

Corporate governance

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Chairman's overview

We are committed to maintaining high standards of leadership, transparency and governance.

We have adopted our own code and have committed to comply with its letter and spirit. As the Board, we fully accept our responsibility and accountability to stakeholders for ensuring effective governance processes are in place and followed.

The Board's role is to:

- *ensure that the company's obligations to, and interests of, its stakeholders, including customers and regulators, are known and met appropriately*
- *provide effective leadership and collective responsibility for the long-term success of the company, to the benefit of its stakeholders*
- *determine overall strategic aims and direction*
- *ensure that sufficient resources are available to the Chief Executive Officer and his team to operate, manage and develop the business appropriately*
- *ensure that appropriate and effective processes and controls are in place to assess and manage risk.*

Southern Water Code of Board leadership, transparency and governance

In the Southern Water Code of Board leadership, transparency and governance, we have fully reflected the Ofwat Principles and drawn extensively on the appropriate principles of the UK Corporate Governance Code. We have committed to comply with the letter and the spirit of the principles and commitments of the Southern Water Code and the board of our parent company, Greensands Holdings (GSH), has committed to assist us. We continue to have regard to corporate governance practices and developments in other sectors and the Board has, during this year, commenced a review of its governance framework. We note that the FRC is undertaking a fundamental review of the UK Corporate Governance Code in 2017 and we will consider this, as well as recommendations from Ofwat, as part of future developments to our code.

The Southern Water Code is published on our website.

Board membership

I was appointed to the position of independent non-executive chairman of the Board on 1 March 2017 following the departure of Robert Jennings, who had served on the Board in this role through April 2014 to 28 February 2017. I was previously one of four independent non-executive directors.

During the past year our Nomination Committee was tasked to consider candidates for the Chief Executive Officer role and my appointment as Chairman. As a result of this process, Ian McAulay was appointed with effect from 1 January 2017, followed by appointment to the Board from 1 February 2017. In addition, as a result of my appointment to the role of Chairman and a vacancy for a shareholder appointed non-executive director, the Nomination Committee is undertaking a recruitment exercise to fill these vacant positions. As part of this process the Nomination Committee evaluated the skill sets of the Board. While concluding that the current skills and experience of the Board provided good coverage, knowledge and diversity, the Nomination Committee has identified the principal areas of expertise required by candidates for the current vacancies.

During 2016–17 the Board was comprised of an independent non-executive Chairman, two executive directors, (the Chief Executive Officer and Chief Financial Officer) and non-executive directors. The number of non-executive directors has changed during the year as a result of the resignation of one investor nominated director and my appointment as Chairman. At all times during the year the majority of non-executive directors have been independent. I believe that, during the year, we comprised a balanced and rounded Board, giving independent support and advice as well as providing new ideas and healthy challenge. The composition of the Board has changed during the period, with one of the shareholder directors resigning as a result of the sale of its shareholding by Future Fund, and my appointment to the role of Chairman.

The presence of the non-executive directors, only one of which is not independent, and the independent non-executive Chairman ensures that we achieve an appropriate balance of governance. The members of the Board, their biographies and descriptions of their complementary skills and extensive experience are on pages 121 to 124.

All members of the Board were and are able to allocate the necessary time to the company and its areas of business to discharge their responsibilities effectively.

Chairman

As Chairman, my role is to lead the Board in its shared responsibilities, to encourage and facilitate the contributions of its members and to ensure adherence to the governance principles and processes of the Board.

I discuss and agree agendas for Board meetings with the Chief Executive Officer and Company Secretary, although any director may sponsor an item to be included on the agenda. I have authority to act and speak for the Board between its meetings, including engaging with the Chief Executive Officer. I report to the Board, chairmen of its committees and individual directors as appropriate on decisions and actions taken between meetings of the Board. I also meet with the non-executive directors, without the executive directors present, to consider the performance of the executive directors and to provide feedback. I am continuing to increase open and constructive contact between all members of the Board, in both formal and informal meetings.

My predecessor, Robert Jennings, was also independent Chairman of the GSH board during the past year, which meets four times a year. The purpose of GSH is to act as a single-purpose entity, being the ultimate holding company for Southern Water, and provide the financing structure for the group. As a consequence, the GSH board complements and supports the aims of the Board of Southern Water for its long-term success. Taking this into consideration it was felt that his cross directorship did not undermine his independence. GSH is currently reviewing its board and governance structure and a chairman has not yet been appointed, therefore, from 1 March 2017 no independent members of our Board sit on the board of GSH.

Investor representation

Our investors comprise the Greensands Consortium, the membership of which is explained on page 96 and our website.

One investor, but not all, is directly represented on the Board and I ensure that the views of all investors can be communicated to the Board.

Senior independent non-executive director

Paul Sheffield is the senior independent non-executive director. He chairs the Health and Safety Committee and Remuneration Committee and is also a member of the Nomination Committee. He would chair Board meetings in the event that I am unable to do so for any reason and is available to discuss matters or concerns with investors as required. Paul has been a non-executive director for three years and brings with him considerable experience in construction and engineering.

Independent non-executive directors

The independent non-executive directors are valued members of the Board. As well as meeting the company's obligation in its licence to have independent non-executive directors, they bring overall independent advice, review and challenge on behalf of all stakeholders, including customers. The independent non-executive directors have been appointed for their individual external expertise and experience in specific areas, such as customer service, the environment, operations, procurement, capital project delivery and finance, and for the range of their experience of general corporate management. They would normally meet without the Chairman at least once a year and appraise the Chairman's performance annually. However, as a result of my appointment from 1 March 2017, this appraisal will take place as part of the Board evaluation 2017–18.

The Board considers the independent non-executive directors to have been, and to continue to be, independent in character and judgment and persons of standing with relevant experience, collectively having connections with, and knowledge of, the company's area and understanding of the interests of our customers and how these can be respected and protected.

The standard terms and conditions of the independent non-executive directors are published on our website.

Shareholder representative non-executive directors

There is currently one non-executive director, who is nominated to the Board by one of our three major investors. He brings the extensive knowledge, skills and resources of his nominating investors and employers as well as his own personal skills, experience and knowledge of businesses and business sectors similar to our own. On our Board, he has all the duties, obligations and rights of a director of Southern Water and acts in the best interests of the company. He does not receive any remuneration from Southern Water. The Nomination Committee is currently leading the process for the appointment of a second non-executive director who will represent the views of other investors at the Board.

Chief Executive Officer

The Chief Executive Officer, Ian McAulay, is a member of the Board and has all the responsibilities of a director of the company. In his executive role, responsibility has been delegated to him to achieve the company's strategy. He is empowered to take all decisions and actions that further the company's strategy and which, in his judgement, are reasonable within the Chief Executive Officer's limits set out in the company's internal controls. The non-executive directors, led by the Chairman, appraise his performance annually.

Ian was appointed as Chief Executive following the resignation of Matthew Wright after nearly six years' service.

Chief Financial Officer

The Chief Financial Officer, William Lambe, is a member of the Board with all the responsibilities of a director of the company. In his executive role and reporting to Ian McAulay, he has the responsibility to manage the company's financial affairs and assist the Chief Executive Officer in the delivery of the company's strategy. His executive performance is reviewed annually by the Chief Executive Officer.

Executive Leadership Team

Reporting to Ian McAulay, the Executive Leadership Team supports him in driving the implementation of strategy in the company. The team is committed to do this in a responsible way that takes account of our commitment to our customers, the environment, the communities in which we live and work and all our other stakeholders and with a view towards the long-term responsible stewardship of the business.

Role of the Company Secretary

All directors have access to the advice and services of the Company Secretary, Joanne Statton, and the Company Secretariat team. The Company Secretary is responsible for ensuring that the Board operates in accordance with the governance framework it has adopted and that there are good information flows to the Board and its committees and between senior executives and the non-executive directors. The appointment and removal of the Company Secretary is reserved to the Board.

Director induction, training and development

On appointment to the Board, a director will discuss and agree induction coverage and then an appropriate comprehensive and individualised induction pack is provided, which will include information on the company and holding group structure, the regulatory framework of our business, customer service and the operation of assets, strategic plans, financial reports, business plans and our governance framework. This and further relevant information, is summarised in the directors' handbook.

Meetings are arranged with members of the Executive Leadership Team and with external advisers, who provide support to the relevant Board committees the directors may serve on, as well as visits to operational and office sites.

Directors received updates and presentations through the year on matters such as Ofwat's Water 2020 programme, market reform, the company's environmental programme and water resource management planning. They also have access to professional development provided by external bodies and our specialist advisers.

Board evaluation

In accordance with the Southern Water Code, I undertook the process of Board evaluation and effectiveness. The results of the evaluation were presented to the Board at its April meeting and I have undertaken evaluations of individual non-executive directors' performance. Overall, the Board is considered to be working well, while recognising the significant change of the company with the appointment of a new Chief Executive Officer and Chairman at the beginning of 2017.

Board operation

There is good understanding of the principles and processes in place regarding the tasks and activities of the Board, the authority delegated to the Chief Executive Officer and the relationship between us.

The following matters are routinely determined by the Board:

- *Business strategy*
- *Financing strategy*
- *Business plans*
- *Approval of annual budgets*
- *Fixing of principal charges and charges schemes*
- *Approval of financial statements*
- *Key regulatory submissions (including, but not limited to, market reform, price review submissions to Ofwat, Interim Determination of K applications, Risk and Compliance Statement and Regulatory Financial Statements)*
- *Key customer and stakeholder publications (including, but not limited to, the Annual Report)*
- *Entering into significant contracts or commitments (including capital schemes over £5 million and disposals over £1 million)*
- *Approval of dividends*
- *Commencing into new businesses*
- *Appointment or removal of auditor*
- *Appointment and remuneration of independent non-executive directors*
- *Appointment or removal of the Company Secretary*
- *Amendment, qualification, addition to or removal from the above.*

The Shareholders' Agreement of our parent company, Greensands Holdings, reserves certain matters by exception to the Board and shareholders of that company. A list of these matters is published on our website.

During the year 2016–17 the Greensands Holdings board and shareholders approved:

- *the decision to dispose of the non-household retail business with effect from 1 April 2017*
- *the bonus issue of 735,000,000 ordinary shares out of the revaluation reserve followed by a capital reduction exercise, creating £735.0 million of distributable reserves.*

Good governance requires a clear division of responsibilities between the Chairman and Chief Executive Officer. A statement of these responsibilities is published on our website.

Board meetings

The Board held 10 scheduled monthly meetings during the year. The agenda and papers are sent to Board members in advance of each meeting. The monthly financial, performance and economic regulation reports are also distributed for the other months when there is no scheduled meeting (August and December). The Board primarily holds its meetings at its principal office in Worthing with at least two meetings each year held in London to facilitate meetings with investors.

In addition to the scheduled Board meetings, the Board and the company's Executive Leadership Team met in September, to discuss strategic considerations of the company, including Water 2020, market reform, innovation and customer experience. Additionally, the Board met separately to discuss the bonus issue of share capital and capital reduction exercise, disposal of the non-household business and matters relating to compliance.

Directors have access to the advice and services of the Company Secretary and are able to take appropriate independent professional advice for the performance of their duties. Where a director has a concern over any unresolved matter, he/she is entitled to require the Company Secretary to record that concern in the minutes of a meeting. Should the director later resign over the issue, I, as Chairman, would bring it to the attention of the Board.

Attendance at scheduled monthly Board meetings in 2016–17

Bill Tame	9/10
Robert Jennings (resigned 28 February 2017)	9/9
Ian McAulay (appointed 1 February 2017)	2/2
Matthew Wright (resigned 31 December 2016)	7/7
William Lambe (appointed 3 May 2016)	9/9
Paul Sheffield	10/10
Rosemary Boot	9/10
Lisa Harrington	8/10
Mark Walters	9/10
Bronte Somes (resigned 19 May 2016)	1/1

Note – Attendance includes attendance in person and by phone.

Board committees

We have established standing committees of the Board with specific responsibilities. They assist by monitoring and reviewing performance and issues in the areas within their respective scopes and by advising and making recommendations to the Board. Specific responsibilities have been delegated to those committees.

The standing committees of the Board that met in 2016–17 are:

- *Audit and Risk Review*
- *Health and Safety*
- *Remuneration*
- *Nomination*

Each committee has written terms of reference to exercise oversight on behalf of the Board and provide advice in its remit area. These terms of reference are published on our website.

Other committees are constituted if and when required for specific matters.

Remuneration

The directors' remuneration report is set out on pages 129 to 138.

Interests

No director declared a material interest at any time during the year in any contract of significance with the company.

Conflicts of interests

Conflicts or potential conflicts are governed by the Companies Act 2006. The Board does not have power to authorise conflicts. If a conflict should arise, the conflicted director takes no part in discussions or voting on that issue.

Annual General Meeting

Southern Water Services Limited is a private company with single corporate ownership and is not required to hold an Annual General Meeting.

Conclusions

The Board and I remain committed to the company continuing to follow good corporate governance to underpin business strategies and plans which ensure that its obligations to, and interests of, its stakeholders, in particular customers and regulators, are known and met appropriately.

Bill Tame
Chairman

Board of directors

The day-to-day running of Southern Water is led by Ian McAulay, Chief Executive Officer, and the Executive Leadership Team, which reports to our Board of Directors.

Bill Tame

Chairman



Bill Tame joined the Board in January 2015 and was appointed Chairman on 1 March 2017.

A chartered accountant by training, Bill held a number of senior finance roles at Courtaulds plc, the UK FTSE 100 chemicals company, both in the UK and overseas,

operating as chief financial officer in Europe, based in France and then as finance director in Asia Pacific, based in Singapore.

He subsequently worked as finance director for Scapa Group plc before joining the board of Babcock International Group plc in 2002 as group finance director, a role he held during Babcock's development from a small cap company to its position as a member of the FTSE 100. Following the acquisition by Babcock of the international aviation services business, Avincis, in 2014, Bill assumed the role of chief executive officer of Babcock's Global Growth & Operations with responsibility for the integration, business development and operations of its international businesses.

From 2006 he was senior independent director and chairman of the audit committee of Carclo plc, a quoted small cap company, before joining Southern Water Services Limited as a non-executive director and Chairman of the Audit and Risk Review Committee in 2015.

Ian McAulay

Chief Executive Officer



Ian joined Southern Water as CEO in January 2017 and was appointed to the Board from 1 February. Ian has more than 30 years of global water and environmental experience and a significant record of achievement operating in both publicly quoted FTSE 100/250 companies

and privately held enterprises.

Ian holds an honours degree in Civil and Environmental Engineering and is a Chartered Member of the ICE, CIWEM.

Throughout his career he has managed major utility, construction and consulting businesses in the UK, Belgium, India and the USA. He has enhanced this practical experience with professional executive education, most notably at Harvard Business School.

He has extensive experience in the UK regulated utility, construction and environmental services sectors, holding board positions across a broad range of commercial and statutory organisations. In his previous role he served as an executive director of the Pennon Group plc and chief executive of its subsidiary company, Viridor, one of the largest renewable energy and recycling companies in the UK.

In a non-executive capacity, he serves as an independently appointed member of Greater Manchester Authorities Low Carbon Hub Board and Scottish Government's 2020 Climate Change Board. He has also provided expert input to Government Review Groups and Industry Partnerships with particular emphasis on the UK skills agenda and development of future smarter regulation and environmental policy.

William Lambe
Chief Financial Officer



William joined Southern Water in May 2016 from Thames Water, where he held the position of finance director for the Thames Tideway Tunnel.

William has a wealth of financial experience in the UK and overseas and has worked for companies including, KPMG, BG

Group plc, Wolseley plc and Thames Water.

William is a member of the Institute of Chartered Accountants England and Wales.

Paul Sheffield
Senior independent
non-executive director



Paul Sheffield joined the Board in June 2014.

In his executive career, he spent over 32 years with Kier Group plc – the construction, services and property group – serving as its chief executive officer between 2010 and 2014. Between 2014 and 2017 he headed up the

construction operations for the European and Middle Eastern business for Laing O'Rourke Services, delivering some of the biggest capital projects under way in the region today.

Graduating as a Civil Engineer in 1983, Paul spent 15 years working on major capital projects around the world and has over 19 years of board level experience, where he has gained significant exposure and experience of strategy, productivity and efficiency – key facets of any successful organisation.

Rosemary Boot
Independent non-executive director



Rosemary Boot joined the Board in March 2015.

In March 2017 she was appointed as a non-executive director of Impact Healthcare REIT plc, a UK care home real estate investment trust that recently undertook a £160 million IPO and listed on the

London Stock Exchange.

Previously Rosemary was the chief financial officer of Future Cities Catapult, one of a network of technology and innovation centres established by the UK Government. She has also worked at Circle Housing Group and was involved in setting up the government-owned Low Carbon Contracts Company and Electricity Settlements Company.

From 2001 to 2011 she was group finance director of the Carbon Trust, the independent company set up in 2001 to work with business and the public sector to accelerate the move to a sustainable, low carbon economy. Prior to that, she worked for 16 years as an investment banker, primarily advising large listed UK companies on mergers and acquisitions.

Rosemary is also a Governor of the Conservatoire for Dance and Drama, the higher education institution for the performing arts, and a Trustee of Green Alliance, the environmental think tank.

Lisa Harrington
Independent non-executive director



Appointed in April 2015, Lisa has a real passion for customers and a strong track record of delivering customer experience improvement in a variety of transformation and operational roles.

Up to May 2017, Lisa was the chief customer officer of British Telecom.

Before BT, Lisa spent 11 years with Accenture, specialising in customer service consulting and delivering big transformation projects for companies such as Microsoft, Compaq, Vodafone and Sainsbury's. She also served as a non-executive director for the NHS West London Mental Health Trust.

When she is not working, she enjoys spending time with her young family.

Joanne Statton
Company Secretary



A qualified solicitor, Joanne has worked for Southern Water since 1997.

She became Company Secretary of both Southern Water and the Greensands companies in 2015, supporting and advising both boards and businesses.

Mark Walters
Non-executive director



Mark Walters joined the Board in March 2014 having previously held shareholder representative positions within the wider Southern Water group over the past five years.

A seasoned investment professional, he is an executive director

and asset manager with the JP Morgan Infrastructure Investments Group, based in London, and is responsible for principle investment activity across Europe.

Mark holds board appointments across a number of JP Morgan's utility investments, including Electricity North West and Zephyr Investments Ltd, and is actively engaged in the strategic oversight and development of these businesses.

Before joining JP Morgan, Mark held investment and advisory positions at Macquarie Bank, Deloitte and Arthur Andersen, where he started his career. Mark is a Chartered Accountant and a fellow of the ICAEW.

Other Board members who served in 2016–17 were:

Robert Jennings
Chairman

(resigned 28 February 2017)

Robert Jennings joined the Board in July 2012 as an independent non-executive director and was appointed Chairman in April 2014.

Matthew Wright
Chief Executive Officer

(resigned 31 December 2016)

Matthew Wright joined the Board in February 2011 and served as Chief Executive Officer until his resignation.

Bronte Somes
Non-executive director

Bronte Somes joined the Board in April 2015 and served as a non-executive director until her resignation on 19 May 2016. With effect from 20 July 2016, Bronte was appointed as a director of our parent company Greensands Holdings.

Executive Leadership Team

Reporting to Ian McAulay, the Executive Leadership Team in 2016–17 consisted of:

William Lambe
Chief Financial Officer

(from 3 May 2016)

Philip Barker
Director of Operations

Chris Maloney
Director of Transformation and People

Simon Oates
Director of Strategy

(to September 2016)

and

Chief Customer Officer
(from September 2016)

Richard Price
Director of Engineering and Construction

Audit and Risk Review Committee

This report describes the role of the Audit and Risk Review Committee (ARRC) and the work it has undertaken during the year.

The ARRC was chaired by Bill Tame until 28 February 2017 when he became Chairman of the company and Rosemary Boot was appointed as the Interim Chairman of the committee from 1 March 2017. The other members of the ARRC are Lisa Harrington, Mark Walters and Paul Sheffield (appointed 1 March 2017), whose experience and background are set out on pages 121 to 124.

The members of the committee receive updates on financial reporting, risk, internal audit and the regulatory framework in various forms throughout the year. The Chairman of the Board, Chief Executive Officer, the Chief Financial Officer and the Head of Audit and Risk are invited to all meetings and are usually in attendance. In addition, key members of the finance team and the external auditor are invited to the ARRC meetings, excluding the annual risk review. Other members of senior management are also invited to attend when necessary or appropriate. The ARRC has access to the services of the Head of Audit and Risk, the Company Secretary and external professional advisers to assist it in performing its duties.

The ARRC met four times in 2016–17 and its work focused on the following key areas:

- *Financial statements*
- *Internal controls*
- *Corporate governance matters*
- *Internal audit*
- *Areas of risk*
- *Oversight of internal and external audit*
- *Regulatory reporting obligations*
- *Annual risk review.*

Audit and Risk Review Committee attendance in 2016–17

Bill Tame (to 28 February 2017)	3/3
Mark Walters	4/4
Rosemary Boot (appointed 1 March 2017)	1/1
Lisa Harrington	3/4
Paul Sheffield (appointed 1 March 2017)	1/1

Note – Attendance includes attendance in person and by phone.

The terms of reference of the ARRC are published on our website.

Financial statements

The ARRC received and reviewed the financial statements, including the key areas of judgment and estimation uncertainty set out in note 2 and the external audit report from Deloitte regarding the year-end financial statements, considering any items of significant judgment that have been made and general IT controls, before making a recommendation to the Board to approve the annual results. There were no significant issues to be addressed.

The ARRC also reviewed and discussed the capital reduction exercise that was completed during January 2017.

Our Ofwat Performance Commitments

For the five-year business plan, we appoint a certifier to independently confirm that we have a robust system of internal controls in place for performance reporting and that such information in the Annual Report fairly represents the company's progress and delivery of its promises. The certifier attends the ARRC and reports formally its results of its assurance. For the current year, there were no significant issues to report.

Internal controls

The ARRC receives regular reports from Internal Audit in respect of its work on internal controls and reviews management letters received from the external auditor. In addition, our risk management processes and arrangements are also monitored and reviewed together with the ongoing development of the compliance and assurance processes in respect of the key risks.

The ARRC also receives a regular report of incidents of fraud or bribery, including the actions taken to investigate and respond to the incidents and information on potential incidents of wrong-doing under investigation. There were no material incidents during the year. During the year the company reviewed and refreshed its whistleblowing policy. A new Speak-Up campaign was launched in January 2017 and forms part of a wider cultural transformation programme.

Further details of our internal control framework, including the main features of our internal control and risk management systems, can be found in the Annual Report on page 101.

Oversight of internal audit and external audit

The ARRC is responsible for overseeing the work of the Internal Audit function and also for managing the relationship with the external auditor. It reviews the performance of the internal and external auditors annually to ensure that they are effective and recommends to the Board whether the external auditor should be reappointed.

The ARRC also holds discussions with both the internal and external auditors in the absence of management.

Internal audit

The Head of Audit and Risk and the team report on a day-to-day basis to management on the effectiveness of the company's systems of internal controls and the adequacy of these systems to manage business risk and to safeguard the company's assets and resources. This work is reported to the ARRC on a regular basis and is a key element of the assurance that the ARRC receives on the risks and controls in the company.

The ARRC reviews, at least annually, the level of resources and the budget of the Internal Audit function. The Head of Audit and Risk is free to raise any issues with the ARRC or its Chairman at any time during the year.

Risk

While the Board is ultimately accountable for ensuring risks are managed effectively across Southern Water and for maintaining robust systems of risk management and internal control, the ARRC is responsible for the robust assessment of the principal risks facing the company, monitoring its risk management and internal control systems and testing its effectiveness. The Chairman of the ARRC reports to the Board those matters reviewed and discussed by the Committee at its previous meeting.

In addition to monitoring individual risks, the ARRC, on behalf of the Board, also undertakes ongoing performance monitoring of the systems of risk management and internal control to ensure they are effective and performing as expected.

The ARRC is responsible for overseeing and challenging the effectiveness of Southern Water's approach to risk management. Key responsibilities include:

- *ensuring the Board receives appropriate assurance that the systems of risk management and internal control are operating effectively, and that all significant failings and weaknesses and principal risks have suitable management activities in place to rectify and/or remain within defined risk appetite*
- *endorsing an internal audit plan that is informed by principal risk exposures, including overseeing targeted reviews of key risk and control areas*
- *maintaining an assurance landscape that has integrity, independence and reliability.*

A risk update report is issued to, and reviewed by, the ARRC four times a year, including one meeting that focuses extensively on risk. This meeting occurred on 26 September 2016 and comprised a high level review of all risks on the corporate dashboard and their movements compared to prior quarters, as well as detailed reviews of risks of key strategic focus. The Chairman of the ARRC provided a report to the Board of the review undertaken.

External auditor

Deloitte LLP was appointed our auditor in 2011 following a tendering process. The ARRC considers the auditor's effectiveness each year and would report to the Board any concerns over the auditor's continuing appointment.

The ARRC reviews annually information provided by the external auditor confirming its independence and objectivity within the context of applicable regulatory requirements and professional standards, including any non-audit work. Under the Southern Water Code of Board leadership, transparency and governance, the external audit contract will be put to tender at least every 10 years. We would also initiate a tender process if there were any concerns about the quality of the audit or the independence and objectivity of the auditor. There are no contractual obligations that act to restrict the Board's choice of external auditor.

All audit related and non-audit fees are subject to a formal approval process before engagement. Details of the amounts paid to Deloitte for these services are provided in note 5 to the financial statements.

Health and Safety Committee

The Health and Safety Committee (H&SC) is responsible for reviewing and advising on our health and safety policy and the implementation of, and compliance with, agreed policies, applicable guidance and standards. The H&SC reviews incident and accident prevention performance and policies and any other matters assigned by the Board.

During the year the H&SC looked in depth at the company's contractor performance and the company's progress on wellbeing. The committee held its November meeting at the company's Woolston Wastewater Treatment Works, the location having been chosen so that the committee could see first-hand an active construction site.

The members of the H&SC are Paul Sheffield (Chairman of the committee), Ian McAulay (from 1 February 2017), Matthew Wright (to 31 December 2016), Rosemary Boot and Mark Walters.

The H&SC met on three occasions in 2016–17.

Health and Safety Committee attendance in 2016–17

Paul Sheffield	3/3
Rosemary Boot	3/3
Matthew Wright (to 31 December 2016)	1/2
Ian McAulay (from 1 February 2017)	1/1
Mark Walters	3/3

Note – Attendance includes attendance in person and by phone.

The terms of reference of the H&SC are published on our website.

Nomination Committee

The Nomination Committee is responsible for reviewing the structure, size and composition of the Board and evaluating the balance of independence, skills, experience, knowledge and diversity.

It prepares descriptions of roles, specifies the capabilities required and leads the process for identifying and nominating candidates for the approval of the Board.

During the year the Nomination Committee met to discuss the appointment of the Chief Executive Officer, Ian McAulay and the Chairman, Bill Tame. When the committee considered the appointment of the Chairman, Bill Tame left the meeting and took no part in the discussions. The committee is currently considering candidates for appointment to non-executive vacancies on the Board, supported by The Zygus Partnership.

The members of the Nomination Committee are Bill Tame (Chairman from 1 March 2017) Robert Jennings (Chairman to 28 February 2017), Paul Sheffield (deputy chairman) and all other non-executive directors.

The Nomination Committee met on three occasions in 2016–17.

Nomination Committee attendance in 2016–17

Bill Tame	3/3
Paul Sheffield	3/3
Rosemary Boot	3/3
Robert Jennings (resigned 28 February 2017)	1/1
Lisa Harrington	2/3
Mark Walters	3/3

Note – Attendance includes attendance in person and by phone.

In addition, the members of the Nomination Committee met as required during the year to discuss the appointments to the Board.

The terms of reference of the Nomination Committee are published on our website.

Director's Remuneration Report

This report details the activities of the Remuneration Committee for the period to 31 March 2017.

It sets out the remuneration policy and remuneration details for the executive and non-executive directors of the company. It has been prepared in accordance with our Code, the guidance issued by Ofwat in Regulatory Accounts Guidance (RAG) 3.09 and, where relevant for a non-listed company, has taken into account the requirements of the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013.

Chairman's annual statement

It has been another year of driving performance improvement, aligning our employees to deliver the outcomes and expectations of our customers and shareholders. Our remuneration strategy was reviewed in February 2017 and a number of improvements were agreed for 2017–18, including the introduction of a new incentive plan.

We believe our policy to align employee pay with the interests of customers and shareholders while keeping total pay levels competitive with our sector and regional competitors meets our stakeholders' needs.

We recognise that much has changed in the past three years. We have revisited our remuneration philosophy, reviewed our remuneration strategy from the top down and listened to views from shareholders, the government and regulators. The resulting changes to our directors' remuneration policy are outlined on page 137. We have also managed significant internal change – the transition to a new Chairman and Chief Executive plus changes in leadership in Customer Engagement, Strategy and Regulation and Transformation and People. We also recognise the significant challenges that our industry faces, as outlined in our Chief Executive's summary on page 18 to 22. In light of this, it is right to be prudent on pay levels. We have only increased base pay compensation by 2.2% this year and have awarded a lower bonus payment than in the previous year.

Our remuneration philosophy

In 2016, the committee carried out a fundamental review of our remuneration philosophy and the resulting pay structures. We continue to believe in our current approach, where the remuneration policy for our executive directors is aligned with that for other employees. Remuneration is clearly aligned to the performance of the company and the value delivered for our customers and shareholders. Long-term thinking is core to Southern Water as our success depends on providing our customers with resilient and sustainable services while ensuring our shareholders meet their long-term financial goals. Our philosophy is to reward value creation and recognise appropriately employees who do the right thing, delivering good outcomes for our customers, investors and shareholders.

We compete for talent in both UK and regional marketplaces, with employees primarily in Kent, Sussex, Hampshire and the Isle of Wight. Our key competitors are located throughout the UK and many of the skills and capabilities we compete for are within the utilities sector. It is against this backdrop, and also our proximity to the highly competitive London markets, that we determine both our pay structures and levels of pay, to ensure that we are able to attract, motivate, reward and retain the best people.

We have also been very mindful of the wide range that exists in all organisations between employees' average pay and executive pay. In recognising our executive structure we have been keen to ensure that we hold executive pay, benefits and retirement packages at the lower end of the FTSE 250 comparator range while creating a competitive package for most employees.

We believe in a structured approach to assessing performance and determining annual bonus awards, which is outcomes based, with a strong element related to how the outcomes are achieved. For the executive directors, this includes taking a balanced approach to encourage the creation of sustainable results and ensuring that a link exists between customers'/shareholders' and employees' interests. This requires growing the business profitably and sustainably, while retaining

and developing our talented people who are key to organisational stability and long-term success. We look to appropriately reward all employees who adhere to the company's values – everyone matters, customers first, local pride, succeeding together, taking ownership and always improving – as well as demonstrating the behaviours we expect in a customer-centric culture. Our discretionary approach also ensures we assess performance on the management of risks and adherence to compliance controls. Our remuneration philosophy supports our long-term approach by deferring a significant part of variable remuneration, which provides clear alignment with the long-term interests of customers and shareholders, through awards under the Long-Term Incentive Plan (LTIP).

The Remuneration Committee's assessment of overall company performance resulted in an annual bonus pool for 2016–17 which is equivalent to 59% of the total potential. Awards from this pool were made based on an assessment of the individual performance during the year of each participant in the scheme.

Remuneration in 2017–18

With effect from 1 April 2017, the committee implemented a new incentive scheme, the Bonus Banking Plan (BBP), which incorporates the existing annual and long-term bonus schemes. This was primarily to incentivise our executive directors to deliver the ambitious AMP6 Business Plan and to ensure the focus remains on delivering improving customer service and shareholder value. It is a perpetual plan and each year's award will be added to a 'bonus bank' with a pay out from the bank, equivalent to 50% of the carrying balance, being made in the year subject to performance. The committee will review the performance metrics each year to ensure that they best reflect the company's priorities. Malus and claw-back entitlements have also been included in the scheme.

The 2018 Long-Term Incentive Plan will continue to operate, until its original vesting date of 31 March 2018.



Paul Sheffield

27 June 2017

Remuneration Committee

The Remuneration Committee (RemCom) is a committee of the Board of Southern Water Services Limited (SWS). The RemCom has responsibility for setting remuneration policy and structure for the executive directors and senior management. It is also responsible for setting the remuneration of the Chairman. The RemCom has defined terms of reference, which are published on our website.

Committee membership

We recognise that the independent non-executive directors have an important role to play in determining and challenging remuneration policy and practice. In order to reflect this, the independent non-executive directors represent a majority on the committee.

The RemCom is chaired by senior independent non-executive director Paul Sheffield. The other members are Robert Jennings (to 28 February 2017), Bill Tame, Rosemary Boot, Lisa Harrington, Mark Walters and Bronte Somes (to 19 May 2016).

Only RemCom members are entitled to attend meetings, but the Director of Transformation and People and the Chief Executive Officer, Ian McAulay, attend by invitation. The Director of Transformation and People acts as secretary to the RemCom on behalf of the Company Secretary.

No attendee participates in discussions regarding their own remuneration.

Details of the attendance during 2016–17 are shown in the table below:

Remuneration Committee attendance in 2016–17	
Paul Sheffield	4/4
Bill Tame	4/4
Lisa Harrington	3/4
Bronte Somes (resigned 19 May 2016)	1/1
Robert Jennings (resigned 28 February 2017)	3/3
Rosemary Boot	4/4
Mark Walters	4/4

Note – Attendance includes attendance in person and by telephone.

How the Remuneration Committee sets the remuneration policy

The primary objective of our remuneration policy is to ensure that competitive reward packages are offered that will attract, retain and motivate talented and experienced senior executives to run the business effectively and to promote the success of SWS.

Within these arrangements, a significant proportion of reward is based on performance against demanding targets. These targets are set by the RemCom based on key strategic priorities benefiting customers, investors and other stakeholders and are consistent with a Board-approved level of risk.

The overall aim is that executive directors' remuneration should be market-competitive relative to other comparable companies, with a significant proportion being performance related. The performance-related element is only paid out if stretching short-term and long-term targets are achieved that benefit both customers and shareholders. In setting the remuneration policy for executive directors, the RemCom takes into account the remuneration practices found in other UK companies of a similar size or operating in the same sector. It also ensures that the remuneration arrangements for the executive directors are appropriate when compared with those for other senior executives and the wider workforce.

In particular, the RemCom is kept informed on a regular basis of:

- *the level of salary increase for the general employee population*
- *company-wide benefit provision and any proposed changes*
- *overall spend on management bonus arrangements.*

An investor representative non-executive director sits on the RemCom and is closely involved in setting remuneration levels, monitoring the performance of the executive directors, agreeing payments and approving any changes to reward packages. This involvement ensures that shareholders play a key part in shaping remuneration policy and decisions. Along with the independent non-executive directors they ensure that the link between pay and performance is closely managed.

To ensure that our remuneration practices remain competitive, the RemCom periodically calls upon experienced specialist consultants. The RemCom last received advice regarding overall remuneration in 2014–15 from Towers Watson (a leading global professional services company) and intends to undertake further reviews every three years. A full review is planned for 2017–18. During 2016–17, PricewaterhouseCoopers have been engaged to undertake a review of the design of the Long-Term Incentive Plan and bonus scheme with the intention of implementing a 'bonus banking' plan from 1 April 2017.

Directors' pay and standards of performance

As required by the Water Act 2003 and Regulatory Accounting Guidance from Ofwat, additional information is given below regarding the remuneration of the directors of SWS.

Executive directors who served during the 2016–17 year are shown below:

Ian McAulay

Chief Executive Officer (CEO)
– appointed 1 January 2017 (appointed to the Board 1 February)

Matthew Wright

Chief Executive Officer (CEO)
– resigned 31 December 2016

William Lambe

Chief Financial Officer (CFO)
– appointed 3 May 2016

Details are given on pages 133 to 136 of the remuneration policy for the directors of SWS and the amounts paid to them in the year ended 31 March 2017.

Matthew Wright resigned from the business on 31 December 2016 and we appointed Ian McAulay to the role of Chief Executive Officer with effect from 1 January 2017.

Remuneration policy

Purpose

The remuneration policy of SWS applies to all its employees. The Board of Directors has adopted the remuneration policy at the recommendation of the Remuneration Committee. The policy applies to remuneration earned from 1 April 2016.

The policy reflects the Board's objectives for good corporate governance, high quality of service to all our customers as well as sustained and long-term value creation for shareholders by eliminating waste from our processes and focusing on efficiency. In addition, it ensures that:

- *SWS is able to attract, develop and retain high-performing and motivated employees in a competitive market*
- *employees are offered a competitive and market median-aligned remuneration package which balances the fixed and variable remuneration components according to job role*
- *employees feel encouraged to create sustainable results and that a link exists between shareholders/customers and employees' interests.*

The policy focuses on ensuring sound and effective risk management through:

- *a stringent governance structure for setting goals and communicating these goals to employees*
- *alignment with our business strategy, values, key priorities and long-term goals*
- *alignment with the principle of protection of customers and investors ensuring prevention of conflict of interests.*

Remuneration components

At an annual performance appraisal interview, individual employees and managers evaluate and document performance in the past year and set new goals. The appraisal results in a decision regarding any adjustments required to the employee's fixed salary or on annual performance-based pay. The various remuneration components are combined to ensure an appropriate and balanced remuneration package.

The five remuneration components are:

- *Fixed remuneration (including fixed supplements)*
- *Performance-based remuneration (variable percentage of salary)*
- *Pension schemes, where applicable*
- *Other benefits in kind*
- *Severance payment, where applicable.*

The fixed remuneration is determined on the basis of the role and position of the individual employee, including professional experience, responsibility, job complexity and local market conditions.

The performance-based remuneration motivates and rewards high performers who significantly contribute to sustainable results, perform according to set expectations for the individual in question, strengthen long-term customer relations and generate income and shareholder value.

The Board of Directors has determined a maximum percentage of performance-based remuneration relative to the fixed remuneration for the executive management positions. This percentage varies through the other management levels of the organisation according to the type of position held by the employee and the business directorate in which they are employed. The general maximum limit on variable remuneration remains at 70% of fixed salary excluding any pension allowance. The only exceptions for 2016–17 are the CEO (100%) and the CFO (80%). Performance-based remuneration is disbursed as a cash bonus. Executive directors are covered by four times salary death in service benefit within their contract of employment.

The defined benefit pension scheme, which was closed to new entrants on 1 April 2005, guarantees employees a four times salary cover for death in service and pension payment on retirement after the age of 55. In general, employees are covered by the defined benefits pension scheme or through the defined contribution plans with a pension insurance company. The death in service cover for the defined contribution scheme is two times salary. The pension contributions of employees subject to collective bargaining agreements are regulated by the collective agreement.

Other benefits are awarded on the basis of individual employment contracts and local market practice.

Severance payments are payable in accordance with relevant legislation and applicable collective agreements. Severance payments may include variable remuneration, pension or other benefits on a discretionary basis.

The design of the total remuneration package for the executive directors ensures that a substantial proportion of the maximum opportunity is dependent on performance. Based on the value of the 2015–18 Long-Term Incentive Plan award and achievement of stretch performance against targets and personal objectives for the annual bonus, the total annual remuneration charged to the company is weighted at around 60% performance-related and 40% non-performance-related for the CEO and 55% performance-related and 45% non-performance-related for the CFO.

The table on page 135 summarises the elements of our executive directors' remuneration package and our policy for each item.

Element of remuneration	Purpose and link to strategy	Policy and approach	Opportunity 2016–17	Change of policy from 2015–16
Base salary	Takes into account experience and personal contribution to our strategy and performance. Attracts and retains executives of the quality required to deliver our strategy.	<ul style="list-style-type: none"> The base salary is a fixed figure and does not vary in relation to business or individual performance. Reviewed annually with changes effective from 1 July if applicable. Consideration given to individual and company performance. General pay increases to all employees taken into consideration. Aim to pay within a mid-market range, but may pay higher salaries to attract and retain executives of the right calibre or for out-performance by the individual or company. Referenced against UK companies of a similar size, utility companies and other water companies. 	Base salary increases are applied in line with the annual review.	No
Annual incentive scheme (Bonus)	Drives and rewards performance against personal objectives and selected customer, operational and financial KPIs, which are directly linked to business strategy.	<ul style="list-style-type: none"> The performance measures included within the annual bonus scheme are selected to ensure that we are focused on our strategic objectives. The balance and nature of the objectives is reviewed annually. A 'bonus pool' is created at a corporate level based on the achievement of the company against these objectives and any individual payment is based on personal performance. The KPIs for 2016–17 are shown on page 94. The threshold, mid-point and stretch targets are established annually by the RemCom, making sure they are sufficiently stretching while also recognising the nature and risk profile of the company. Where applicable, between 60% and 80% of the bonus pool is created for achieving the mid-point target and 100% for achieving the stretch target. RemCom has discretion to amend or withdraw payments based on the consideration of other factors which could significantly affect business performance. From 2017–18 the annual incentive scheme will be replaced by the BBP detailed on page 138. 	Maximum percentage of salary – shown in table on page 138.	No
Long-Term Incentive Plan (LTIP)	Aligns interests of executives, customers and shareholders.	<ul style="list-style-type: none"> The current scheme was introduced on 1 April 2015 and covers a three-year performance period to 31 March 2018. Subject to continuing employment over the three-year period. If the participant resigns during the period then participation in the scheme will lapse. The RemCom has the discretion to make awards for 'good' leavers as appropriate subject to performance. From 2017–18 the long-term incentive scheme will be replaced by the BBP detailed on page 138. 	The annualised maximum award for each director is: CEO £504k CFO £188k	No
Pension	Defined contribution scheme minimises the risk to the company associated with defined benefit pension plans.	<ul style="list-style-type: none"> A company contribution into a defined contribution scheme, or A cash allowance in lieu of pension. 	Contribution of: CEO 18% CFO 15%	No
Other benefits	Provides market competitive benefits.	<ul style="list-style-type: none"> Car allowance Health cover Disturbance or relocation allowances. 	Based on individual circumstances	No

A basic pay increase of 2.4% for William Lambe for 2017–18 was approved in May 2017 and will be applicable to his basic salary with effect from 1 July 2017. This is in line with the average pay increase for the remainder of employees in the business. As Ian McAulay joined the company on 1 January 2017 he has not been awarded a salary increase for 2017–18.

The terms of the contracts for the executive directors require notice periods of 12 months by both parties for Ian McAulay and William Lambe. If the notice period is worked, no termination payment is payable, otherwise a payment up to a maximum equivalent to the notice period of basic salary, plus pension and car allowance is payable.

Annual remuneration report

Details of the remuneration received by the executive directors are shown below:

Directors' remuneration for 2016–17							
£'000	Base salary	Benefits	Relocation	Annual Bonus	Total	DC pension contribution/compensation	Total including pension
Ian McAulay	105.0	3.2	7.6	68.2	184.0	18.9	202.9
Matthew Wright	277.4	379.4	–	166.4	823.2	49.9	873.1
William Lambe	227.9	6.8	5.6	119.2	359.5	34.2	393.7

Matthew Wright left his position of CEO on 31 December 2016 and the benefits disclosed for him here include a sum for loss of office totalling £369,822. Of this, £184,911 remains unpaid along with the potential performance bonus of £166,419, which remain subject to approval by the RemCom.

Directors' remuneration for 2015–16							
£'000	Base salary	Benefits	Annual Bonus	Total	DC pension contribution/compensation	Total including pension	
Matthew Wright	364.4	12.7	273.2	650.3	65.6	715.9	
Michael Carmedy	255.6	12.9	153.4	421.9	38.3	460.2	

The Chairman and the independent non-executive directors each receive a fee and do not participate in any of our performance-related incentive arrangements. The investor-nominated non-executive directors do not receive any remuneration from the company.

Details of the emoluments received by the Chairman and non-executive directors are shown below:

Emoluments received by the Chairman and non-executive directors							
£'000	2016–17			2015–16			
	Fees	Other	Total	Fees	Other	Total	
Robert Jennings (Chairman to 28 February 2017)	206.2	76.3	282.5	225.0	1.1	226.1	
Bill Tame (Chairman from 1 March 2017)	66.7	2.6	69.3	50.0	0.4	50.4	
Paul Sheffield	60.0	1.4	61.4	56.7	0.4	57.1	
Rosemary Boot	50.0	1.0	51.0	50.0	0.7	50.7	
Lisa Harrington	50.0	1.4	51.4	50.0	0.4	50.4	
David Golden	–	–	–	15.0	7.0	22.0	
Mark Walters	–	–	–	–	–	–	

Robert Jennings left his position of Chairman on 28 February 2017 and received a payment of £75,000 in lieu of notice.

The other amounts payable to the non-executive directors include taxable expenses incurred in the attendance at Board meetings. In 2015–16 payments were also made to David Golden for consultancy services provided separately to his duties as the senior independent non-executive director.

None of the directors who held office during the financial year had any disclosable interests in the shares of Southern Water or the group; there are no share options in place and no payments were made to them by any other group companies.

Annual performance-related incentive scheme

Our incentive scheme focuses on the achievement of specific strategic goals which are designed to drive exceptional customer service, financial and operational performance. The structure of the scheme and specific target criteria, both used for the creation of a bonus pool and individual objectives, are set and reviewed on an annual basis by the RemCom. The bonus pool targets for 2016–17 were set and approved in June 2016.

A balanced scorecard, based on five measures, was used for the creation of the bonus pool. The standard weightings applied to each measure were balanced at 50% for operational and customer performance and 50% for financial performance. The measures for 2016–17 were Service Incentive Mechanism (SIM – qualitative ranking), Outcome Delivery Incentives (ODIs), cash collection, operational expenditure (Opex) and the bad debt provision charge. For some of the measures, stretch targets and weightings are possible to reward exceptional performance but the overall value of the bonus pool cannot exceed 100%.

Performance-based remuneration is awarded in a manner which promotes sound risk management and does not induce excessive risk-taking. Performance-based pay is granted to reflect our financial results, the results of the business directorate in which the employee is employed and the individual employee's performance. Further, both financial and non-financial factors shall be taken into consideration when determining the individual's bonus, i.e. compliance with internal guidelines and procedures, including customer and investor-related guidelines. A discretionary assessment is always made to ensure that other factors, including factors which are not directly measurable, are considered, including maintaining and promoting corporate values.

Performance-based pay is granted to employees with particular influence on our results and shareholder value. As an overall starting point, we ensure a balanced split between fixed salary and variable pay.

Details of the targets agreed by the RemCom for 2016–17 together with the maximum bonus opportunity available to each executive director are shown in the table below. The performance for 2016–17 was assessed in May 2017 by the RemCom and the achievement against each target together with the personal achievement level and payments made in relation to 2016–17 are also shown below.

Performance measure		Standard weight for 2016–17 (as % of bonus pool)	Stretch weight for 2016–17 (as % of bonus pool)	Achievement 2016–17 (as % of bonus pool)
Service standards	<p>Deliver a targeted improvement in the Service Incentive Mechanism qualitative score for 2016–17.</p> <p>Purpose – to deliver significant improvements in customer service performance.</p> <p>Measure – Ofwat SIM qualitative score.</p>	25%	30%	0%
Outcome delivery incentives	<p>ODIs target the priority improvement areas for customers through the attachment of financial incentives to ODIs, mostly in the form of penalties.</p> <p>Purpose – to maintain Asset Health by focusing on the avoidance of annual Ofwat penalties.</p> <p>Measure – the avoidance of annual Asset Health penalties across all of the ODI measures.</p>	25%	25%	25%
Cash collection	<p>Collect a targeted level of cash receipts from unmeasured and measured customers.</p> <p>Purpose – to ensure good financial performance and provide our customers with an affordable service and our ultimate shareholders with a return on their investment.</p> <p>Measure – financial information from the financial statements.</p>	15%	18%	17.4%
Operating costs	<p>Operate the business within a targeted level of total operational expenditure.</p> <p>Purpose – to ensure good financial performance and provide our customers with an affordable service and our ultimate shareholders with a return on their investment.</p> <p>Measure – financial information from the financial statements.</p>	15%	18%	16.8%
Bad debt provision charge	<p>To bring the level of bad debt charge down in line with that of other water and wastewater companies.</p> <p>Purpose – to reduce the impact of bad debt costs to the company and drive future improvements in cash collection.</p> <p>Measure – ratio of bad debt charge to revenue.</p>	20%	24%	0%
Total maximum/actual award		100%	Max 100%	59.2%

Bonus 2016–17	Ian McAulay	Matthew Wright	William Lambe
Maximum bonus opportunity (% of base salary)	100%	100%	80%
Bonus percentage awarded based on business and personal performance (% of base salary)	65%	60%	52%
Qualifying months	3	9	11
Base salary (£'000)	£420.0	£369.9	£250.0
Bonus (£'000)	£68.2	£166.4	£119.2

The bonuses awarded to Ian McAulay and William Lambe were paid in July 2017. The provisional bonus reported for Matthew Wright remains unpaid and is subject to final consideration and approval by the RemCom.

Bonus Banking Plan

The RemCom has agreed to replace both the annual bonus scheme and the LTIP with a single scheme, the Bonus Banking Plan (BBP) commencing from 1 April 2017.

The new scheme is designed to align the remuneration of the executive directors in delivering the business strategy to fulfil the short-term and long-term aims of customers, stakeholders and shareholders. It will use a balanced scorecard approach and performance will be assessed against six short-term measures, cash collection, operational expenditure, bad debt provision, outcome delivery incentives, SIM and capital expenditure and long-term measures of total shareholder return and average cost to serve – which will help ensure we can keep bills at an affordable level despite ongoing investment in the renewal of our infrastructure.

Any award made will form a bonus bank with 50% of the value in the bank being paid out and the remainder being carried forward.

Long-Term Incentive Plan

The LTIP for the period 1 April 2015 to 31 March 2018 was agreed by the RemCom in June 2015.

Performance payments under the LTIP will be based on the performance measures shown below:

Performance measure		Weight (% of max. LTIP)
Total shareholder return	Our achievement of a minimum level of shareholder return as measured using an agreed company valuation model that reflects a combination of value appreciation and distribution yield to shareholders.	50%
AMP6 Delivery Plan	Our achievement of AMP6 Delivery Plan efficiencies, consistent with the management team's plans for delivering the required transformation in organisational structure, commercial arrangements, expenditure efficiencies and operational performance. The metric is designed to reward out-performance relative to the 2014 Final Determination.	25%
Service Incentive Mechanism 2016–17	The company's SIM ranking (qualitative score) published by The Water Services Regulation Authority for the year ending 31 March 2017, measured against the other 17 English and Welsh Water Only and Water and Sewerage Companies (WOCs and WaSCs).	12.5%
Service Incentive Mechanism 2017–18	The company's SIM ranking (qualitative score) published by The Water Services Regulation Authority for the year ending 31 March 2018, measured against the other 17 English and Welsh Water Only and Water and Sewerage Companies (WOCs and WaSCs).	12.5%
Total maximum/actual award		100%

To date no payments have been made in relation to this scheme. An accrual has been made in the financial statements for the period to 31 March 2017 in anticipation of the final award under the LTIP. The value of the cumulative accrual following the second year of the scheme is shown below:

Ian McAulay – accrual at March 2017 £88k

William Lambe – accrual at March 2017 £120k

Matthew Wright – accrual at March 2017 £366k

Actual performance against the scheme will be assessed in 2018–19 by the RemCom and the value of any award may differ from the accruals made. The recognition of an accrual for an award does not constitute confirmation of an obligation to make a payment under scheme. As Matthew Wright resigned from the company on 31 December 2016 he is no longer eligible to participate in the scheme and an accrual has been made in respect of his service for the period to 31 December 2016.

Ian McAulay and William Lambe have both joined the scheme and their entitlements under the scheme will be pro-rated based on their dates of joining the company.

Directors' report for the year ended 31 March 2017

The directors of Southern Water Services Limited (registered no. 02366670) present their report and the audited financial statements for the year ended 31 March 2017.

Principal activities

The principal activities of the company, also referred to as SWS, are the provision of water supply and wastewater services in the South East of England. The company is regulated by the Water Services Regulation Authority (Ofwat) and supplies water to nearly 2.5 million people and provides wastewater services to nearly 4.6 million people.

Strategic report

The information that fulfils the requirement of the Strategic Report can be found in our Annual Report on pages 23 to 86.

Future developments

The information regarding future developments of the company can be found in our Annual Report on pages 23 to 86.

Post balance sheet events

On 1 April 2017, the company disposed of its non-household retail business function to Business Stream as disclosed in note 33.

Results and dividends

The income statement on page 146 shows the company's results and profit for the year. Further details are also available in the Annual Report on pages 88 to 94.

Interim dividends of £812.37 per ordinary share (2016: £812.37 per share), totalling £45.5 million (2016: £45.5 million) were paid during the year to Southern Water Services Group (SWSG). These dividends, along with associated group tax relief of £11.4 million, enable SWSG to pay the interest of £56.9 million due to SWS on an inter-company loan as disclosed in note 10 to the financial statements.

Ordinary dividends totalling £124.2 million, equivalent to £2,217.86 per share, (2016: £79.6 million, equivalent to £1,421.31 per share) were declared in the year. Of these dividends £61.0 million (£1,089.29 per share) was paid during the year and the final dividend of £63.2 million (£1,128.57 per share) was paid after the year end. Of these dividends £108.2 million was paid to our ultimate investors.

The revaluation reserve arose on transition to IFRS at 1 April 2014, when the company elected to measure its infrastructure and operational assets at their fair value and to use that fair value as their deemed cost at that date. During the year, the company undertook a bonus issue of 735,000,000 ordinary shares out of its revaluation reserve. Following this bonus issue, the company completed a capital reduction exercise, creating £735.0 million of distributable reserves.

Directors and their interests

The directors who held office during the year ended 31 March 2017 and up to the date of signing the financial statements, unless otherwise stated, were as follows (further details can be found on pages 121 to 124):

Directors and their interests

Bill Tame	(Independent non-executive director) (appointed as Chairman 1 March 2017)
Robert Jennings	(Independent non-executive director) (resigned 28 February 2017)
Ian McAulay	(Executive director – Chief Executive Officer) (appointed 1 February 2017)
Matthew Wright	(Executive director – Chief Executive Officer) (resigned 31 December 2016)
William Lambe	(Executive director – Chief Financial Officer) (appointed 3 May 2016)
Paul Sheffield	(Senior independent non-executive director)
Rosemary Boot	(Independent non-executive director)
Lisa Harrington	(Independent non-executive director)
Mark Walters	(Non-executive director)
Andrew Truscott	(Alternate non-executive director)
Bronte Somes	(Non-executive director) (resigned 19 May 2016)
Paul Moy	(Alternate non-executive director) (resigned 19 May 2016)

None of the directors who held office during the financial year had any disclosable interests in the shares of the company or the group.

Research and development

The improvement of existing services and processes, together with the identification and development of new technology and innovative solutions, are important aspects of the company's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £1.0 million (2016: £0.7 million).

Financial risk management

The Financial Risk Management Policy is included in the Strategic Report on pages 101 to 114.

Employees

Employee involvement

The company recognises the importance of its employees and is committed to effective two-way communication and consultation.

The company has established Business Involvement Groups to facilitate meaningful consultation between company management and employees through elected employee representatives. The groups meet regularly at both a functional and company-wide level. An employee survey is also completed on an annual basis to seek input from employees.

The company recognises the rights of every employee to join a trade union and participate in its activities. SWS has a single union agreement with Unison.

The company publishes its own in-house newspaper, Southern Water News, on a regular basis. General information is posted on the company intranet and regular team briefing sessions are also held. The information in these publications and briefings covers a wide range of subjects that affect the business, including progress on business and capital projects, the impact of regulatory issues and wider financial and economic issues that may affect the company.

Equal opportunity

The company's policy is to promote equality of opportunity in recruitment, employment continuity, training and career development. The company takes full account of the needs of people with disabilities and follows set policies and procedures to support reasonable adjustments in the workplace.

Health, safety and wellbeing

The company recognises its duties to make proper provision for the health, safety and welfare at work of its employees.

Every employee receives a copy of the corporate policy statement on health and safety. There are regular meetings of employee representatives and managers to consider all aspects of health and safety. In addition there is a Health and Safety Management Review Group which ensures that there is an adequate system for meeting the company's responsibilities for health and safety to its staff, customers and members of the public.

SWS provides an internal occupational health service for employees, including the provision of physiotherapy. These services have been developed and are continuously reviewed to ensure they meet the needs of the business and our employees at work.

Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the abilities of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

Speak Up

Employees are actively encouraged to Speak Up if they see things that are not quite right. This helps us work better as a company and fosters a culture where we ensure that we are always doing the right thing for each other, our customers, the environment and other stakeholders.

Environmental issues

The company is committed to meeting or improving upon legislative and regulatory environmental requirements and codes of practice and aims to contain the environmental impact of its activities to a practicable minimum.

The company's environmental performance is reported on pages 64 to 74. The company recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

Political donations

No political donations were made.

Land and buildings

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

Going concern

The directors believe, after due and careful enquiry, that the company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the financial statements to 31 March 2017.

In forming this assessment the directors have considered the following information:

- *The company's business activities, together with the factors likely to affect its future development, performance and position, which are set out in the Strategic Report on pages 23 to 86.*
- *The financial position of the company, its cash flows, liquidity position, covenants and borrowing facilities, which are described in the Financial Performance review on pages 88 to 114.*

- *The company has available a combination of cash and committed undrawn bank facilities totalling £635.3 million at 31 March 2017 (2016: £357.9 million). These funds are sufficient to fund the operating and capital investment activities of the company for the 12 months from the date of signing the financial statements.*
- *The company operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities.*

As a consequence, the directors believe that the company is well placed to manage its business risks successfully.

The directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Long-term viability statement

In accordance with provision C.2.2 of the UK Code, the Board has assessed the prospects of the company over a longer period than the 12 months required by the 'Going Concern' provision. Details of its assessment and the associated viability statement can be found on page 100 of this report.

Qualifying third party indemnity

Following shareholder approval, the company has also provided an indemnity for its directors and the Company Secretary, which is a qualifying third party indemnity provision for the purposes of the Companies Act 2006.

Directors' responsibilities statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 101 Reduced Disclosure Framework. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- *select suitable accounting policies and then apply them consistently*
- *make judgments and accounting estimates that are reasonable and prudent*
- *state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and*
- *prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.*

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

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

Responsibility statement

We confirm that to the best of our knowledge:

- *the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company*
- *the management report, which is incorporated into the Strategic Report, includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal risks and uncertainties that they face.*

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.

Auditor

Deloitte LLP has indicated its willingness to continue in office.

Approved by the Board of Directors and signed by order of the Board.



Joanne Statton
Company Secretary

27 June 2017