Financial statements

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Income statement

For the year ended 31 March 2017

Income statement for the year ended 31 March 2017	Note	2017 £m	2016 £m
Continuing operations			
Revenue	4	**809.7**	803.7
Other operating income	4	**1.3**	1.7
Operating costs			
– before depreciation and amortisation		**(306.9)**	(286.3)
– depreciation and amortisation		**(245.2)**	(234.6)
Total operating costs		**(552.1)**	(520.9)
Operating profit	5	**258.9**	284.5
Profit on disposal of fixed assets		**0.4**	0.4
Finance income	8	**58.1**	59.3
Finance costs	8	**(161.2)**	(145.5)
Fair value losses on derivative financial instruments	20	**(416.8)**	(70.4)
Net finance costs	8	**(519.9)**	(156.6)
(Loss)/profit before taxation		**(260.6)**	128.3
Taxation	9	**84.9**	(8.4)
(Loss)/profit for the financial year		**(175.7)**	119.9

The notes on pages 151 to 189 form part of these financial statements.

Statement of other comprehensive income

for the year ended 31 March 2017

Statement of other comprehensive income for the year ended 31 March 2017	Note	2017 £m	2016 £m
(Loss)/profit for the year		**(175.7)**	119.9
Other comprehensive (loss)/income:			
Items that cannot be reclassified to profit or loss:			
Actuarial loss on pension scheme	22	**(71.4)**	(14.0)
Movement on deferred tax relating to retirement benefit obligations	21	**12.8**	2.8
Deferred tax movement due to rate change	21	**(1.7)**	18.6
Total other comprehensive (loss)/income for the year, net of tax		**(60.3)**	7.4
Total comprehensive (loss)/income for the year attributable to the owner of the company		**(236.0)**	127.3

Statement of financial position

as at 31 March 2017

Statement of financial position as at 31 March 2017	Note	2017 £m	2016 £m
Non-current assets			
Intangible assets	11	**61.1**	42.0
Property, plant and equipment	12	**5,684.6**	5,607.5
Other non-current assets	13	**812.3**	812.3
Investments	14	**29.2**	29.2
		6,587.2	6,491.0
Current assets			
Inventories	15	**2.7**	2.4
Trade and other receivables	16	**197.3**	192.3
Cash and cash equivalents	29	**285.3**	17.9
		485.3	212.6
Total assets		**7,072.5**	6,703.6
Current liabilities			
Trade and other payables	17	**(310.1)**	(188.1)
Borrowings	18	**(39.4)**	(88.9)
		(349.5)	(277.0)
Non-current liabilities			
Borrowings	19	**(3,933.7)**	(3,631.8)
Derivative financial instruments	20	**(1,338.0)**	(923.7)
Deferred tax liabilities	21	**(257.6)**	(365.0)
Retirement benefit obligations	22	**(176.9)**	(102.3)
Provisions for liabilities	23	**(0.5)**	(0.5)
Other non-current liabilities	24	**(62.2)**	(43.5)
		(5,768.9)	(5,066.8)
Total liabilities		**(6,118.4)**	(5,343.8)
Net assets		**954.1**	1,359.8
Equity			
Called up share capital	25	**0.1**	0.1
Share premium account	26	**46.3**	46.3
Revaluation reserve	27	**–**	745.1
Retained earnings	28	**907.7**	568.3
Total equity		**954.1**	1,359.8

The financial statements of Southern Water Services Limited (Registered no. 02366670) on pages 146 to 189 were approved by the Board and authorised for issue on 27 June 2017. They were signed on its behalf by:

W. A. Lambe

William Lambe
Chief Financial Officer

Statement of changes in equity

for the year ended 31 March 2017

Statement of changes in equity for the year ended 31 March 2017	Called up share capital (Note 25) £m	Share premium account (Note 26) £m	Revaluation reserve (Note 27) £m	Retained earnings (Note 28) £m	Total £m
Balance at 31 March 2015	**0.1**	**46.3**	**757.3**	**553.9**	**1,357.6**
Profit for the financial year	–	–	–	119.9	119.9
Other comprehensive income for the year	–	–	–	7.4	7.4
Total comprehensive income for the year	**–**	**–**	**–**	**127.3**	**127.3**
Equity dividends paid (Note 10)	–	–	–	(125.1)	(125.1)
Revaluation reserve transfer	–	–	(12.2)	12.2	–
Balance at 31 March 2016	**0.1**	**46.3**	**745.1**	**568.3**	**1,359.8**
Loss for the financial year	–	–	–	(175.7)	(175.7)
Other comprehensive loss for the year	–	–	–	(60.3)	(60.3)
Total comprehensive loss for the year	–	–	–	(236.0)	(236.0)
Issue of bonus shares	735.0	–	(735.0)	–	–
Capital reduction	(735.0)	–	–	735.0	–
Equity dividends paid/declared (Note 10)	–	–	–	(169.7)	(169.7)
Revaluation reserve transfer	–	–	(10.1)	10.1	–
Balance at 31 March 2017	**0.1**	**46.3**	**–**	**907.7**	**954.1**

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.

Statement of cash flows

for the year ended 31 March 2017

Statement of cash flows for the year ended 31 March 2017	Note	2017 £m	2016 £m
Cash from operating activities	29	**524.3**	482.0
Tax paid		**(11.4)**	(15.1)
Net cash generated from operating activities		**512.9**	466.9
Investing activities			
Interest received		**57.9**	59.7
Purchase of property, plant and equipment		**(246.7)**	(237.9)
Purchase of intangible assets		**(31.1)**	(6.8)
Receipt of grants and contributions		**3.1**	5.2
Sale of property, plant and equipment		**–**	0.6
Movement on loan to subsidiary		**(7.5)**	14.3
Net cash used in investing activities		**(224.3)**	(164.9)
Financing activities			
Equity dividends paid		**(106.5)**	(125.1)
Interest paid		**(136.8)**	(132.5)
Preference share dividends		**(13.4)**	(11.2)
Payment of derivative accretion		**(2.5)**	(298.4)
Repayment of short-term borrowings		**(80.0)**	–
Repayments of obligations under finance leases		**(0.3)**	(0.2)
Issue costs of new loans		**–**	(0.2)
Proceeds of new loans		**318.3**	110.0
Net cash used in financing activities		**(21.2)**	(457.6)
Net increase/(decrease) in cash and cash equivalents		**267.4**	(155.6)
Cash and cash equivalents at beginning of the year		**17.9**	173.5
Cash and cash equivalents at end of the year		**285.3**	17.9

Notes to the financial statements

for the year ended 31 March 2017

1 Accounting policies

The principal accounting policies, which have been applied consistently throughout the current and preceding year, are set out below.

Basis of preparation

Southern Water Services Limited is a company incorporated in the United Kingdom under the Companies Act. The company is a private company limited by shares and is registered in England and Wales. The address of the registered office is given on the back cover. The nature of the company's operations and its principal activities are set out in the Strategic Report on pages 23 to 86.

These financial statements have been prepared in accordance with FRS 101 incorporating the Amendments to FRS 101 issued by the FRC in July 2015 and the amendments to Company law made by The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015.

The financial statements have been prepared on a going concern basis under the historical cost convention, as modified by the revaluation of property, plant and equipment, available-for-sale financial assets, and financial assets and financial liabilities (including derivative instruments) at fair value through profit and loss.

Historical cost is generally based on the fair value of the consideration given in exchange for the goods and services.

Fair value is the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the company takes into account the characteristics of the asset or liability as if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement purposes in these financial statements is determined on such a basis, except leasing transactions that are within the scope of IAS 17 'Leases', and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 'Inventories' or value in use in IAS 36 'Impairment of Assets'.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- *Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date*
- *Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly*
- *Level 3 inputs are unobservable inputs for the asset or liability.*

The financial statements contain information about Southern Water Services Limited (SWS) as an individual company and do not contain consolidated financial information as the parent of subsidiary companies. The company is exempt under Section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it and its subsidiary undertaking are included by full consolidation in the consolidated financial statements of the ultimate holding company, Greensands Holdings Limited. The group financial statements of Greensands Holdings Limited are available to the public and can be obtained from the company website, southernwater.co.uk.

As permitted by FRS 101, the company has taken advantage of the disclosure exemptions available under that standard in relation to non-current assets held for sale, financial instruments, standards not yet effective and related party transactions. Where required, equivalent disclosures are given in the group financial statements of Greensands Holdings Limited.

Adoption of new and revised accounting and financial reporting standards

The amendments to the following revised accounting standard have been adopted in the current year:

Amendments to IAS 1 Disclosure Initiative	The company has adopted the amendments to IAS 1 Disclosure Initiative for the first time in the current year. The amendments clarify that an entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material, and give guidance on the bases of aggregating and disaggregating information for disclosure purposes. However, the amendments reiterate that an entity should consider providing additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, events and conditions on the entity's financial position and financial performance. The amendments also address the structure of the financial statements by providing examples of systematic ordering or grouping of the notes. The adoption of these amendments has not resulted in any impact on the financial performance or financial position of the company.

Going concern

The company's business activities, together with the factors likely to affect its future development and position, are set out in the Strategic Report pages 23 to 86.

The directors have undertaken a detailed review of the company's liquidity requirements compared with the cash and facilities available, the financial covenant position including projections based on future forecasts, the current ratings and financial risk. On the basis of their assessment of the company's financial position the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements. For this reason they continue to adopt the going concern basis of accounting in preparing the annual financial statements, further details can be found in the Directors' Report on page 139.

In addition and in accordance with provision C.2.2 of the UK 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 selected to conduct this review each year based on a rolling five-year period and full details of the assessment and the viability statement are set out within the Strategic Report on page 100.

Segmental reporting

The company's revenue arises from the provision of services within the United Kingdom. It has a large and diverse customer base and is not reliant on any single customer.

The Southern Water Board and management team review all internal management information on a single segment basis and accordingly no segmental information is provided in this report.

Revenue recognition

Revenue represents the income receivable (net of value added tax) in the ordinary course of business for goods and services provided. In respect of unbilled charges, revenue includes an estimate of the consumption between the date of the last meter reading and the period-end. The revenue accrual is estimated using a defined methodology based upon historical billing, consumption information and the applicable tariff.

Revenue from the supply of services represents the value of services provided under contracts to the extent that there is a right to consideration and is recorded at the fair value of the consideration due. Revenue is recognised when the amount of revenue can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the company. Revenue is not recognised when it is considered probable that economic benefits will not be received. In these circumstances revenue is only recognised when collectability is reasonably certain. Payments received in advance of revenue recognition are recorded as deferred income.

Unmetered income is based on either the rateable value of the property or on an assessed volume of water supplied. Metered income is based on actual or estimated water consumption.

Interest income is recognised on a time-proportionate basis using the effective interest method.

Provision for impairment of trade receivables

The bad debt provision is calculated by applying estimated recovery rates to various categories of debt, reflecting past collections experience and expectations of future recovery of outstanding receivables at the date of the statement of financial position.

Taxation

Taxation in the income statement represents the sum of the tax currently payable and deferred tax.

Current taxation is based on the result for the year as adjusted for disallowable and non-taxable items and items of income or expense which are taxable or deductible in other years. The company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

Deferred taxation is tax expected to be payable on temporary differences between the treatment of certain items for taxation and accounting purposes. Deferred taxation is provided on all temporary differences that have originated, but not reversed, by the end of the reporting period. It is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax laws and rates that have been enacted or substantively enacted at the reporting date.

Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is regarded as probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the company intends to settle its current tax assets and liabilities on a net basis.

Intangible assets

Intangible assets are measured at cost less subsequent amortisation and any impairment. Amortisation of intangible assets is calculated on a straight-line basis over the estimated useful lives, which are primarily three to 10 years. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Property, plant and equipment

Property, plant and equipment comprises:

i. *Freehold land and buildings – comprising land and non-operational buildings.*

ii. *Infrastructure assets – comprising a network of systems consisting of mains and sewers, impounding and pumped raw water storage reservoirs, sludge pipelines and sea outfalls.*

iii. *Plant and machinery – comprising structures at sites used for water and wastewater treatment; pumping or storage, where not classed as infrastructure, along with associated fixed plant.*

iv. *Other assets – comprising vehicles, computers, mobile plant and meters.*

v. *Assets under construction.*

All property, plant and equipment is stated in the statement of financial position at cost or at deemed cost on transition to FRS 101, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

The difference between depreciation based on the fair valued carrying amounts of assets and depreciation based on the asset's original cost is transferred annually from the revaluation reserve to retained earnings through equity.

The costs of repairs to the infrastructure network are recognised in the income statement as they arise.

Expenditure which results in replacement or renewal of infrastructure or enhancements to the operating capability of the infrastructure network is capitalised.

Items of property, plant and equipment that are transferred to the company from customers or developers are initially recognised at fair value in accordance with IFRIC 18 'Transfers of Assets from Customers'. The corresponding credit is recorded as deferred income and released to other income over the expected useful lives of the related assets.

Borrowing costs directly attributable to the construction of qualifying assets, that necessarily take a substantial period of time to get ready for their intended use, are capitalised during the period of time that is required to complete and prepare the asset for its intended use. The commencement of capitalisation begins when both finance costs and expenditures for the asset are being incurred and activities that are necessary to get the asset ready for use are in progress. Capitalisation ceases when substantially all the activities that are necessary to get the asset ready for use are complete. Other borrowing costs are expensed.

Subsequent costs are included in the asset's carrying amount or recognised as separate assets, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the company and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the income statement as incurred.

Freehold land is not depreciated, nor are assets in the course of construction until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor, following completion of performance and take-over tests.

Other assets are depreciated on a straight-line basis over their estimated operating lives, which are principally as follows:

Non-infrastructure assets	**Years**
Buildings	*10–60*
Operational structures	*15–80*
Fixed plant	*10–40*
Vehicles, computers and mobile plant	*3–10*

Infrastructure assets	**Years**
Water mains	*100–120*
Sewers	*80–200*
Reservoirs	*200*
Ancillary structures	*10–70*

Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

The estimated useful lives and depreciation method are reviewed at the end of each reporting period, with the effect of any changes in estimate accounted for on a prospective basis.

Impairment of tangible and intangible assets

At the end of each reporting period, the company reviews the carrying amounts of its tangible and intangible assets, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Grants and contributions

Grants and contributions received are treated as either revenue or deferred income in line with IFRIC 18 as defined by the nature of the receipt.

Infrastructure receipts, contributions received following new connections towards enhancing the network, are recognised as revenue when they are receivable.

Grants and contributions receivable in respect of non-current assets are treated as deferred income and released to other income over the useful economic life of those fixed assets.

Grants and contributions received in respect of new connections to the water and sewerage networks are treated as deferred income and released to revenue in line with the expected expenditure they are intended to compensate.

Grants and contributions which are given in compensation for expenses incurred with no future-related costs are recognised in revenue in the period that they become receivable.

Leased assets

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The company as lessee

Where the company enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a 'finance lease'. Assets held under finance leases are recognised as assets of the company at their fair value or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease.

The asset is recorded in the statement of financial position as a non-current asset and is depreciated over its estimated useful life or the term of the lease, whichever is shorter. Future liabilities to the lessor under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the income statement, and the capital element which reduces the outstanding obligation for future instalments.

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases. Rentals payable under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Sale and leaseback transactions occur when an asset is sold but use is immediately re-acquired by entering into a lease with the buyer. Where the new lease is an operating lease, the transaction is treated as the disposal of an asset and the operating lease accounted for in accordance with existing policies.

The company as lessor

The sale of income rights relating to aerial masts and sites owned by the company to third parties is treated as an operating lease. Income received from such sales is received entirely in advance and is therefore taken to deferred revenue and credited to other operating income in the income statement over the life of the lease.

Non-current asset investments

Investments held as non-current assets, including investments in subsidiaries, are stated at cost, less where appropriate, provision for any impairment in value. The carrying values of non-current asset investments are reviewed for impairment in periods, if events or changes in circumstances indicate the carrying value may not be recoverable.

Inventories

Inventory is held for use in the production of water supply and treatment of wastewater. Raw materials and work in progress are valued at the lower of cost and net realisable value. Net realisable value is the estimated selling price, less further costs expected to be incurred to completion and costs to be incurred in marketing, selling and distribution.

Deferred revenue

Deferred revenue includes monies received from customers where the related service has not yet been provided.

Amounts are deferred to the statement of financial position and released to the income statement in line with the period of the service provided.

Provisions

Provisions are recognised when the company has a present obligation (legal or constructive) as a result of a past event, it is probable that the company will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

An environmental provision is made for the costs relating to decommissioned or dormant assets which have been identified as having an environmental impact.

Retirement benefits

SWS operates a defined benefit pension scheme, the assets of which are held separately from those of the company in independently administered funds. An independent actuary conducts a valuation of this pension scheme every three years.

The liability recognised in the statement of financial position in respect of the defined benefit pension scheme is the present value of the defined benefit obligation at the end of the period less the fair value of plan assets. The current service cost, which is the increase in the present value of the liabilities of the company's defined benefit pension scheme expected to arise from employee service in the period, is charged to operating costs. The net interest on the scheme's net assets/(liabilities) is included in other finance charges. Actuarial gains and losses are recognised in the statement of other comprehensive income.

The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 22.

Profit before taxation and net assets are affected by the actuarial assumptions used. The key assumptions include: discount rates, pay growth, mortality and increases to pensions in payment and deferred pensions, and may differ from actual results due to changing market and economic conditions and longer or shorter lives of participants.

The company also operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the company in an independently administered fund. Company contributions to the scheme are charged to the income statement in the period to which they relate. Differences between contributions actually paid are shown as either accruals or prepayments in the statement of financial position.

Financial instruments

Financial assets and financial liabilities are recognised in the company's statement of financial position when the company becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss (FVTPL)) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVTPL are recognised immediately in the income statement.

Financial assets

(i) **Loans and receivables**

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

(ii) **Impairment of financial assets**

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account.

(iii) **Derecognition of financial assets**

The company derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. On derecognition of a financial asset the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

Financial liabilities

Fixed rate interest-bearing borrowings are initially measured at fair value, net of transaction costs and are subsequently measured at amortised cost using the effective interest method, with the interest expense recognised on an effective yield basis.

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Issue costs in relation to index-linked and variable rate bonds are separately disclosed within creditors.

The carrying value of index-linked debt instruments is adjusted for the annual movement in the retail price index. The change in value arising from indexation is charged or credited to the income statement in the year in which it arises.

Premiums and proceeds from gilt lock agreements received on issue of debt instruments are credited to the income statement over the term of the debt at a constant rate on the carrying amount.

Derecognition of financial liabilities

The company derecognises financial liabilities when, and only when, the company's obligations are discharged, cancelled or they expire.

Derivative financial instruments

The company enters into a variety of derivative financial instruments to manage its exposure to inflation and interest rate risk in line with the company's risk management policy and no speculative trading in financial instruments is undertaken. Further details of derivative financial instruments are disclosed in note 20.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently re-measured to their fair value at the end of each reporting period. The resulting gain or loss is recognised in the income statement immediately.

Certain derivative instruments, principally index-linked swaps, do not qualify for hedge accounting and, as such, the company does not currently apply hedge accounting.

Derivatives with a positive fair value and derivatives with a negative fair value are set-off against each other with the net position being presented as either a financial liability or financial asset. A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not measured at fair value through profit and loss.

An embedded derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the hybrid instrument to which the embedded derivative relates is more than 12 months and is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

2 Critical accounting judgments and key sources of estimation uncertainty

In the application of the company's accounting policies, which are described in note 1 above, the directors are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgments

Critical judgments, apart from those involving estimations, that are applied in the preparation of the financial statements are discussed below:

Revenue recognition

The company recognises revenue generally at the time of delivery and when collection of the resulting receivable is reasonably assured. When the company considers that the criteria for revenue recognition are not met for a transaction, revenue recognition is delayed until such time as collectability is reasonably assured. Payments received in advance of revenue recognition are recorded as deferred income.

Property, plant and equipment

The company recognises property, plant and equipment (PPE) on its water and wastewater infrastructure assets where such expenditure enhances a significant length of the network or increases the capacity of the network, whereas any expenditure classed as maintenance is expensed in the period it is incurred. Determining enhancement from maintenance expenditure is a subjective area, particularly when assessing whether the length of network replaced enhances the network. In addition, management capitalise time and resources incurred by the company's support functions on capital programmes based on judgments made in respect of the proportion of capital work performed by these functions. The assessment of useful economic lives is also a key judgment in determining the carrying value of property, plant and equipment.

Provisions and contingent liabilities

The company exercises judgment in recognising provisions (see note 23) and the exposures to contingent liabilities related to pending litigation or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as other contingent liabilities (see note 30). Judgment is necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and the point of recognition for the associated liability.

Sources of estimation uncertainty

The key assumptions about the future, and other key sources of estimation uncertainty at the reporting period end that may have a risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are discussed below:

Measured income accrual

The measured income accrual is an estimation of the amount of water and wastewater unbilled at the period end. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff. The calculation is sensitive to estimated consumption for measured customers.

Allowance for doubtful receivables

At each reporting date, the company evaluates the recoverability of trade receivables and records an allowance for doubtful receivables based on experience. This allowance is based on, among other things, a consideration of actual collection history. The actual level of receivables collected may differ from the estimated levels of recovery, which could impact future operating results positively or negatively.

Retirement benefit obligations

The company operates a defined benefit scheme as well as a defined contribution scheme. Under IAS 19 'Employee Benefits' the company has recognised an actuarial loss of £71.4 million (2016: loss of £14.0 million).

The pension cost and liabilities under IAS 19 are assessed in accordance with directors' best estimates using the advice of an independent qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on CMI 2015 actuarial tables with an allowance for future longevity improvement.

The principal assumptions used to measure schemes' liabilities, sensitivities to changes in those assumptions and future funding obligations are set out in note 22 of the financial statements.

Provisions and contingent liabilities

The company evaluates its exposures to contingent liabilities relating to pending litigation or other outstanding claims and recognises provisions using estimates to quantify the possible range of the financial settlement. Because of the inherent uncertainty in this evaluation process, actual losses may be different from the originally estimated provision.

3 Segmental analysis

The directors believe that the whole of SWS's activities constitute a single class of business. The company's revenue is generated wholly from within the United Kingdom. The Southern Water Board and management team review all internal management information on a single segment basis and accordingly no segmental information is provided in this report.

4 Revenue

An analysis of the company's revenue is as follows:

Revenue	2017 £m	2016 £m
Continuing operations		
Water and sewerage services	**764.8**	759.0
Other services	**44.9**	44.7
Total revenue	**809.7**	803.7
Other operating income	**1.3**	1.7
Interest receivable (note 8)	**1.2**	2.4
Interest revenue from Southern Water Services Group Limited	**56.9**	56.9
Total income	**869.1**	864.7

Other operating income includes rents receivable.

5 Profit for the year

Profit for the year	2017 £m	2016 £m
Profit for the year has been arrived at after charging/(crediting):		
Depreciation on		
– owned assets	**229.6**	224.6
– assets held under finance leases	**0.7**	1.3
	230.3	225.9
Amortisation of intangible assets included in other operating expenses:		
– other	**14.9**	8.7
Profit on disposal of fixed assets	**0.4**	0.4
Research and development expenditure	**1.0**	0.7
Rentals under operating leases:		
– Properties	**1.7**	1.7
– Vehicles	**2.2**	2.2
Employee costs (note 6)	**56.5**	56.3
Amortisation of grants and contributions (note 24)	**(1.2)**	(1.1)
Rates rebate (see note below)	**–**	(13.3)
Fees payable to the company's auditor in respect of:		
– Statutory audit of the company's financial statements	**0.3**	0.2
– Other services pursuant to legislation	**0.1**	0.1
– All other services	**0.2**	0.7

Audit-related and non-audit services primarily relate to regulatory assurance fees, and other taxation and professional fees.

Note
The rates rebate of £13.3 million, received in 2015–16, relates to a refund of historic rates charges following a successful appeal.

6 Employee information

(a) Employee costs (including directors' emoluments)	2017 £m	2016 £m
Wages and salaries	**81.9**	77.4
Social security costs	**8.3**	7.1
Pension costs – Defined contribution	**2.6**	2.3
– Defined benefit	**5.1**	6.3
Total employee costs	**97.9**	93.1
Less: charged as capital expenditure	**(41.4)**	(36.8)
Charged to the income statement	**56.5**	56.3

Employee costs that are charged as capital expenditure are those directly related to the construction or acquisition of assets.

The average monthly numbers of persons (including executive directors) employed by the company during the year was:

(b) Average number of persons employed by activity	2017 Number	2016 Number
Operations	**1,298**	1,239
Customer services	**317**	378
Corporate centre	**505**	502
	2,120	2,119

7 Directors' emoluments

Directors' emoluments	2017 £000	2016 £000 (restated)*
Aggregate emoluments (including benefits in kind)	**1,616**	1,633
Compensation for loss of office	**370**	–
	1,986	1,633

*The prior year amount has been restated to include an amount of £104,000 for cash allowances in lieu of pension.

No retirement benefits accrued to directors (2016: nil) under a Southern Water defined benefit scheme. No retirement benefits accrued to directors (2016: nil) under a Southern Water defined contribution scheme.

The emoluments disclosed include sums for loss of office and bonus awards to the highest paid director totalling £351,000 which have not yet been paid. These remain subject to approval by the Remuneration Committee.

A long-term incentive plan (LTIP) is in operation for the three-year period from 1 April 2015 to 31 March 2018. To date, no payments have been made in relation to this scheme. A total amount of £574,000 has been accrued for the period to 31 March 2017 in relation to this scheme and is not included within the figures disclosed above.

Further details can be found in the Directors' Remuneration Report on page 129.

Details of emoluments and benefits for the highest paid director	2017 £000	2016 £000
Highest paid director's aggregate emoluments and benefits	**503**	716
Compensation for loss of office	**370**	–
	873	716

During the year the company made contributions of £nil (2016: £nil) to a money purchase pension scheme in respect of the highest paid director's qualifying services.

8 Net finance costs

Net finance costs	2017 £m	2016 £m
Finance income		
Interest revenue from Southern Water Services Group Limited	**56.9**	56.9
Deposit income on short-term bank deposits	**1.2**	2.4
	58.1	59.3
Finance costs		
Interest payable on other loans	**(6.8)**	(6.1)
Interest paid to Southern Water Services (Finance) Ltd	**(133.6)**	(128.5)
Indexation	**(20.9)**	(10.0)
Amortisation of issue costs	**(1.9)**	(1.9)
Amortisation of gilt lock proceeds	**0.1**	0.1
Amortisation of deferred credits	**9.7**	9.7
Amortisation of bond premium	**0.7**	0.6
Other finance expense (note 22)	**(3.7)**	(3.9)
Dividends on preference shares – see note (a) and (b) below	**(13.4)**	(11.2)
	(169.8)	(151.2)
Amounts capitalised on qualifying assets	**8.6**	5.7
	(161.2)	(145.5)
Fair value losses on derivative financial instruments		
Derivative financial instruments not designated as hedges	**(416.8)**	(70.4)
Net finance costs	**(519.9)**	(156.6)

The interest revenue from Southern Water Services Group Limited relates to the long-term loan disclosed in note 13.

Borrowing costs included in the cost of qualifying assets during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 4.23% to expenditure on such assets (2016: 4.00%).

Dividends on preference shares

(a) Class A1 preference share dividends amounted to £40 per share and Class B £70 per share totalling £9.0 million (2016: £9.0 million).

(b) Dividend due to the Class A2 preference shareholders of £134.73 (2016: £67.35) per share totalling £4.4 million (2016: £2.2 million) was declared and settled in the year at base value plus an amount for out-performance and savings in the year ended 31 March 2016 (see note 19(vii)).

9 Taxation

Tax on profit on ordinary activities	2017 £m	2016 £m
Current tax:		
Current year	**11.4**	11.4
Adjustment in respect of prior years	**–**	8.8
Total current tax charge	**11.4**	20.2
Deferred tax:		
Origination and reversal of timing differences	**(79.3)**	9.7
Adjustment in respect of prior years	**(0.1)**	0.5
Effect of corporation tax rate change	**(16.9)**	(22.0)
Total deferred tax credit	**(96.3)**	(11.8)
Total tax credit/(charge) on (loss)/profit	**(84.9)**	8.4

The tax assessed for the year is different to the standard rate of corporation tax in the UK due to the following factors:

	2017 £m	2016 £m
(Loss)/profit before tax	**(260.6)**	128.3
Tax at the UK corporation tax rate of 20% (2016: 20%)	**(52.1)**	25.7
Permanent differences	**3.3**	2.4
Group relief received for nil payment	**(27.9)**	(7.0)
Differences between current and deferred tax rates	**8.8**	–
Impact of tax rate changes	**(16.9)**	(22.0)
Adjustment in respect of prior years:		
Current tax	**–**	8.8
Deferred tax	**(0.1)**	0.5
Total tax (credit)/charge for year	**(84.9)**	8.4

Factors that may affect future tax charges:

Reductions in the main rate of corporation tax to 19% from the 1 April 2017 and to 18% from the 1 April 2020 were enacted in the Finance Bill 2015, and deferred tax balances at 31 March 2016 are calculated based on these reduced rates.

It was subsequently announced in the 2016 UK Budget that the corporation tax rate would instead reduce to 17% from 1 April 2020.

This further reduction has been substantively enacted in Finance Bill 2016 at the reporting date, and deferred tax balances at 31 March 2017 have been calculated using this reduced rate. A credit of £16.9 million has been recognised in the income statement in the period to reflect the reduction in the deferred tax liability as a result of the rate change.

In addition, charges of £1.7 million have been recognised in the statement of other comprehensive income to reflect the reduction in the deferred tax asset relating to the pension deficit.

Based on current capital investment plans, the company expects to continue to be able to claim capital allowances in excess of depreciation in future years at a similar level to the current year.

9 Taxation (continued)

In addition to the amount recognised in the income statement, the following amounts relating to tax have been recognised in the statement of other comprehensive income:

Deferred tax	2017 £m	2016 £m
Arising on income and expenses recognised in other comprehensive income:		
Tax credit on actuarial losses on defined benefit pension scheme	**(12.8)**	(2.8)
Deferred tax movement due to rate change	**1.7**	(18.6)
Total deferred tax credits recognised in other comprehensive income	**(11.1)**	(21.4)

10 Dividends

Amounts recognised as distributions to equity holders in the year	2017 £m	2016 £m
Current year interim dividend of £812.37 (2016: £812.37) per share	**45.5**	45.5
Current year interim dividend of £1,089.29 (2016: £522.32) per share	**61.0**	29.2
Current year final dividend of £1,128.57 (2016: £899.11) per share	**63.2**	50.4
	169.7	125.1

The interim dividends of £45.5 million are paid to Southern Water Services Group Limited (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 Southern Water Services Limited on an inter-company loan as disclosed in note 13. These transactions are illustrated in the diagram on page 99 of the Annual Report.

In addition, a current year interim dividend of £61.0 million was paid in October 2016 and a final dividend of £63.2 million was declared in March 2017 and paid in April 2017. £108.2 million of these dividends were ultimately paid to investors in SWS's parent company Greensands Holdings Ltd.

11 Intangible assets

Intangible assets	Externally generated		
	Assets under construction £m	Computer software £m	Total £m
Cost			
At 1 April 2016	11.7	64.5	**76.2**
Additions	16.9	17.1	**34.0**
Transfers	(8.5)	8.5	**–**
At 31 March 2017	20.1	90.1	**110.2**
Amortisation			
At 1 April 2016	–	34.2	**34.2**
Charge for the year	–	14.9	**14.9**
At 31 March 2017	–	49.1	**49.1**
Net book amount			
At 31 March 2017	**20.1**	**41.0**	**61.1**
At 31 March 2016	11.7	30.3	42.0

The company does not currently have any internally generated intangible assets.

Included within additions above is £1.3 million of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing costs'. The cumulative net book value of the borrowing costs capitalised amount to £1.8 million (2016: £0.7. million). The company has elected to apply IAS 23 from 1 April 2003, as permitted by the standard.

12 Property, plant and equipment

Property, plant and equipment	Land and buildings £m	Plant and machinery £m	Infrastructure assets £m	Assets under construction £m	Other £m	Total £m
Cost						
At 1 April 2016	1,534.4	2,887.9	2,427.3	252.9	606.6	**7,709.1**
Additions	1.6	87.9	35.9	167.3	14.7	**307.4**
Transfers	(1.4)	36.2	71.8	(106.4)	(0.2)	**–**
Disposals	–	(5.5)	(0.3)	–	(1.4)	**(7.2)**
At 31 March 2017	1,534.6	3,006.5	2,534.7	313.8	619.7	**8,009.3**
Depreciation						
At 1 April 2016	642.3	1,053.1	56.1	–	350.1	**2,101.6**
Charge for the year	39.9	117.4	28.7	–	44.3	**230.3**
Disposals	–	(5.5)	(0.3)	–	(1.4)	**(7.2)**
At 31 March 2017	682.2	1,165.0	84.5	–	393.0	**2,324.7**
Net book amount						
At 31 March 2017	**852.4**	**1,841.5**	**2,450.2**	**313.8**	**226.7**	**5,684.6**
At 31 March 2016	892.1	1,834.8	2,371.2	252.9	256.5	**5,607.5**

Freehold land is stated at a cost of £51.7 million at 31 March 2017 and 31 March 2016 and is not depreciated.

The company's interest in land and buildings are almost entirely freehold.

Included within additions above is £7.3 million (2016: £5.7 million) of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing costs'. The cumulative net book value of the borrowing costs capitalised amount to £167.4 million (2016: £167.0. million). The company has elected to apply IAS 23 from 1 April 2003, as permitted by the standard.

Included in the amounts shown above are the following amounts in relation to property, plant and equipment held under finance leases:

Assets held under finance leases	**2017 £m**	2016 £m
Net book amount at 31 March	**5.3**	5.9

13 Other non-current assets

Non-current receivables	2017 £m	2016 £m
Amounts owed by SWSG	**812.3**	812.3

Amounts owed by group undertakings represent a loan to Southern Water Services Group Limited which is secured on the assets held under the Southern Water Services Group Security agreement and repayable on 31 July 2052 with interest payable at 7% per annum.

14 Investments

Shares in subsidiary Southern Water Services (Finance) Limited	2017 £m	2016 £m
At 1 April and 31 March	**29.2**	29.2

The company has the following direct investments in subsidiary undertakings at 31 March 2017:

	Registered Office	Class of share capital	Activity
Southern Water Services (Finance) Ltd (SWSF)	Ugland House, PO Box 309, George Town, Grand Cayman	Ordinary (100%)	To raise debt finance
Southern Water Executive Pension Scheme Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant
Southern Water Pension Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant

SWSF is registered in the UK for tax purposes. The directors are satisfied that the carrying value of the investment in SWSF is supported by the underlying assets and activities of SWSF.

15 Inventories

Inventories	2017 £m	2016 £m
Raw materials	**2.0**	1.5
Work in progress	**0.7**	0.9
	2.7	2.4

16 Trade and other receivables

Trade and other receivables	2017 £m	2016 £m
Trade receivables	**224.6**	198.5
Provision for impairment	**(123.3)**	(111.9)
Net trade receivables	**101.3**	86.6
Loan to Southern Water Services (Finance) Limited	**8.3**	0.8
Amounts owed by other group undertakings	**5.2**	4.0
Other amounts receivable	**9.7**	6.2
Accrued income	**53.1**	80.1
Prepayments	**19.7**	14.6
	197.3	192.3

Amounts owed by group undertakings are unsecured, interest-free and settled regularly.

Accrued income as at 31 March 2017 includes water and sewerage income not yet billed of £50.2 million (2016: £73.1 million).

The directors consider that the carrying values of trade and other receivables are reasonable approximations of their fair values.

(i) Provision for impairment

Movements on the doubtful debts provision were as follows:

	2017 £m	2016 £m
At 1 April	**(111.9)**	(110.5)
Charge for bad and doubtful debts	**(25.3)**	(21.5)
Amounts written off during the year	**13.9**	20.1
At 31 March	**(123.3)**	(111.9)

At each reporting date, the company evaluates the recoverability of trade receivables and records allowances for doubtful receivables based on experience.

The following table provides information regarding the ageing of receivables that are specifically provided for:

	2017 £m	2016 £m
Current	**0.7**	0.7
1-2 years	**2.4**	0.9
2-3 years	**11.8**	9.9
3-4 years	**14.1**	7.0
more than 4 years	**39.8**	37.5
	68.8	56.0

A collective provision is recorded against assets which are past due but for which no specific provision has been made. This is calculated based on historical experience of levels of recovery.

16 Trade and other receivables (continued)

The aged analysis of receivables that were overdue at the reporting date but not individually provided for is as follows:

	2017 £m	2016 £m
Current	59.7	56.5
1-2 years	32.1	30.3
2-3 years	13.7	19.5
3-4 years	8.6	12.5
more than 4 years	6.4	6.7
	120.5	125.5

The amounts above are reconciled to gross and net debtors in the tables below:

At 31 March 2017	Gross £m	Provision £m	Net £m
Not due	35.3	–	35.3
Overdue not specifically provided	120.5	(54.5)	66.0
Overdue and specifically provided	68.8	(68.8)	–
	224.6	(123.3)	101.3

At 31 March 2016	Gross £m	Provision £m	Net £m
Not due	17.0	–	17.0
Overdue not specifically provided	125.5	(55.9)	69.6
Overdue and specifically provided	56.0	(56.0)	–
	198.5	(111.9)	86.6

17 Trade and other payables

Trade and other payables	2017 £m	2016 £m
Trade payables	18.9	13.7
Amounts owed to group undertakings	86.4	22.2
Capital creditors and capital accruals	96.8	59.3
Taxation and social security	3.0	2.8
Accruals and deferred revenue	105.0	90.1
	310.1	188.1

Amounts owed to group undertakings include the final dividend declared of £83.2 million which was paid in April 2017. The directors consider that the carrying values of trade and other payables are not materially different from their fair values.

18 Current borrowings

Current borrowings	2017 £m	2016 £m
Debt issue costs (note 19 (iv))	**(1.9)**	(1.9)
Bond premium deferred	**0.7**	0.7
Deferred gilt lock proceeds (note 19 (v))	**0.1**	0.1
Deferred proceeds	**9.7**	9.7
Term Facility Agreement 2014 £50m – 6-month Libor plus 0.5% 2016	**–**	50.0
Other loans from subsidiary SWSF	**30.3**	30.3
Obligations under finance leases	**0.5**	–
	39.4	88.9

19 Non-current borrowings

Non-current borrowings	Note	2017 £m	2016 £m
Loans from subsidiary SWSF:	(i)		
Class A £350m – 6.202% fixed rate 2029	(ii)	**348.4**	348.3
Class A £150m – 3.716% index linked 2034		**221.7**	217.7
Class A £35m – 3.716% index linked 2034		**51.7**	50.1
Class A £350m – 6.650% fixed rate 2026	(ii)	**348.6**	348.5
Class A £150m – 3.826% index linked 2023		**221.7**	217.7
Class A £350m – 5.010% fixed rate 2021	(ii)	**348.2**	347.8
Class A £150m – 5.010% fixed rate 2041	(ii)	**146.9**	146.8
Class A £200m – 4.510% fixed rate 2052	(ii)	**197.1**	197.1
Class A £300m – 5.135% fixed rate 2056	(ii)	**292.5**	292.4
Class A £300m – 6.135% fixed rate 2019	(ii)	**299.1**	298.7
Class A £175m – 2.790% fixed rate 2031	(ii)	**173.9**	–
Class A £75m – 2.970% fixed rate 2036	(ii)	**74.5**	–
Artesian £165m – 4.086% index linked 2033		**244.0**	239.5
Artesian £156.5m – 3.645% index linked 2032		**225.8**	221.7
Total Class A debt from SWSF		**3,194.1**	2,926.3
Class B £250m – 4.510% fixed rate 2022	(ii), (iii)	**247.1**	246.6
Debt issue costs	(iv)	**(16.1)**	(18.1)
Bond premium deferred		**10.2**	10.9
Deferred gilt lock proceeds	(v)	**5.0**	5.1
Deferred proceeds*		**105.3**	115.0
Other loans from subsidiary SWSF	(vi)	**30.3**	30.3
Total loans and other borrowings from SWSF		**3,575.9**	3,316.1
Class B, Term Facility Agreement 2014 £150m – 6-month Libor plus 1.950% 2021		**150.0**	150.0
Class A, Term Facility Agreement 2016 £50m – 6-month Libor plus 0.500% 2016		**–**	50.0
Class A £60m – 0.000% index linked 2025	(vii)	**62.1**	60.5
Class A £40m – 0.000% index linked 2026	(vii)	**41.0**	–
Class A1 Preference shares	(viii)	**32.6**	32.6
Class B Preference shares	(viii)	**110.0**	110.0
Obligations under finance leases		**1.5**	1.5
Total borrowings		**3,973.1**	3,720.7
Current borrowings		**39.4**	88.9
Non-current borrowings		**3,933.7**	3,631.8

*Deferred proceeds represent consideration received by the company in connection with taking on various debt obligations that were 'out of the money' at the time the debt obligations were entered into. The deferred proceeds are amortised over the lives of the related debt instruments.

19 Non-current borrowings (continued)

These loans (excluding the preference shares) are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertakings of each of SWS, SWSF, SWS Holdings Limited, and SWS Group Holdings Limited. In the case of SWS, this is to the extent permitted by the Water Industry Act 1991 and Licence. Further, the company has a contingent liability arising on certain inter-company financing arrangements which will have the effect that if certain refinancing's do not take place when the underlying instruments mature in 2021 to 2029, the company will make good certain obligations of its subsidiary SWSF. The directors do not believe this to be likely and the liability, if any, cannot currently be quantified as it will depend wholly on the circumstances at the time of the maturity.

Notes in respect of the specific instruments on page 173:

(i) Under the loan agreements between SWS and SWSF, SWSF advances an amount equal to each bond or other debt raised at the same interest rate plus 0.01%. Therefore each individual back-to-back inter-company loan has been separately disclosed.

(ii) Fixed rate borrowings are recognised net of issue costs and discounts on issue and are carried at amortised cost using the effective interest rate method.

(iii) The interest rate on the Class B £250 million is fixed at 4.51% until March 2022 when it reverts to Libor plus a margin to be determined with a premium of 0.01%.

(iv) Debt issue costs represent issue fees paid to SWSF that are not otherwise accounted for within the amortised cost of specific loans. Where these costs are attributable to a specific instrument they are being amortised over the life of that instrument. The remaining costs are being amortised over the weighted average life of the loans advanced at the time the costs were incurred. As at 31 March 2017 debt issue costs amounted to £16.1 million of which £1.9 million represents the short-term amount which is disclosed separately in note 18.

(v) Prior to the issue of the Class A £300 million bond in the year to 31 March 2008, SWSF entered into a gilt lock agreement, resulting in the receipt of £6.3 million, which was advanced to SWS along with the proceeds of the bond issue. The proceeds have been deferred in the financial statements of SWS and are being released to the income statement over the life of the loan.

(vi) The loan from SWSF is unsecured, interest-free, and shall be repayable in whole or part upon demand at any time, provided that:

(a) On the date of such demand, no Class A debt is outstanding, no Class B debt is outstanding and no mezzanine debt is outstanding; or

(b) The consent of the Security Trustee is given.

(vii) The Class A £60 million loan is index linked with an interest rate of 0.00% until August 2025. The Class A £40.0 million loan is index linked with an interest rate of 0.00% until May 2026.

(viii) The preference shares are redeemable at the option of SWS at any time.

The Class A1 and B preference shares, which do not carry voting rights, were issued on 23 July 2003, and are redeemable at their nominal value plus the share premium paid, on 31 March 2038 or at the company's option anytime earlier. Class A1 and B shares were issued at £1,000 per share and the amounts received totalled £260.0 million for both classes of shares. Class A2 preference shares were issued for £0.01 per share on 7 May 2003 and the amount received totalled £1,500. Class A2 shares, which do not carry voting rights, are also redeemable at nominal value. Shareholders are entitled to receive dividends annually as follows:

Class A1 – £40 per share

Class A2 – the base value dividend plus an amount for company out-performance and any savings arising from any refinancing of the mezzanine debt. The base value is £nil per share increasing by £15 every five years. (Out-performance from 1 April 2007 onwards is the difference between Southern Water Services Limited's audited 'profit before interest and taxation' and the targeted 'profit before interest and taxation' as determined by Ofwat in the periodic review).

Class B – £70 per share

These dividends are payable on 31 March and 30 September each year.

It is anticipated that a dividend will be declared and paid to the A2 preference shareholders in September 2017 for out-performance in the year ended 31 March 2017.

On winding up the preference shareholders rank above ordinary shareholders with the preference shareholders being paid in order of Class A1, Class A2 then Class B.

19 Non-current borrowings (continued)

Repayments fall due as follows:	2017 £m	2016 £m
Borrowings excluding finance leases:		
Between one and two years not by instalments	**299.1**	–
Between two and five years not by instalments	**742.8**	646.5
After five years not by instalments	**2,890.8**	2,983.8
	3,932.7	3,630.3
On demand or within one year not by instalments	**38.9**	88.9
	3,971.6	3,719.2
Finance leases:		
Between one and two years not by instalments	**0.6**	1.3
Between two and five years not by instalments	**0.4**	0.2
After five years not by instalments	**–**	–
	1.0	1.5
On demand or within one year not by instalments	**0.5**	–
	1.5	1.5
Borrowings including finance leases:		
Between one and two years not by instalments	**299.7**	1.3
Between two and five years not by instalments	**743.2**	646.7
After five years not by instalments	**2,890.8**	2,983.8
	3,933.7	3,631.8
On demand or within one year not by instalments	**39.4**	88.9
	3,973.1	3,720.7

It is the company's policy to lease certain of its fixtures and equipment under finance leases. Obligations under finance leases comprise optional residual value balloon payments due on vehicle leases at the end of the lease period, where the minimum lease payments (including finance charges) have been prepaid at the start of the lease. If the company opts not to pay the balloon payment, it must return the vehicle to the lessor.

The average lease term is five years.

For the year ended 31 March 2017, the average effective borrowing rate was 5.31% (2016: 6.52%). Interest rates are fixed at the contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

All lease obligations are denominated in sterling.

The fair value of the company's lease obligations is approximately equal to their carrying amount.

The company's obligations under finance leases are secured by the lessors' rights over the leased assets disclosed in note 12.

20 Derivative financial instruments

Categories of financial instruments at fair value	2017 £m	2016 £m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	**9.3**	12.4
Total derivative financial assets	**9.3**	12.4
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	**(1,347.3)**	(936.1)
Total derivative financial liabilities	**(1,347.3)**	(936.1)

The derivative assets and liabilities meet the offsetting criteria in paragraph 42 of IAS 32. This results in the presentation of a net derivative liability of £1,338.0 million in the statement of financial position.

Changes in value of financial instruments at fair value	2017 £m	2016 £m
Profit for the year has been arrived at after charging/(crediting):		
Financial assets at fair value		
Designated as FVTPL	**(3.1)**	(1.4)
Financial liabilities at fair value		
Designated as FVTPL	**(413.7)**	(69.0)
Fair value losses on derivative financial instruments	**(416.8)**	(70.4)

The derivative liability was reduced by £2.5 million in the year (2016: £298.4 million) due to payment of accrued indexation associated with the swap instruments.

The fair values of derivative instruments (interest rate swaps) at the reporting date are determined using quoted prices adjusted for credit risk.

The regulatory framework, under which revenues and the RCV are indexed, exposes the company to inflation risk. The company enters into inflation linked derivative financial instruments to manage its exposure to that risk.

Under interest rate swap contracts, the company agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the company to mitigate inflation risk on issued fixed rate debt held.

21 Deferred tax liabilities

Deferred tax is provided as follows:

Deferred tax liabilities	Accelerated tax depreciation £m	Revaluation of financial instruments £m	Retirement benefit obligations £m	Other – timing differences £m	Total £m
At 1 April 2015	590.2	(173.9)	(25.4)	7.3	**398.2**
(Credit)/charge to income statement	23.1	(10.0)	6.2	(9.1)	**10.2**
Charge to other comprehensive income	–	–	(2.8)	–	**(2.8)**
Effect of change in tax rate					
– income statement*	(42.8)	18.4	2.2	0.2	**(22.0)**
– other comprehensive income	(18.6)	–	–	–	**(18.6)**
At 1 April 2016*	551.9	(165.5)	(19.8)	(1.6)	**365.0**
(Credit)/charge to income statement	(11.4)	(67.5)	0.1	(0.5)	**(79.3)**
Prior year adjustment:					
(Credit)/charge to income statement	0.3	–	–	(0.4)	**(0.1)**
Credit to other comprehensive income	–	–	(12.8)	–	**(12.8)**
Effect of change in tax rate					
– income statement	(30.0)	12.9	0.1	0.1	**(16.9)**
– other comprehensive income	–	–	1.7	–	**1.7**
At 31 March 2017	**510.8**	**(220.1)**	**(30.7)**	**(2.4)**	**257.6**

* The effect of the change in tax rate in the income statement under the heading 'Revaluation of financial instruments' of £18.4 million in the year ended 31 March 2016 includes £19.4 million previously classified as 'Other timing differences'.

Deferred tax assets and liabilities are offset where the company has a legally enforceable right to do so. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2017 £m	2016 £m
Deferred tax liabilities	**510.8**	641.2
Deferred tax assets	**(253.2)**	(276.2)
	257.6	365.0

22 Retirement benefit obligations

The deficit associated with retirement benefit obligations has increased to £176.9 million (2016: £102.3 million) as a result of a decrease in corporate bond yields which decrease the discount rate used to calculate the value of pension scheme liabilities, offset by asset returns.

Pension schemes operated

The company principally operates one defined benefit pension scheme (final salary) and one defined contribution scheme, details of which are shown below:

1. Southern Water Pension Scheme (SWPS), a funded defined benefit scheme, was closed to new members on 31 December 1998, re-opened in July 2003 and closed once more to new entrants on 1 April 2005. This scheme has nine trustee directors. The Southern Water Services Executive Pension Scheme (SWEPS) was also closed to new entrants and merged with the SWPS on 1 April 2005.

   The Trustees are responsible for administrating the Fund which is held separately from the company. Legal and General and Blackrock are unit registrars for Southern Water Pension Scheme unit holdings, and appoint custodians at individual pooled fund level (not client holding level). The company directors are responsible for setting the accounting assumptions for the fund for inclusion in these financial statements.

   As part of the company's interactions with both the Trustees and when required the Pensions Regulator, we look to agree a long-term funding and risk management strategy for the pension liability and this is viewed as a key risk as set out on page 111. We are currently in regular dialogue with the Trustees and also in ongoing discussions and correspondence with the Pension Regulator regarding the current deficit and the Board are keen to agree a reasonable resolution of a long-term funding solution for the scheme.

   The main risks of the scheme are as follows:

   a) *Asset volatility:*

      For the purpose of setting the contribution requirements, the calculation uses a discount rate set with reference to government bond yields, with allowance for additional return to be generated from the investment portfolio – whereas under FRS 101, the defined benefit obligation is calculated using a discount rate set with reference to corporate bond yields.

      The schemes hold a significant proportion of their assets in growth assets. The returns on these assets may be volatile and are not correlated to the value placed on the liabilities. This means that the deficit may be volatile in the shorter term, which may result in an increase in the contribution requirements and an increase in the net defined benefit liability recorded on the statement of financial position.

      However, the company believes that return-seeking assets offer an appropriate level of return over the long term for the level of risk that is taken. Furthermore, the scheme's other assets are well-diversified by investing in a range of asset classes, including liability driven investments, government bonds and corporate bonds.

   b) *Changes in bond yields:*

      A fall in bond yields increases the value placed on the liabilities for reporting purposes and for setting the company's contribution requirements. However, in this scenario the scheme's investment in corporate and government bonds is expected to increase and therefore offset some of the increase in the value placed on the liabilities.

   c) *Life expectancy*

      The majority of the scheme's obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the scheme's liabilities. This is particularly significant where the longer duration and inflation-linked nature of the payments result in higher sensitivity to changes in life expectancy. The scheme does not contain a hedge against increases in future life expectancy.

   d) *Inflation risk*

      The majority of the scheme's benefit obligations are linked to inflation and higher out-turn inflation will lead to a higher benefit obligation (although in most cases caps on the level of inflationary increases are in place to protect the plan against extreme inflation). The majority of the schemes' assets do not provide a direct hedge against changes in inflation as they are either fixed-interest in nature e.g. corporate bonds and government bonds, or have an indirect link to inflation e.g. equities.

22 Retirement benefit obligations (continued)

2. A second company stakeholder scheme, which is a defined contribution scheme, is also available to all employees.

Contributions made to the defined contribution scheme for the year ended 31 March 2017 amounted to £2.6 million (2016: £2.3 million). No contributions were outstanding at either year end.

Members of all schemes receive an annual statement of their accrued benefits.

The latest actuarial valuation of the SWPS was carried out as at 31 March 2013 using the projected unit method. For closed schemes under this method the current service cost will increase as the members of the schemes approach retirement. The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on investments, and the level of inflation, which drives pension increases in the SWPS.

The principal assumptions in the valuation were as follows:

	2013 SWPS % per annum (pa)
Return on investments: pre-retirement Return on investments: post-retirement (pensioner/non-pensioner)	FI Gilt curve + 65 bps
Salary growth	2.50%
Pension increases on the excess over guaranteed minimum pensions (where capped at 5% pa)	2.75%

The term 'FI Gilt curve' refers to the generally available fixed interest gilt yield curve agreed by the Trustees and the company for the purposes of the 2013 actuarial valuation.

The assets of the scheme had a market value of £574.5 million at 31 March 2013. This was sufficient to cover 77% of the scheme's benefits. The duration of the scheme liabilities is 21 years.

Expected employer and employee contributions to the defined benefit scheme for 2017–18 are £5.6 million and £0.2 million respectively under the current Schedule of Contributions.

IAS 19 – assumptions, asset, liability and reserves disclosures

The formal actuarial funding valuation was carried out as at 31 March 2013 and updated to 31 March 2017 by a qualified independent actuary. The major assumptions used by the actuary are set out in the table below.

	2017 **% pa**	2016 % pa
Price inflation (RPI)	3.3	3.0
Price inflation (CPI)	2.3	2.0
Rate of increase in salaries (plus an age-related promotional scale)	2.4	2.5
Rate of increase of pensions in payment (MIS* members only)***	2.3	2.0
Rate of increase of pensions in payment (Old section** members only)***	3.3	3.0
Rate of increase of pensions in payment (all other members)***	3.2	2.9
Rate of increase for deferred pensions (MIS* members only)***	2.3	2.0
Rate of increase for deferred pensions (all other members)***	3.2	2.9
Discount rate	2.8	3.6

* MIS refers to the Southern Water Mirror Image Pension Scheme. Pensions in payment and deferment for this section will be indexed in line with the Consumer Price Index.

** For this section the Trustee will endeavour to meet any indexation of excess pension above the 5% per annum cap on increases that apply to other sections of the Scheme.

*** In excess of any Guaranteed Minimum Pension (GMP) element.

22 Retirement benefit obligations (continued)

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. For 2016–17, the company has used the post-retirement mortality assumptions based on the standard SAPS mortality tables together with future improvements in line with CMI 2015 improvements with a long-term improvement rate of 1.25% per annum.

	2017 Years	2016 Years
Longevity at age 65 for current pensioners		
Male	**22.7**	23.0
Female	**24.8**	25.1
Longevity at age 65 for future pensioners		
Male	**24.4**	24.8
Female	**26.7**	27.0

The assets and liabilities in the schemes and the expected rates of return at 31 March 2017 and 31 March 2016 were:

	Value at 2017 £m	Value at 2016 £m
Equities	**186.1**	171.5
Government bonds	**190.3**	196.2
Non-government bonds	**355.5**	266.3
Cash	**11.0**	40.1
Total market value of plan assets	**742.9**	674.1
Total value of plan liabilities	**(919.8)**	(776.4)
Accrued deficit in the plan	**(176.9)**	(102.3)
Related deferred tax asset	**30.7**	19.8
Net retirement benefit obligation	**(146.2)**	(82.5)

The equity investments and bonds which are held in plan assets are quoted and are valued at the current bid price.

Reconciliation of the present value of the scheme liabilities	2017 £m	2016 £m
At 1 April	**776.4**	789.3
Current service cost	**5.1**	5.4
Interest expense	**27.5**	26.4
Member contributions	**0.2**	0.2
Experience gain on liabilities	**(12.0)**	–
Actuarial (gain)/loss on liabilities:		
– due to changes in demographic assumptions	**(11.0)**	10.0
– due to changes in financial assumptions	**165.6**	(27.1)
Benefits paid	**(32.0)**	(27.8)
Scheme liabilities at 31 March	**919.8**	776.4

22 Retirement benefit obligations (continued)

The sensitivity of the present value of the scheme liabilities to changes in the principal assumptions used is set out below.

Sensitivity analysis of the scheme liabilities

	Change in assumption		Impact on scheme liabilities (%)		Impact on scheme liabilities (£m)	
Discount rate	+/-	1%	-/+	17	-/+	156
Rate of inflation*	+/-	1%	+/-	15	+/-	135
Rate of increase in pensions in payment	+/-	1%	+/-	12	+/-	114
Mortality	+/-	1yr	+/-	4	+/-	37

*A change in inflation is assumed to be reflected in a change in the assumed rates of deferment revaluation and pension increase (on pension in excess of GMP).

The above sensitivity analysis is based on a change in an assumption while holding all other assumptions constant. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. The methods and types of assumptions used in preparing the sensitivity analysis did not change compared to the previous period.

Reconciliation of the value of the scheme assets

	2017 £m	2016 £m
At 1 April	**674.1**	674.0
Interest income	**23.8**	22.5
Gain/(loss) on assets above interest	**71.2**	(31.1)
Employer contributions	**5.6**	37.2
Member contributions	**0.2**	0.2
Benefits paid	**(32.0)**	(27.8)
Administrative expenses	**–**	(0.9)
Bid value of scheme assets at 31 March	**742.9**	674.1

The total return on scheme assets was £95.0 million (2016: loss of £9.5 million).

Total cost recognised as an expense

	2017 £m	2016 £m
Current service cost	**5.1**	5.4
Net interest cost	**3.7**	3.9
Administration expenses	**–**	0.9
Total income statement expense before deduction for tax	**8.8**	10.2

22 Retirement benefit obligations (continued)

Analysis of the amounts recognised in other comprehensive income	2017 £m	2016 £m
Actual return less expected return on pension scheme assets	**71.2**	(31.1)
Experience gain arising on scheme liabilities	**12.0**	–
Gain/(loss) due to changes in demographic assumptions	**11.0**	(10.0)
(Loss)/gain due to changes in financial assumptions	**(165.6)**	27.1
Total loss recognised in OCI before adjustment for tax	**(71.4)**	(14.0)

The cumulative amount of actuarial losses recognised in other comprehensive income is £264.9 million (2016: £193.5 million).

Analysis of the movement in the schemes' deficit during the year	2017 £m	2016 £m
Deficit in the scheme at 1 April	**(102.3)**	(115.3)
Employer's contributions	**5.6**	37.2
Employer's current service cost	**(5.1)**	(5.4)
Financing charge	**(3.7)**	(3.9)
Administration expenses	**–**	(0.9)
Actuarial loss	**(71.4)**	(14.0)
Deficit in the scheme at end of year	**(176.9)**	(102.3)

23 Provision for liabilities

Environmental obligations	2017 £m	2016 £m
At 1 April	**0.5**	0.5
Utilised in year	**–**	–
At 31 March	**0.5**	0.5

The environmental provision relates to management's best estimate for the decommissioning of abandoned sites. No reimbursement is expected. The period over which the provision will be utilised cannot be determined, and, as a result, the provision is not discounted. Discounting the provision would not materially affect its value.

24 Other non-current liabilities

Other non-current liabilities	Deferred Revenue £m	Grants and contributions £m	Total £m
Balance at 1 April 2016	14.5	29.0	43.5
Receivable in year	–	20.2	20.2
Released to income statement	(0.3)	(1.2)	(1.5)
Balance at 31 March 2017	**14.2**	**48.0**	**62.2**

These grants and contributions relate to property, plant and equipment.

Deferred revenue £14.2 million (2016: £14.5 million) relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by SWS. The income will be credited to the income statement evenly over the life of the lease.

25 Called up share capital

Called up share capital	2017 £m	2016 £m
Equity shares		
Authorised		
46,050,000 ordinary shares of £1 each	**46.1**	46.1
Allotted and fully paid		
56,000 ordinary shares of £1 each	**0.1**	0.1
Non-equity shares		
Issued		
Preference shares		
32,607 Class A1 shares of £1 each	**–**	–
32,607 Class A2 shares of £0.01 each	**–**	–
110,000 Class B shares of £1 each	**0.1**	0.1

The redeemable preference shares are presented as a liability (see note 19) at an amount of £142.6 million including share premium of £142.5 million and accordingly are excluded from called up share capital in the balance sheet. The total statutory company share premium of £188.8 million includes ordinary share premium of £46.3 million.

26 Share premium account

Share premium account	2017 £m	2016 £m
Balance at 1 April and at 31 March	**46.3**	46.3

27 Revaluation reserve

Revaluation reserve:	
	£m
Balance at 1 April 2015	757.3
Transfer to retained earnings	(12.2)
Balance at 1 April 2016	745.1
Capital reduction	(735.0)
Transfer to retained earnings	(10.1)
Balance at 31 March 2017	–

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. On completion of this process, the issued share capital remained unchanged from the share capital in issue at the start of the year.

28 Retained earnings

Retained earnings	£m
Balance at 1 April 2015	553.9
Equity dividends paid	(125.1)
Profit for the financial year	119.9
Other comprehensive income for the year	7.4
Transfer from revaluation reserve	12.2
Balance at 1 April 2016	568.3
Equity dividends paid	(169.7)
Loss for the financial year	(175.7)
Other comprehensive loss for the year	(60.3)
Capital reduction	735.0
Transfer from revaluation reserve	10.1
Balance at 31 March 2017	**907.7**

29 Notes to the statement of cash flows

Cash generated by operations	2017 £m	2016 £m
Continuing operations		
Operating profit	**258.9**	284.5
Adjustments for:		
Depreciation of property, plant and equipment	**230.3**	225.9
Amortisation of intangible assets	**14.9**	8.7
Difference between pension charge and cash contributions	**(0.4)**	(31.0)
Amortisation of grants and contributions	**(1.2)**	(1.1)
Operating cash flows before movements in working capital	**502.5**	487.0
Increase in inventories	**(0.3)**	(0.2)
Decrease in receivables	**3.3**	11.8
Increase/(decrease) in payables	**18.8**	(16.6)
Cash from operating activities	**524.3**	482.0
Tax paid	**(11.4)**	(15.1)
Net cash generated from operating activities	**512.9**	466.9

Cash and cash equivalents	2017 £m	2016 £m
Cash and bank balances	**285.3**	17.9

Cash and cash equivalents comprise cash and short-term bank deposits with an original maturity of three months or less. The carrying amount of these assets is equal to their fair value.

Analysis of net debt	At 1 April 2016 £m	Cash flow £m	Other non-cash changes £m	At 31 March 2017 £m
Cash and cash equivalents	17.9	267.4	–	**285.3**
Derivative financial instruments	(923.7)	2.5	(416.8)	**(1,338.0)**
Debt issue costs	18.1	–	(2.0)	**16.1**
Gilt lock proceeds	(5.1)	–	0.1	**(5.0)**
Borrowings due within one year	(90.7)	50.0	–	**(40.7)**
Borrowings due after one year	(3,641.5)	(288.3)	(12.2)	**(3,942.0)**
Finance leases	(1.5)	0.3	(0.3)	**(1.5)**
Net debt	(4,626.5)	31.9	(431.2)	**(5,025.8)**

29 Notes to the statement of cash flows (continued)

Balances at 31 March 2017 comprise	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m	Total £m
Cash and cash equivalents	–	285.3	–	–	**285.3**
Derivative financial instruments	–	–	–	(1,338.0)	**(1,338.0)**
Debt issue costs	–	–	1.9	14.2	**16.1**
Gilt lock proceeds	–	–	(0.1)	(4.9)	**(5.0)**
Borrowings due within one year	–	–	(40.7)	–	**(40.7)**
Borrowings due after one year	–	–	–	(3,942.0)	**(3,942.0)**
Finance leases	–	–	(0.5)	(1.0)	**(1.5)**
Net debt	–	285.3	(39.4)	(5,271.7)	**(5,025.8)**

The non-cash movement of £431.2 million relates to an increase in debt as a result of indexation, movements on the fair value of derivatives, plus the amortisation of loan issue costs, gilt lock proceeds, deferred proceeds and a reduction in finance lease obligations.

Borrowings due within one year relate to amounts owed to group undertakings that are repayable on demand (see note 19).

30 Contingent liabilities

Contractors submit claims to the company for the estimated final cost of their works. These claims are reviewed to assess where the liability for the costs rests and the amount that will actually be settled. The expected amount is included within capital creditors and a further sum is identified as a contingent liability, representing a proportion of the difference between the contractor's claim and Southern Water's valuation.

The company had no contingent liabilities for capital claims at the year-end (2016: £nil).

Companies of the size and scale of Southern Water are sometimes subject to a number of claims disputes and potential litigation. The significant ones currently include ongoing investigations by regulatory bodies (the EA, DWI and Ofwat) as well as a potential claim in respect of property search income. The directors consider that, where it is possible to be estimated reasonably an appropriate position has been taken in reflecting such items in these financial statements. It is not currently possible to estimate the financial effect and likely timing of any associated outflow of some of these given the early stage of the investigations and claims and the potential range of outcomes.

31 Financial commitments

(a) Capital commitments are as follows:

	2017 £m	2016 £m
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	**354.8**	183.9
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	**9.7**	9.9

(b) The company as lessee

	2017 £m	2016 £m
Lease payments under operating leases recognised as an expense in the year	**3.9**	3.9

As at 31 March 2017 and 2016, the company had outstanding commitments for future minimum lease payments under non-cancellable operating leases in respect of vehicles and land and buildings which fall due as follows:

	Land and Buildings		Other	
	2017 £m	2016 £m	2017 £m	2016 £m
Within one year	**1.7**	1.7	**0.2**	0.2
In the second and fifth years inclusive	**6.2**	6.3	**0.3**	0.4
After more than five years	**13.0**	14.5	**0.1**	0.1
	20.9	22.5	**0.6**	0.7

Operating leases are charged to the income statement over the lease term.

Operating lease payments represent rentals payable by the company for certain of its office properties and company vehicles.

Commercial vehicle leases are negotiated for an average term of five years, and rentals are fixed for an average of five years, with an option to extend on an adhoc basis at the then prevailing market rate.

32 Related party transactions and ultimate controlling party

The immediate parent undertaking is SWS Holdings Limited.

The ultimate parent company and ultimate controlling party is Greensands Holdings Limited (GSH), a company incorporated in Jersey.

The largest shareholder in GSH as at 31 March 2017 is an institutional investment company advised by JP Morgan Asset Management owning 39.8%.

GSH is the only group company to prepare consolidated financial statements, copies of which may be obtained from the Company Secretary of GSH at Southern House, Yeoman Road, Worthing, BN13 3NX, or from our website.

The company has taken advantage of the exemption under FRS 101 'Reduced Disclosure Framework' in not disclosing details of transactions with other companies which are 100% wholly owned, equivalent disclosures are given in the group financial statements of GSH.

33 Post balance sheet events

Following careful consideration of the options available regarding the opening of the non-household retail market, the company disposed of its non-household retail business function with effect from 1 April 2017. It is estimated that this disposal will have an immaterial impact on operating profit.

Independent auditor's report to the members of Southern Water Services Limited

We have audited the financial statements of Southern Water Services Limited for the year ended 31 March 2017 which comprise the Income Statement, Statement of Other Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, the Cash Flow Statement and the related notes 1 to 33.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 'Reduced Disclosure Framework'.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

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

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements:

- *give a true and fair view of the state of the company's affairs as at 31 March 2017 and of its loss for the year then ended;*
- *have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and*
- *have been prepared in accordance with the requirements of the Companies Act 2006.*

Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- *the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and*
- *the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.*

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the Directors' Report.

Matters on which we are required to report by exception

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

- *adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or*
- *the financial statements are not in agreement with the accounting records and returns; or*
- *certain disclosures of directors' remuneration specified by law are not made; or*
- *we have not received all the information and explanations we require for our audit.*

Anthony Matthews

Anthony Matthews
(Senior statutory auditor)

for and on behalf of
Deloitte LLP
Statutory Auditor
London, United Kingdom

4 July 2017