.31	2019	19.9	11 Nov 2024
Weir Wood	0.53	2023	16.5	11 Nov 2024

Mains repairs

Definition:

Mains repairs is defined in the reporting guidance for PR19 – Mains Repairs per 1000 km, published on 27 March 2018. **ofwat.gov.uk/publication/reporting-guidance-mains-repairs-per-1000km/**

It is reported as the number of mains repairs per thousand kilometres of the entire water main network (excluding communication and supply pipes).

Unplanned water outage

Definition:

Unplanned outage is defined in the reporting guidance for PR19 – Unplanned Outage, published on 4 April 2019. **ofwat.gov.uk/publication/reporting-guidance-unplanned-outage/**

This measure is reported as the temporary loss of peak week production capacity (PWPC) in the reporting year weighted by the duration of the loss (in days). Unplanned outage for each water production site is calculated separately and then summed over the reporting year to give a total actual unplanned outage for the water resource zone.

The company water resource zone weighted outage should then be summed (Ml/d) and normalised based on overall company peak week production capacity to be reported as a percentage.

Risk of sewer flooding in a storm

Definition:

Risk of sewer flooding in a storm is defined within the guidance titled, Reporting guidance – Risk of sewer flooding in a storm, published on 4 April 2019: **ofwat.gov.uk/publication/reporting-guidance-risk-of-sewer-flooding-in-a-storm/**

This measure will record the percentage of the region's population at risk from internal hydraulic flooding from a 1 in 50-year storm, based on modelled predictions.

D-MeX

Definition:

D-MeX is a measure of customer satisfaction. A company's overall D-MeX score is calculated from two components that contribute equally:

- qualitative D-MeX score, based on the ratings provided by developer services customers who transacted with the company throughout the reporting year to a customer satisfaction survey; and
- quantitative D-MeX score, based on the company's performance against a set of selected Water UK performance metrics throughout the reporting year.

The survey results which are used to calculate the qualitative component of the company's D-MeX score will be supplied by a survey agent appointed by Ofwat. This is supplied out of 100 to form the score for the qualitative component of D-MeX.

The set of Water UK performance metrics which are used to calculate the quantitative component of the company's D-MeX score, in place at the time of PR19 final determinations publication, are set out in annex 2 of 'PR19 final determinations: Customer measure of experience (C-MeX) and developer services measure of experience (D-MeX) policy appendix'. For each metric, a percentage is reported and a simple average of these metrics is taken. This is rescaled to be out of 100 to form the score for the quantitative component of D-MeX.

Water supply resilience

Definition:

Number of residential properties at risk of long term loss of supply (>48 hours) in the company's Thanet, Brighton and the Isle of Wight water supply zones.

A property is considered at risk of long term loss of supply (>48 hours) if it is likely to experience a long term supply interruption if one of the key hazards identified in the table below were to occur.

The key hazards and assets that are considered in the assessments are summarised in the table below.

Key hazards	Water supply works	Service reservoir	% completion allocation	Target completion date of the works
Flooding	✓	✓	✓	✗
Critical Asset Failure	✓	✓	✓	✓
Contamination	✗	✓	✗	✓
Raw Water Loss	✓	✗	✗	✗
Malicious Damage	✓	✓	✓	✗
Cyber Security Incident	✓	✓	✓	✗

Protect and improve the environment

Abstraction Incentive Mechanism	Definition: The abstraction incentive mechanism (AIM) reduces abstraction of water at environmentally sensitive sites when flow or levels are below an agreed point otherwise known as a trigger. The trigger point is usually based on a level or flow, beyond which the AIM is considered to be 'switched on'. This trigger will usually be related to the point at which damage is caused and is intended to prevent this from happening or ameliorate the negative impacts. The company has included one site for AIM for the period 2020–25, this is Otterbourne and Twyford. The trigger point for this site is the month of September as this is when impacts on the environment are most severe. The September total abstraction limit for the 2020–25 period is 2280 Ml. The company's stated target is to outperform this by 15 Ml/d. The abstraction incentive mechanism is defined in the reporting guidance – Guidelines on the abstraction incentive mechanism, published in 2016: **ofwat.gov.uk/wp-content/uploads/2016/02/gud_pro20160226aim.pdf**
Pollution incidents	Definition: Pollution incidents is defined in the following guidance for PR19 – Water & Sewerage Company Environmental Performance Assessment (EPA) Methodology (version 3). Published November 2017 by the Environment Agency. **ofwat.gov.uk/wp-content/uploads/2017/12/WatCoPerfEPAmethodology_v3-Nov-2017-Final.pdf**
Thanet sewers	Definition: The expected number of months delay to deliver an enhancement scheme related to the reduction of exfiltration from sewers located within tunnels in Thanet by 31 March 2025. The specification of the scheme is set out in the company's April 2019 business plan
Maintain bathing waters at 'excellent'	Definition: The number of bathing waters maintained at 'Excellent' each year, as designated by the Environment Agency, based on a four-year average. This measures the number of designated bathing waters within the Southern Water region which are assessed as having Excellent bathing water quality at the end of each bathing season. This is based on a four-year assessment. If a bathing water is closed for sampling the company will use the most recent classification as reported by the Environment Agency.

Protect and improve the environment

Improve the number of bathing waters to at least 'good'	**Definition:** The cumulative number of named bathing waters that are improved and assessed as at least 'Good' water quality classification by the Environment Agency in the 2020-25 period. The following are the named bathing waters to be taken to 'Good' classification: • Broadstairs Viking Bay • Littlestone • Lancing, Beach Green • Hastings Pelham Beach • Felpham If during investigations an additional bathing water is identified it can be added to this list with the agreement of the Environment Agency. If a bathing water is de-designated during the period, it will not be counted and will reduce the potential for the company to perform. For the 2024–25 reporting year, if a season is classed as 'abnormal' as there are at least two samples two standard deviations away from typical wet weather affected samples, an underperformance payment will not apply for the 2024–25 year so far that it relates to an 'abnormal' assessment. The performance assessment would be deferred to the following year. The performance assessment for bathing waters assessed as abnormal will not be deferred again. It is expected that any underperformance or outperformance payments for bathing waters assessed as abnormal for the 2024–25 year will apply instead for the year 2025–26, this will be confirmed at the next price review. The overall amount of underperformance or outperformance payments should be the same as if an assessment takes place in 2025–26, had taken place in 2024–25.
Improve the number of bathing waters at 'excellent' quality	**Definition:** The cumulative number of named beaches that are improved and assessed as 'Excellent' bathing water classification by the Environment Agency in the 2024–25 period. At least two from the following four bathing waters will be improved: • Gurnard; • Seagrove; • Ramsgate Sands; and • Pevensey Bay If a bathing water is de-designated during the period, it will not be counted and will reduce the potential for the company to perform. For the 2024–25 reporting year, if a season is classed as 'abnormal' as there are at least two samples two standard deviations away from typical wet weather affected samples, underperformance payments will not apply for the 2024–25 year so far that it relates to an 'abnormal' assessment. The performance assessment would be deferred to the following year. The performance assessment for bathing waters assessed as abnormal will not be deferred again. It is expected that any underperformance or outperformance payments for bathing waters assessed as abnormal for the 2024–25 year will apply instead for the year 2025–26, this will be confirmed at the next price review. The overall amount of underperformance or outperformance payments should be the same as if an assessment that takes place in 2025–26, had taken place in 2024–25.
Effluent re-use	**Definition:** Volume of treated effluent in cubic metres (m^3) made available annually for direct re-use by customers. The measurement will be m^3 of treated effluent utilised by local authorities, businesses, farmers and communities on an annual basis. It measures effluent that the company no longer discharges direct to the environment but instead provide to a third party (at the appropriate quality required) for use. This could be, for example, to a council for watering flower beds or to a grower for crop irrigation.

Protect and improve the environment

Natural capital	**Definition:** The cumulative number of river catchments for which the company establishes and publishes baseline natural capital accounts. The company will establish baseline natural capital accounts for at least three of its ten catchments (the Test, Arun & Western Streams and Medway catchments) supported by natural and social capital metrics that will allow it to monitor and measure changes in natural capital stocks (extent and condition) and the value of water-related ecosystem services over time as a result of it investments/activities.
Distribution input	**Definition:** This measure is reported as an annual average in megalitres per day (Ml/d). Distribution input should be reported using the following criteria: • Distribution input to the system shall be metered with at least daily readings at all locations of water input to the distribution network at treatment works, boreholes and bulk supply locations; • Meters shall be an appropriate size for the flow to be measured and located at appropriate inputs to the network confirmed by record plans. Any treatment works' take-off downstream of a meter shall be excluded from the distribution input calculations; Data validity checks shall be carried out at least monthly; • Any missing data shall be infilled using both pre- and post-data for the location over at least one month, extrapolated from pump hours or use of upstream or downstream meters; and • The data transfer systems from meter output to the central database shall be checked and validated on a risk-based frequency every one to two years. This measure should be calculated consistently with other water balance components. If any missing data is infilled then the same data should be used in leakage and per capita consumption (PCC) reporting.
Treatment works compliance	**Definition:** Treatment works compliance is defined in the reporting guidance for PR19 – Water & Sewerage Company Environmental Performance Assessment (EPA) Methodology (version 8). **ofwat.gov.uk/publication/environment-agencys-epamethodology/** The discharge permit compliance metric is reported as the number of failing sites (as a percentage of the total number of discharges) and not the number of failing discharges.
Renewable generation	**Definition:** Total renewable electricity generated as a percentage of the company's total electricity consumption. The measure includes all electricity consumed at the company's sites, including both operational sites and offices. All renewable energy generated on the company's sites will contribute towards this performance measure, irrespective of whether it has been generated using assets owned, operated and maintained by it, or on behalf of it by a third party, non-regulated, or subsidiary business unit. In this way performance against the target will be intrinsically linked to behaviours incentivised by the market for the purpose of value creation and not restricted by a traditional operating model. The total amount of renewable electricity generated at the company's sites is measured in kilowatt hours (kWh) at the generation source after deducting any power not used (parasitic loads) and including electricity both consumed on site and any surplus exported into the National Grid.

Protect and improve the environment

Satisfactory bioresources recycling	**Definition:** The overall percentage of company sludge satisfactorily used or disposed of in line with version 3 of the Environment Agency's Water and Sewerage Company Environmental Performance Assessment (EPA) methodology (published November 2017), which includes compliance with certain environmental laws and industry agreements in effect at the date of final determination, including: • the Sludge (Use in Agriculture) Regulations 1989; • Environmental Permitting (England and Wales) Regulations 2010; and • Water company voluntary compliance with the Safe Sludge Matrix. The full methodology, published in 2017, can be found here: **ofwat.gov.uk/wp-content/uploads/2017/12/WatCoPerfEPAmethodology_v3-Nov-2017-Final.pdf**
River water quality	**Definition:** The cumulative length of river improved as a consequence of regulatory and legislative drivers. The length of river defined as improved will be based on the delivery of specified schemes in the WINEP. The commitment level will be limited to those schemes with Green status as at 1 April 2019 and which are already confirmed. The length of river water quality improvements will be derived from specified schemes in the WINEP. It is assumed for the purposes of this performance commitment that delivery of the WINEP schemes will deliver the specified improvements to water quality.
Combined Sewer Overflows (CSO) Monitoring	**Definition:** Percentage of CSOs with effective monitoring. To count as effective monitoring under this measure, the following criteria will apply: • The monitor is an 'Event and Duration Monitor', which is a monitor that monitors that a CSO has spilt and the duration of the spill; • The monitor is in place and available providing at least 10 months valid data in any one year; • Data from the monitor has been validated, through either internal or external review; and • Data from the monitor has been made available on the company's website.
WINEP delivery	Has the company 'met' or 'not met' all of its requirements for WINEP, in the reporting year. This measure tracks the completion of required schemes in each year, as per the latest WINEP programme published by Defra. If any scheme is not delivered by the time specified in the WINEP tracker titled 'Completion Date (DD/MM/YY)', the company will report 'not met'. All WINEP schemes will be included including those reported under other performance commitments.

Use water wisely

Access to daily water consumption data	**Definition:** Number of residential properties provided with a device which can give access to daily water consumption. The measure includes all residential properties.
Water saved from water efficiency visits	**Definition:** Estimated reduction in consumption in cubic meters per days from 1 April 2020. The estimate is based on the number and type of water saving devices fitted and their estimated usage reduction. This will be calculated by the company's water efficiency visit supplier at the time of the visit. A water saving device is any physical device designed to save water (for example, a low flow shower head or tap aerator) or other intervention (for example, dripping tap repair). The estimated saving will be based on the estimated daily saving associated with each device installed and the customer's stated usage. The estimated daily saving associated with each device installed will be published on the company website. The annual savings will be calculated as the sum of the estimated daily savings at each property. The measure includes all residential properties.
Leakage	**Definition:** The percentage reduction of three year average leakage in megalitres per day (Ml/d) from the 2019–20 baseline. The total level of leakage is defined in the Final reporting guidance for PR19 – Leakage, published on 27 March 2018: **ofwat.gov.uk/publication/reporting-guidance-leakage/** Three-year average values are calculated from annual average values for the reporting year and two preceding years and expressed in megalitres per day (Ml/d).
Per capita consumption	**Definition:** Per capita consumption is defined in the Final reporting guidance for PR19 – Per Capita Consumption, published on 27 March 2018: **ofwat.gov.uk/publication/reporting-guidance-per-capita-consumption/** Three-year average values are calculated from annual average values for the reporting year and two preceding years and expressed in litres/person/day (l/p/d).
Target 100	**Definition:** Percentage of household population with estimated per capita consumption (PCC) of less than 100 litres/person/day. PCC is defined as the average amount of water used by each customer that lives in a household property

Appendix 3. Board statement on the accuracy and completeness of the data and information (financial and non-financial)

We, the Board of Southern Water (SWS), have considered carefully the requirements of the Board statement on the accuracy and completeness of the data and information (financial and non-financial). The Board is pleased to provide the following Board Statements.

We believe that our stakeholders deserve to have trust and confidence in the integrity of the information we provide in our annual reports. In order to achieve this, our performance reporting is subject to a system of checks to ensure that we meet the highest quality of reported information.

The Board has been fully aware of previous issues with the control environment of the company and has over the last five years worked with the executive management team to rebuild capability in this area. This work is on-going and is on track but will require further work in coming years.

Subject to this, the Board has actively engaged and challenged the assurance processes that have been adopted by the company. This covers assurance on both the financial and non-financial reporting and assessment of applicable confidence grades. The Board has, over recent years, taken action to ensure that exceptions and weaknesses in the assurance approaches have been addressed. The Board is satisfied that the approaches have appropriately identified and addressed risks to the provision of materially accurate and complete data and information. This has been discharged through the SWS Board and its relevant Committees (most notably the Audit Committee).

Detail of this activity is included below:

Financial Reporting

- The Board reviewed the assurance outputs regarding the financial performance and prospects, reported in the 2021–22 Annual Performance Report, from Deloitte relating to the statutory and regulatory accounts (and the Long-Term Viability Assessment). Deloitte presented their views to the Audit Committee on 15 June 2022.
- The Board have visibility of the high-level financial governance and controls that are in place around our financial reporting, and this is captured as part of the annual external audit, internal audit reports looking at financial controls and updates on the implementation of new accounting standards as reflected in the Schedule of Matters Reserved to the Board.
- The Board reviews the monthly KPI reports, including performance against budgets.
- The Board, via its Committees, monitors the Southern Water internal control framework and if necessary, how weaknesses are being addressed. This applies to both Financial and Non-Financial controls.
- The Board has approved updates in the Annual Report, Interim Accounts, Annual Performance Report and Data Assurance Summary that detail improvements in governance and controls, and has included specific caveats where capability has been improving.

Non-Financial Reporting

- SWS is becoming a more resilient organisation and continues to deliver a wide-ranging transformation programme. The company has been building on improvements to business monitoring and compliance processes, systems and training and reporting. These are part of a continuing programme that have been taking place since 2016, when concerns came to the attention of the SWS Board. The key focus of these programmes is on the embedment of controls across the business and reflects the fact that the company is well into its long-term programme of change.
- The Board continues to support the company to ensure it maintains the standards required by our regulators and ourselves – for example, data reporting and assurance – work is ongoing to materially improve processes and systems, underpinned by values-based ethical business practice, to ensure the mistakes of the past are not repeated.
- SWS has adopted the ‘three lines of defence’ framework for reporting governance and assurance activity. This has been in place since 2017 and has supported the continued maturity of the internal system of control and helps to assure performance information by applying multiple levels of control. The process continues to be embedded across the business, and the management focus is on the areas of highest risk. The framework is delivered and reviewed as part of the Final Assurance Plan and the Internal Audit Annual plan (both of which are signed off by the Audit Committee).
- In high-risk areas, the company has applied separation of duties in the monitoring and control of compliance, in line with the ‘three lines of defence’ model. This has been in place since 2017 and is subject to regular review from internal assurance teams and external assurance.

- Internal controls are applied and improved processes are now in place to mitigate the risk of supplying incorrect or inaccurate information in all the company's non-financial regulatory reporting. A programme of improvements continues to strengthen first and second-line assurance processes for all regulatory reporting. The improvements to reporting are being applied to new Ofwat reporting for AMP7 and build on the improvements in the last three years of reporting for the previous AMP. The next phase of control improvements will be supported by the implementation of new technology (including a new Governance Risk and Control system) that will help to systemise some of the manual improvements that have been implemented over the last four years.
- The Board and Audit Committee regularly receives and reviews information and reports on non-financial resources and performance that support the efficient delivery of services to our customers and other stakeholders.
- The Audit Committee review progress of non-financial reporting improvement plans, IAP Action plans, and the Ofwat Section 19 undertakings.
- The Board reviewed the assurance outputs regarding the non-financial performance, reported in the 2021–22 Annual Performance Report from KPMG. KPMG presented their views to the Board Audit Committee at the meeting on 15 June 2022.
- The Board, via its Audit Committee has, received an internal assurance report in March 2022, which reported Southern Water compliance with their Licence of Appointment.
- The Board, via its Committees, monitors the Southern Water internal control framework and if necessary, how weaknesses are being addressed. This applies to both Financial and Non-Financial controls.
- The Audit Committee has monitored the completion of a risk-based programme of internal assurance activities during the year, as part of a three-year rolling Internal Audit programme.

Data Assurance Summary

We have published a separate document that details the completed assurance work performed on our reported information for the 2021–22 financial year. The results, both positive and improvement areas are published in the document entitled 'Data Assurance Summary' which is available on our Southern Water website **southernwater.co.uk/our-reports**.

KG Lough

Sebastiaan Boelen
Chief Financial Officer

Keith Lough
Chair

15 July 2022

Appendix 4. Condition P – Ring-fencing Certificate – Board assurance statement

The Board is pleased to provide the following Statements:

Financial resources and facilities:

- During the past year a fund managed by Macquarie Asset Management (MAM) invested £1 billion into the Greensands group, including £530 million into Southern Water. This strengthens our balance sheet enabling us to increase investment in our network and accelerate the transformation plans we have put in place. This investment ensures we will be able to spend more than £2 billion in the next four years improving the resilience of our existing network to reduce pollution incidents and leakages.
- The Board is aware of the development of an increased investment plan and associated financing activity to support it, with a timetable focussed on September 2022 for Board approval. MAM is supportive of this.
- The Board has reviewed the going concern for at least 12 months from signing the accounts and the long-term viability assessment (LTVA) to March 2030 (in June 2022). This included the company's liquidity position, headroom against the financial covenants, credit ratings and financial risk assessment against a number of downside scenarios.
- The company obtained a waiver from its Lenders in February 2021 which allows full use of available liquidity, plus the raising of new finance, even in a Trigger Event scenario of a credit rating downgrade or a breach of a trigger debt compliance ratio. The next planned financing activity will be in anticipation of a bond maturity on 31 March 2023.
- The Board reviewed the assurance outputs regarding the financial performance and prospects, reported in the 2021–22 Annual Performance Report, from Deloitte relating to the statutory and regulatory accounts and the LTVA. Deloitte presented their views on the progress of the financial audit to the Audit Committee on 15 June 2022.
- The Board approved the plans that were presented to them in the updated SWS Business Plan (BP22) for the period up to the end of this business plan period and concluded that they are aligned to meeting the needs of our customers and stakeholders and are in line with the final determination that has been agreed with Ofwat
- The Board is confident that the BP22 delivers our statutory and regulatory obligations and allows us to demonstrate compliance with Condition P of the Licence of Appointment.
- The Board approved the BP22 including the Budget for 2022–23 in June 2022.
- The Board receives updates on the financial status of the company including cash flow forecast and monitoring. The Board also receives updates on the company's credit ratings and meetings with the credit rating agencies.
- The Board is aware of potential litigation in relation to investigations by the Environment Agency, and has approved related financial disclosures within the financial accounts.

The Board therefore confirms that the company has sufficient financial resources and facilities.

Management resources:

- The Board is focused on ensuring the company has the right organisational capability including Management skills, experience and/ or any relevant qualifications to deliver the rest of this very challenging five-year business plan over the period to March 2025.
- The Board has acknowledged that, in the past, the company failed to meet its own high expectations. The Board continues to strongly support the executive management, who have continued to work to ensure previous improvements are embedded into the way the company carries out its business (an example of this has been the regular updates the Audit Committee receives on the embedment of the Three Line Defence model).
- The Board has reviewed and made some changes to the Board governance since the MAM investment. This includes a re-fresh of the committee structure and Terms of Reference. Changes include the introduction of a new Environment, Social Governance (ESG) Committee and changes to Audit Committee to incorporate Enterprise Risk and a re-focussing of Risk Committee to become the Health and Safety and Operational Risk Committee.
- The Board have also reviewed Board reporting and oversight after the MAM investment.
- The company has evolved its management structure in the financial year, bringing in key resource at executive level to support the further development of the company. This includes making a number of key appointments at senior director level.
- The Chief Executive changed on 1 July 2022 with the previous Chief Operating Officer being appointed to the role to lead the company through the rest of this business plan delivery and the development of the next five-year business plan. The Chief Financial Officer is also changing with an interim being appointed pending a permanent replacement.

- The Risk and Compliance Director and directorate continue to act as the second line team and provide the check and challenge on the rest of the company. It delivers a risk-based programme (structured around our obligations) to ensure that the company is meeting its regulatory and statutory obligations.
- The executive management team continues to rebuild capability in the company. A range of training programmes in compliance, public health and protecting the environment were put in place and these programmes continue to develop and strengthen with key training material in these areas being delivered in 2021–22. These programmes are actively monitored to ensure they are embedded in teams across the business.
- The Board challenges the organisational capacity, capability, and culture to deliver the significant changes required and monitors progress, both directly and through the Audit Committee.
- The Board received a "Culture Dashboard" in September 2021 and March 2022 and will continue to receive these on a six-monthly basis. The Dashboard provides key metrics on the development of company culture and helps provides key information to help the Board to comment on culture change initiatives.
- The executive team have implemented the People plan and the necessary Business Plan resourcing.
- The Board also carries out reviews of its own capability through Board effectiveness reviews, which are supported by external assessments of their capability. An external assessment was undertaken in 2021–22.
- The Board also looks to ensure that its membership is diverse to ensure a diversity of perspectives. The Board's Nomination Committee has committed to review this area following the recent changes of shareholder representative which has reduced the Board's diversity.
- The ESG Committee recently undertook a deep dive on the company's ED&I initiatives.
- The Remuneration Committee is refreshing the senior incentive pay structures to attract and retain the people the company needs to succeed.

The Board therefore confirms that the company has sufficient management resources.

Systems of planning and internal control:

- SWS is working to become a more resilient organisation and continues to deliver a wide-ranging transformation programme. The company has continued to build improvements to business monitoring and compliance processes, systems and training and reporting. These are part of a continuing programme that have been taking place since 2016, when concerns came to the attention of the SWS Board. The key focus of these programmes is on the embedment of controls across the business and reflects the fact that the company is well into its long-term programme of change.
- The Board continues to support the company to ensure it maintains the standards required by our regulators and ourselves – for example, asset compliance, or data reporting and assurance – work is ongoing to materially improve processes and systems, underpinned by values-based ethical business practice, to ensure the mistakes of the past are not repeated.
- The Board has previously had visibility of the asset management approach taken by the company. The Board has regular visibility of the capital programme of delivery, via the monthly KPI Board pack.
- SWS has adopted the 'three lines of defence' framework for reporting governance and assurance activity. In relation to non-financial reporting, this has been in place since 2017 and has supported the continued maturity of the internal system of control and helps to assure performance information by applying multiple levels of control. The process continues to be embedded across the business, and management focus is on the maturing of first-line controls. The framework is delivered and reviewed as part of the Final Assurance Plan and the Internal Audit Annual plan (both of which are signed off by the Audit Committee).
- In high-risk non-financial reporting areas, the company has applied separation of duties in the monitoring and control of compliance, in line with the 'three lines of defence' model. Again, this has been in place since 2017 and is subject to regular review from second-line assurance teams and external assurance as described in the published Final Assurance Plan, as well as in the Internal Audit Plan. Internal controls are applied, and improved processes are now in place to mitigate the risk of supplying incorrect or inaccurate information in all the company's non-financial regulatory reporting.

- A programme of improvements continues to strengthen first and second-line assurance processes for all regulatory reporting. The next phase of control improvements will be supported by the implementation of new technology and process automation that will help to systemise some of the manual improvements that have been implemented over the last four years. A key focus of these improvements is on the capability of first line teams.
- The Board and Audit Committee regularly receives and reviews information and reports on non-financial performance that support the efficient delivery of services to our customers and other stakeholders.
- The Board have visibility of the high-level financial governance and controls that are in place around our financial reporting, and this is captured as part of the annual external audit, internal audit reports looking at financial controls and updates on the implementation of new accounting standards. There is a Schedule of Matters Reserved to the Board.
- The Board have also commissioned a review of the schedule of delegated authority and financial approvals
- The Board reviews the monthly KPI reports, including performance against budgets.
- The Audit Committee reviews progress of non-financial reporting improvement plans, IAP Action plans, and the Ofwat Section 19 undertakings.
- The Board reviewed the assurance outputs regarding the non-financial performance, reported in the 2021–22 Annual Performance Report from KPMG. KPMG presented their views to the Audit Committee at the meeting on 15 June 2022.
- The Board, or its Committees as appropriate, has sought to ensure that Southern Water has an effective policy framework to protect the reputation of the business and that it operates in a compliant and ethical manner. Critical policies are reviewed by the Board. The Board is aware that improvements are being enacted to improve the quality of the policies, and to ensure that they are up to date. The Board also refers to the Schedule of Matters Reserved to the Board, which outlines the Board sign off responsibilities.
- The Board are involved in the approval of key milestones on our work on Water For Life Hampshire and our submissions to RAPID.
- The Board is actively involved in supporting the development of the PR24 submission to Ofwat. The Board has a key role in the PR24 process and signed off a Board Assurance strategy in April 2022. The PR24 Board Assurance Process includes the development of oversight structures and a detailed programme of board assurance, which will cover all areas of the plan and include specific arrangements for approving and assuring the WRMP and DWMP submissions.
- The Board, via its Audit Committee, has received an internal assurance report in March 2022 (produced by the Risk and Assurance Team), which reviewed Southern Water compliance with its Licence of Appointment.
- The Board, via its Committees, monitors the Southern Water internal control framework and if necessary, how weaknesses are being addressed.
- The Board, via its Audit Committee, has received an internal assurance report in March 2022 (produced by the Risk and Assurance Team), which reviewed Southern Water compliance with its Licence of Appointment.
- The Board, via its Committees, monitors the Southern Water internal control framework and if necessary, how weaknesses are being addressed.
- The Board, via its Audit Committee, is actively involved in reviewing current gaps and the resulting preparations for the UK government proposed changes in relation to Corporate reform and internal controls over financial reporting.
- The Board has also supported the compliance training of front-line operational teams. This has been reflected in high level of uptake from teams across the company.
- The Audit Committee has monitored the completion of a risk-based programme of internal assurance activities during the year, as part of a three-year rolling Internal Audit programme.
- The Board has overall responsibility for risk management and is supported in this role by the Audit Committee (who have recently taken on the responsibility for Enterprise Risk) and the Health and Safety and Operational Risk Committee.
- The Board continues to recognise the importance of effective risk and resilience management, champion its use within decision making forums and is deeply committed to support the embedment of risk management at every level of the organisation.

- The Board recognised the need to improve SWS's approach to risk and resilience management and has provided key support and challenge on the risk management improvements being delivered by the company.
- Additional work has delivered improvements in the approach to Enterprise Risk Management, with Board approval of an updated Risk Policy and Operational Risk Policy, in addition to annual reviews of Risk Appetite and associated Risk Taxonomy. This includes specific elements that relate to compliance, regulatory and statutory obligations.
- To successfully embed risk management across Southern Water, the risk management process is supported by a governance structure that defines roles and responsibilities at each level of the company.
- The Board, via the Audit Committee and the Health and Safety and Operational Risk Committee, reviews key areas of risk for the company in regular "deep-dive reviews".
- The Board commissioned a "deep-dive" review into Health and Safety management, culture, and maturity.
- The Board also commissioned a review into Environment, Social and Governance (ESG)
- The Board has also commissioned a review of critical water and wastewater sites.
- The Board commissioned a review of the Cyber Security
- The Board has approved updates in the Annual Report, Interim Accounts, Annual Performance Report and Data Assurance Summary that detail improvements in governance and controls and has included specific caveats where capability is still improving.
- The executive team had implemented strategies that maintained service levels, despite the challenges of working with the post COVID-19 environment. This has provided firm foundations as we moved to a new way of working.

The Board has been fully aware of previous issues with the control environment of the company and has over the last five years worked with the executive to rebuild capability in this area. This work is on-going and is on track but will require further work in coming years. Subject to this, the Board therefore confirms that the company has appropriate governance policies and procedures in place to maintain an effective control environment.

Resources other than financial or management resources:

- The Board consider the culture of the company to be a key foundation for the company when it manages its business and delivers its obligations. To reflect this, the Board has appointed a Non-Executive Director with responsibility for employee engagement. In addition, the Board received an update on Culture and Ethics. The Board also receive regular written updates on the overall employee engagement position.
- The Board has continued to support the embedment of the Southern Water values. The company values developed in 2019 continue to be embedded, and the Board continues to support and sign up to the Code of Ethics. These actions, along with the establishment of a Modern Compliance Framework, have already successfully started to change the culture in Southern Water.
- The Board were presented and discussed the Code of Ethics in September 2021. The company's Speak Up procedures have been enhanced, and an annual review of Speak Up was presented to the Audit Committee in March 2022.
- The Audit Committee receives regular detailed reports on Speak Up cases and discusses progress on resolution.
- The Board received a "Culture Dashboard" in September 2021 and March 2022 and will continue to receive these on a six-monthly basis. The Dashboard provides key metrics on the development of company culture and helps provides key information to help the Board to comment on culture change initiatives.

The Board therefore confirms that the company has sufficient programmes on culture and employee engagement to support non-financial resources and facilities.

Contracting:

- The Board has reviewed the terms of a number of the key contracts that the business has put in place and has previously reviewed the procurement strategy.
- The company does have active Associated Companies, but these are used for financing purposes and do not have any operational contracts or transactions with the operating company.

The Board therefore confirms that the company has adequate contractual relationships in place and is active in its review of key contracts. The Board also confirms that whilst it does have Associated Companies in place it can confirm that these do not have any operational contracts or transactions with the operating company.

Material issues or circumstances:

- The Board has considered the following material issues or circumstances that meet our Condition P Certificate in relation to the operation of our wastewater business (as detailed in our S19 undertakings with Ofwat):
- The Board has reviewed the financial resources and facilities related to our wastewater business as part of the Execution Plan (BP22) including the budget and confirms that they are sufficient resources in relation to our wastewater operations over the next twelve months.
- The Board has previously considered the organisational structures and governance within our wastewater business and confirms that we are able to deliver services to our customers and stakeholders and meet our statutory and regulatory requirements in this area – the Board originally approved changes to company's organisational structure that took place in 2017, and included work on the separation of duties in the Wastewater Directorate and the establishment of the Risk and Compliance Directorate and the development of a "Three Lines of Defence" model of compliance. The Board is confident that these changes have been embedded in the company and are a key element of improvements and transformation of the company. These arrangements are subject to detailed external assurance as part of our S19 Undertakings to ensure they remain in place and are embedded in the way the company carries out its duties.
- The Board confirms that is aware of the material risks faced by the wastewater business and the company has undertaken appropriate investigations to ensure all significant risks are identified, together with the monitoring of key risk mitigation actions.

- The Board has considered the specific operational plans relating to our wastewater business, as part of our review of the updated Execution Plan (BP22) including the budget and confirm they are aligned to meeting the needs of our customers and stakeholders and are aligned with the final determination and Undertakings that have been agreed with Ofwat.
- The Board, via its Audit Committee, has been provided regular updates on the progress of the S19 Undertakings and has provided robust check and challenge on the process over the year.

The Board therefore confirms that they have considered the material issues facing our wastewater business (as detailed in our Section 19 undertakings with Ofwat), and that the company has sufficient financial, non-financial resources and facilities.

The Condition P ring-fencing certificate and Board assurance statements which cover a period of at least 12 months from the date of signing the accounts were approved by the Board at its meeting on 24 June 2022.

Sebastiaan Boelen
Chief Financial Officer

Keith Lough
Chair

15 July 2022

Appendix 5. Glossary of regulatory terms

Appointed business

The appointed business comprises the regulated activities of the company which are necessary for it to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991.

Arm's-length trading

Where the company treats associate companies on the same basis as external third parties.

Asset Management Plan (AMP)

A plan agreed with Ofwat on a five-yearly basis for the management of water and wastewater assets. The plan runs for a five-year period. AMP7, the seventh plan since privatisation, covers April 2020 to March 2025.

Associated company

Condition A of the Licence defines an associated company to be any group or related company. Condition F of the Licence requires all transactions between the company and its associated companies to be disclosed subject to specified materiality considerations.

C-MeX

C-MeX is Ofwat's measure of customer experience. It comprises two surveys – a survey of customers who have recently contacted their company and a survey of random members of the public in relation to their water company. These are used to calculate a score which can be compared between water companies, with rewards and penalties for the best and worst performers.

Final Determination (FD)

The conclusion of discussions on the scale and content of the Asset Management Plan for the forthcoming five-year period. It includes a determination of the allowable revenues for the period and the performance targets that must be achieved.

K factor

The annual increase, set by Ofwat, in wholesale revenues that companies in the water industry can recover from customers. The amount by which a company can increase (or must decrease) its revenues is controlled by the price limit formula CPIH + or – 'K'. CPIH is expressed as the percentage increase in the Consumer Price Index (including owner occupiers' housing costs) in the year to November before the charging year. 'K' is a number determined by Ofwat for each company, usually at a price review, for each year to reflect the revenues it needs above or below inflation in order to finance the provision of services to customers.

Licence

The Instrument of Appointment dated August 1989 under Sections 11 and 14 of the Water Act 1989 (as in effect on 1 August 1989) under which the Secretary of State for the Environment appointed Southern Water Services Limited as a water and wastewater undertaker under the Act for the areas described in the Instrument of Appointment, as modified or amended from time to time.

Non-appointed business

The non-appointed business activities of the company are activities for which the company as a water and wastewater undertaker is not a monopoly supplier (for example, the sale of laboratory services to an external organisation) or involves the optional use of an asset owned by the company (for example, the use of underground assets for cable television).

Ofwat

The name used to refer to the Water Services Regulation Authority (WSRA). The WSRA is the economic regulator of the water industry.

Outcome Delivery Incentive (ODI)

Performance Commitments with outperformance and/or underperformance payments agreed with customers and Ofwat through the periodic review process.

Performance Commitment (PC)

Performance Commitments are service targets set by Ofwat as part of the Final Determination.

Periodic review

A review conducted by Ofwat each five years for the purpose of determining price controls. Each water and wastewater undertaker submits a business plan covering the five-year period for which Ofwat will set the controls. (PR19 relates to 2020–25; PR24 will cover the period 2025–30).

Price control

A price control determines the limit on the level of charges or revenues that can be recovered from customers. As part of the price control Ofwat also determines performance targets and other related matters.

Regulatory Accounting Guidelines (RAG)

The accounting guidelines for regulatory accounts issued, and amended from time to time, by Ofwat.

Regulatory Capital Value (RCV)

The capital base used in setting price limits. The value of the appointed business that earns a return on investment. It represents the initial market value (200-day average), including debt at privatisation, plus subsequent net new capital expenditure including new obligations imposed since 1989. The capital value is calculated using the Ofwat methodology (i.e. after current cost depreciation and infrastructure renewals accrual).

Consumer Price Index (CPIH)

CPI is a measure of the change in consumer prices based on the prices of a typical basket of goods and services in the United Kingdom. The CPIH measure, includes owner occupier's housing costs. This is the principal measure of inflation used by Ofwat for regulatory purposes, including inflating allowed revenues or prices.

Totex

Total expenditure is the sum of operating expenditure and capital expenditure. It is used by Ofwat to determine the efficient level of costs as part of the periodic review process.

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