Annual Performance Report 2016–17

Committed to our customers

Southern Water

Contents

Introduction

We operate in accordance with an Instrument of Appointment (our 'Licence') issued, by the Secretary of State, to us as a water and sewerage undertaker under the Water Industry Act 1991.

The Water Services Regulation Authority (Ofwat) has a duty under the Water Industry Act 1991 to ensure compliance with the conditions of this Licence.

The Annual Performance Report sets out the performance in 2016–17 of Southern Water's regulated business, as defined under our Licence, in financial terms and against our business outcome and performance commitments.

The Annual Performance Report comprises four sections:

1. *Regulatory financial reporting*
2. *Price control and additional segmental reporting*
3. *Outcome performance summary*
4. *Additional regulatory information.*

It also includes a compliance statement in relation to our position with regard to compliance with relevant statutory, licence and regulatory obligations and how we are taking appropriate steps to manage and/or mitigate any risks we face.

In addition we have also published a data assurance summary on our website – **southernwater.co.uk/our-reports**. This sets out the results of the data assurance undertaken on our reporting for 2016–17.

Company Monitoring Framework

On 30 November 2016, Ofwat published its updated assessment of companies' assurance activity and the Annual Performance Report for 2015–16 in its company monitoring framework.

Ofwat's assessment highlighted a number of areas of our good practice, however, overall its view was that we failed to meet requirements in terms of our information transparency and quality. As a result it gave us an assurance rating of 'prescribed', which is lower than our previous rating of 'targeted'. Companies in this category are described by Ofwat as having a reduced level of trust and confidence in their reported data.

In response, our Board, instigated an urgent review of our monitoring framework, and we have since made a number of changes which we are sure will restore confidence in the way we present our data. We fully agree that stakeholders must be able to trust the integrity of our performance reporting and are determined to ensure that Ofwat, our customers and other stakeholders can have confidence in our ability to provide that integrity.

We established an internal working group which met regularly to review progress against the actions identified to improve our reporting for 2016–17, in preparation for the publication of this report. We have also discussed our proposals with Ofwat to improve its confidence in our approach.

We have detailed our commitments to the additional actions we are taking in our final Statement of Risks, Strengths and Weaknesses, with finalisation of these actions in our Final Assurance Statement. A summary of our data assurance is included on page 47 and a more detailed report has been published on our website – **southernwater.co.uk/our-reports**.

Annual risk and compliance statement

The purpose of the annual risk and compliance statement is to give assurance to Ofwat, customers and other stakeholders that we have understood their expectations in relation to compliance with all our relevant statutory, licence and regulatory obligations and are taking appropriate steps to comply or manage and mitigate any risks identified.

Customer expectations

In preparing our business plan for the period 2015–20, we completed an extensive programme of engagement to understand the expectations of our customers and other stakeholders. Through a range of workshops and focus groups, we engaged with more than 34,000 customers and 448 key stakeholders across our region. We sought opinions and feedback from customers and stakeholders on the service they want and expect us to deliver. We partnered with the Citizens Advice Bureau to engage hard-to-reach customer groups and we publicised our business plan consultation through press, radio adverts and television news, reaching more than one million people. This engagement was essential in helping shape our future plans. Based on the findings of this programme we developed our plan for 2015–20 to deliver six customer priorities.

We have continued this engagement as we deliver our plans to provide our services and improvements in the future. We will also continue to engage with customers on how we are performing. For example, we have consulted extensively with customers on the selection of the seven bathing waters for inclusion in our bathing waters improvement programme.

We have also now begun preparations for the next business plan, covering the period from 2020–25. In June 2017, we published the first results of this engagement in the form of Let's Talk Water, Starting the conversation. This described our customers' long-term priorities, the challenges and opportunities we face and some of the choices we have about how we meet them in the future. We will be carrying out an ongoing programme of engagement as we develop our long-term vision for our region and our business plan for 2020–25.

Building on the success of the independent Customer Challenge Group, which was established during the last price review to ensure our business plan reflected the priorities of our customers, we established an independent Customer Advisory Panel (CAP) to monitor delivery of our business plan promises and advise the Board on key business issues from a customer perspective. During 2017, the CAP will begin its scrutiny of our preparations for the next price review and will report to Ofwat in 2018 on how we have engaged with our customers and reflected their views in our future plans.

We are committed to honest and transparent reporting on our performance to our customers and other stakeholders and where we have identified the need to improve our reporting we are committed to making the changes necessary.

Statutory and regulatory obligations

Our primary obligations and duties are set out in the Water Industry Act 1991, the Water Resources Act 1991 and our Licence.

During 2016–17, a number of concerns were raised in relation to some of our specific reporting and assurance processes. Our Board have taken these matters seriously, conducting an immediate review, and we have been working hard to make improvements for this year. In some areas this work will continue into 2017–18 in order to make all of the changes to processes required.

As mentioned above we are addressing the points raised by Ofwat in its Company Monitoring Framework and these have been included in our assurance plan for the Annual Performance Report this year.

The Drinking Water Inspectorate (DWI) raised some concerns regarding some delays to some site specific improvement works, our monitoring and reporting processes, and our compliance with Water Quality regulations regarding the collection of the required number of samples which resulted in some enforcement actions. We are working closely with the DWI to address these concerns. Details of the DWI's concerns are outlined in our updated Statement of Risks, Strengths and Weaknesses, January 2017, and Financial Assurance Plan March 2017, which are available on our website – **southernwater.co.uk/our-reports**.

We provide a significant amount of data to the EA about the performance of our assets and any wastewater or sewage discharges we make into what is known as the 'water environment', such as rivers, streams and coastal waters. We have identified the need to review and improve our end-to-end reporting processes with a view to implementing process and control improvements. Detailed process reviews have continued and a programme of improvements is being developed. We will establish a programme of rolling audits of our EA reporting and data integrity, starting with the 2017–18 internal audit programme of assurance. In addition, we will complete assurance of the 2015–16 and 2016–17 data. Independent external assurers will be assigned to the review, which will commence in August 2017.

We are also working with Ofwat in relation to the management and operation of our wastewater treatment works and the reporting of relevant information in connection with them.

In order to meet our obligations we have put in place a system of internal controls. We continually review performance information against a wide range of measures. Monthly reporting to the Board and the Executive Leadership Team (ELT) focuses on delivery of our regulatory and statutory obligations. This information is provided by way of a detailed performance dashboard, including our business plan promises and additional regulatory targets.

All members of the ELT are required, every six months, to provide a declaration that they and their teams are fully compliant with our procedures and controls, or otherwise record any areas of non-compliance, for areas of the business for which they are accountable. An action plan is required to address any areas of non-compliance, in appropriate timeframes.

Awareness training is given to all key individuals involved in providing regulatory compliance information and further training is planned this year to address concerns raised. The purpose of the training is to ensure there is understanding of internal controls and the importance of maintaining effective operation of controls.

A system of controls has been rolled out for data capture, collation and reporting within the business to make sure information used to measure compliance is complete, accurate and reliable. In light of the concerns raised this year we have been making improvements to these processes, and further changes are planned.

Senior managers and ELT members are accountable for the provision and sign-off of information from their business areas. This includes ensuring adequate procedures and processes are in place for data collection and reporting. Data providers are accountable for submitting accurate data to set timescales. Subject matter experts within the relevant business areas are accountable for ensuring that this data, and the processes and procedures used in collating it, comply with Ofwat's reporting requirements.

The Audit and Risk Review Committee (ARRC) has monitored the completion of a risk-based programme of assurance activities during the year, as part of a three-year rolling programme, covering the practices, procedures and systems used to secure compliance with our Licence and related statutory obligations.

In addition, an assessment of the audit approach required to provide assurance for all our 2016–17 business plan non-financial information, supporting our Performance Commitments and Outcome Delivery Incentives, has been completed by our technical assurers PricewaterhouseCoopers LLP. This has been done in collaboration with our Business Plan Performance team. This was completed in order to identify the appropriate assurance work required, for the year, to address the concerns raised by Ofwat in their Company Monitoring Framework. It will also ensure we comply with our business plan commitments and requirements under the 'prescribed' category for independent third party assurance.

We also engaged with our key stakeholders on areas of risks, strengths and weaknesses in our reporting. We published the findings of this exercise in November, with an invitation to stakeholders to comment on the findings. Following Ofwat's Company Monitoring Framework report for the year, we undertook further engagement and updated our statement in January 2017.

The publication set out how we would respond to stakeholders' feedback, detailed how our corporate assurance practices would meet our reporting compliance obligations and listed a number of actions we would take to resolve the issues raised by Ofwat within the Company Monitoring Framework. Our final assurance plan was published on 31 March 2017 and PricewaterhouseCoopers LLP, as our independent technical assurer, completed the audits of our Performance Commitments and Outcome Delivery Incentives. No material weaknesses were found from this testing.

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

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

Managing risks

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

Our approach to managing risk is to incorporate checks at every stage of our business so that they become part of our routine. Our Board is one of the drivers behind promoting a culture of assessing potential risks to every aspect of our business operations. Teams are encouraged to formally and regularly consider any risks in their aspect of the business, how they might impact on outcomes, and ensure that, as far as possible, they are managed to within acceptable levels.

The company's Executive Leadership Team (ELT) conducts a 'top down' identification of potential risks across the business on a biannual basis. This supplements each directorate's 'bottom up' evaluation, performed quarterly. In addition, consideration of risk is also embedded into key processes such as budgeting, business planning and performance management.

All identified risks are captured in the corporate risk system that details what each risk is, what might lead to it, the circumstances in which it might occur and its likely consequences. The impact and likelihood values of risks are assessed over an annual timeline, using a five-point severity scale. This allows reliable and consistent measurement and comparison of risks on a like-for-like basis.

All risks are assessed from three perspectives:

- *Residual risk – assuming controls and mitigating activities already in place work as intended*
- *Inherent risk – assuming the controls and mitigating activities do not exist or do not work as intended*
- *Targeted risk – capturing the desired level of risk exposure.*

Assessing risks in this way supports an understanding of the reliance placed on existing controls and mitigation, the worst case scenario for the risk, and how acceptable current levels of exposure are compared to target positions. This helps inform the focus of management oversight and challenge as well as prioritisation of responses.

Where the residual severity of a risk exceeds acceptable levels (i.e. is not aligned with target levels) then appropriate actions may need to be selected and implemented to bring the residual risk position in line with the target risk position.

In addition to monitoring individual risks, the ARRC works on behalf of the Board to undertake regular performance monitoring of risk management systems and internal controls, to ensure they are effective and performing as expected.

Risks are reviewed each month and the highest are reported to our ELT and the Board, with quarterly updates to the Audit and Risk Review Committee. Any new risks added to the database with a maximum score of 25 are passed to a director and the Chief Executive Officer for immediate review.

The company's appetite for risk – the Board's expression of the types and amounts of risk it is willing to take or accept in pursuit of its objectives – is also a key consideration. Having a corporate understanding of how much risk the company is prepared to accept overall, determines which individual risks we believe are an acceptable part of running a business and those which we consider pose an unacceptable threat. The latter require management responses, escalation and reporting.

The most significant risks facing the organisation are those considered by ELT and the Board to have the greatest potential to disrupt Southern Water's strategic objectives. These are referred to as the principal risks. Details of our principal risks and more information regarding our risk management process are provided under the Risks section on page 101 of the Annual Report.

Regulatory matters

The following regulatory accounting statements, and required regulatory information, are provided to comply with Condition F of our Licence, which requires that regulatory accounts are prepared in accordance with the Regulatory Accounting Guidelines issued by Ofwat as supplemented by IN16/09 issued in October 2016.

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

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

Ring fencing statement

Under paragraph 3.1 of Condition K of the Licence, the company is at all times required to ensure, so far as is reasonably practicable, that if a special administration order were made, the company would have available to it sufficient rights and assets (other than financial resources) to enable the special administrator to manage the affairs, business and property of the company. In the opinion of the directors, the company was in compliance with that requirement as at 31 March 2017.

Protection of the core business (Licence Condition F6A Certificate)

The directors declare that, in their opinion:

i) *The company will have available to it sufficient financial resources and facilities to enable it to carry out, for at least the next 12 months, its regulated activities (including the investment programme necessary to fulfil its obligations under its appointments)*

ii) *The company will, for at least the next 12 months, have available to it:*

a) management resources; and

b) systems of planning and internal control which are sufficient to enable it to carry out those functions.

In providing this certificate, the directors have taken into account:

– *the company's performance during 2016–17, the liquidity position based on projected operating and capital expenditure and working capital requirements, and headroom against financial covenants, credit ratings and financial risks*

– *the company's employment policies and strategy*

– *the company's formal risk management process which reviews, monitors and reports on the company's risks and mitigating controls and considers potential impact in terms of service, compliance, value, people, society and partners*

– *the company's plans for the remainder of this regulatory period*

– *the need to improve and improvements being made to the monitoring and effectiveness of our water and wastewater compliance controls, reporting and data integrity.*

The directors confirm that all contracts entered into with any associate company include all necessary provisions, and requirements concerning the standard of service to be supplied to the company, to ensure that it is able to meet all its obligations as a water and sewerage undertaker.

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

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

a) *ensuring that proper accounting records are maintained by the company to enable compliance with the requirements of Condition F and having regard also to the terms of guidelines notified by Ofwat to the company from time to time*

b) *preparing on a consistent basis for each financial year accounting statements in accordance with Condition F, having regard also to the terms of guidelines notified by Ofwat from time to time, which so far as is reasonably practicable have the same content as the annual accounts of the company prepared under the Companies Act 2006 and which are prepared in accordance with the formats, accounting policies and principles which apply to those accounts*

c) *preparing accounting statements on a current cost basis in respect of the same accounting period in accordance with guidelines issued by Ofwat, from time to time*

d) *preparing such other accounting and related information as is required by Condition F having regard also to the terms of guidelines issued by Ofwat from time to time.*

The directors approved the regulatory accounting statements (on pages 8 to 46) on 27 June 2017.

Section 35A of the Water Industry Act 1991

The company is required under s35A of the Water Industry Act 1991 to provide a statement that the remuneration paid to executive directors is linked to standards of performance. This statement is provided within the Directors' Remuneration Report section of the Annual Report and Financial Statements.

Long-term viability statement

In accordance with provision C.2.2 of the 2014 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 section on page 100 of the Annual Report.

Board statement

Save for those specific matters mentioned on pages 3 and 4 (where the company has identified a risk of shortcomings or potential shortcomings in the monitoring and effectiveness of its water and wastewater compliance controls, reporting and data integrity, and where the company has set out the steps it is taking or will take to manage and/or mitigate those risks), the Board confirms, that having taken all the steps that they ought to have taken as directors to make themselves aware of any relevant information, the company has:

1) *a full understanding of, and is meeting, its obligations and has taken steps to understand and meet customer expectations*

2) *sufficient processes and internal systems of control to fully meet its obligations*

3) *appropriate systems and processes in place to allow it to identify, manage and review its risks.*

Ian McAulay
Chief Executive Officer

Bill Tame
Chairman

27 June 2017

Regulatory financial reporting

1A – Income statement for the 12 months ended 31 March 2017

	Note	Statutory £m	Adjustments: Differences between statutory and RAG definitions £m	Adjustments: Non-appointed £m	Total adjustments £m	Total appointed activities £m
Revenue		**809.7**	**(5.9)**	**10.1**	**(16.0)**	**793.7**
Operating costs		(552.1)	(1.9)	(7.5)	5.6	**(546.5)**
Other operating income		0.4	–	–	–	**0.4**
Operating profit		**258.0**	**(7.8)**	**2.6**	**(10.4)**	**247.6**
Other income		1.3	14.9	–	14.9	**16.2**
Interest income		58.1	–	–	–	**58.1**
Interest expense		(157.6)	(8.6)	–	(8.6)	**(166.2)**
Other interest expense		(3.7)	–	–	–	**(3.7)**
Profit/(loss) before tax and fair value movements		**156.1**	**(1.5)**	**2.6**	**(4.1)**	**152.0**
Fair value losses on derivative financial instruments		(416.7)	–	–	–	**(416.7)**
(Loss)/profit before tax		**(260.6)**	**(1.5)**	**2.6**	**(4.1)**	**(264.7)**
UK Corporation tax	3	(11.4)	–	–	–	**(11.4)**
Deferred tax		96.3	–	–	–	**96.3**
(Loss)/profit for the year		**(175.7)**	**(1.5)**	**2.6**	**(4.1)**	**(179.8)**
Dividends		(169.7)	–	(2.6)	2.6	**(167.1)**

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

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

1B – Statement of comprehensive income for the 12 months ended 31 March 2017

	Statutory £m	Adjustments: Differences between statutory and RAG definitions £m	Adjustments: Non-appointed £m	Total adjustments £m	Total appointed activities £m
(Loss)/profit for the year	**(175.7)**	**(1.5)**	**2.6**	**(4.1)**	**(179.8)**
Actuarial losses on post-employment plans	(58.6)	–	–	–	**(58.6)**
Other comprehensive income	(1.7)	–	–	–	**(1.7)**
Total comprehensive expense for the year	**(236.0)**	**(1.5)**	**2.6**	**(4.1)**	**(240.1)**

1C – Statement of financial performance for the 12 months ended 31 March 2017					
		Adjustments			
	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	Total adjustments £m	Total appointed activities £m
Non-current assets					
Fixed assets	5,684.6	(167.4)	0.4	(167.8)	**5,516.8**
Intangible assets	61.1	(1.8)	–	(1.8)	**59.3**
Investments – loans to group companies	812.3	–	–	–	**812.3**
Investments – other	29.2	–	–	–	**29.2**
Total non-current assets	6,587.2	(169.2)	0.4	(169.6)	**6,417.6**
Current assets					
Inventories	2.7	–	0.4	(0.4)	**2.3**
Trade and other receivables	197.3	–	0.8	(0.8)	**196.5**
Cash and cash equivalents	285.3	–	–	–	**285.3**
Total current assets	485.3	–	1.2	(1.2)	**484.1**
Current liabilities					
Trade and other payables	(197.0)	10.3	(1.6)	11.9	**(185.1)**
Capex creditor	(96.8)	–	–	–	**(96.8)**
Borrowings	(39.4)	–	–	–	**(39.4)**
Current tax liabilities	(16.3)	–	–	–	**(16.3)**
Total current liabilities	(349.5)	10.3	(1.6)	11.9	**(337.6)**
Net current assets/(liabilities)	**135.8**	**10.3**	**(0.4)**	**10.7**	**146.5**
Non-current liabilities					
Trade and other payables	(14.2)	(17.4)	–	(17.4)	**(31.6)**
Borrowings	(3,791.0)	–	–	–	**(3,791.0)**
Financial instruments	(1,338.0)	–	–	–	**(1,338.0)**
Retirement benefit obligations	(177.0)	–	–	–	**(177.0)**
Provisions	(0.5)	–	–	–	**(0.5)**
Deferred income – grants and contributions	(48.0)	7.1	–	7.1	**(40.9)**
Preference share capital	(142.6)	–	–	–	**(142.6)**
Deferred tax	(257.6)	–	–	–	**(257.6)**
Total non-current liabilities	(5,768.9)	(10.3)	–	(10.3)	**(5,779.2)**
Net assets	**954.1**	**(169.2)**	**–**	**(169.2)**	**784.9**
Equity					
Called up share capital	0.1	–	–	–	**0.1**
Retained earnings and other reserves	954.0	(169.2)	–	(169.2)	**784.8**
Total equity	**954.1**	**(169.2)**	**–**	**(169.2)**	**784.9**

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

1D – Statement of cash flows for the 12 months ended 31 March 2017		Adjustments			
	Statutory £m	Differences between statutory and RAG definitions £m	Non-appointed £m	Total adjustments £m	Total appointed activities £m
Operating profit	258.0	(7.8)	2.6	(10.4)	**247.6**
Other income	1.3	14.9	–	14.9	**16.2**
Depreciation	245.2	(7.1)	–	(7.1)	**238.1**
Amortisation – grants and contributions	(1.2)	–	–	–	**(1.2)**
Changes in working capital	21.8	–	–	–	**21.8**
Pension contributions	(0.4)	–	–	–	**(0.4)**
Profit on sale of fixed assets	(0.4)	–	–	–	**(0.4)**
Cash generated from operations	**524.3**	**–**	**2.6**	**(2.6)**	**521.7**
Net interest paid	(92.3)	–	–	–	**(92.3)**
Tax paid	(11.4)	–	–	–	**(11.4)**
Net cash generated from operating activities	**420.6**	**–**	**2.6**	**(2.6)**	**418.0**
Investing activities					
Capital expenditure	(278.1)	–	–	–	**(278.1)**
Grants and contributions	3.1	–	–	–	**3.1**
Other	(7.3)	–	–	–	**(7.3)**
Net cash used in investing activities	**(282.3)**	**–**	**–**	**–**	**(282.3)**
Net cash generated before financing activities	**138.3**	**–**	**2.6**	**(2.6)**	**135.7**
Cash flows from financing activities					
Equity dividends paid	(106.5)	–	(2.6)	2.6	**(103.9)**
Net loans received	235.6	–	–	–	**235.6**
Net cash used in financing activities	**129.1**	**–**	**(2.6)**	**2.6**	**131.7**
Increase in net cash	**267.4**	**–**	**–**	**–**	**267.4**

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

1E – Net debt analysis at 31 March 2017				
	Interest rate risk profile			
	Fixed rate £m	Floating rate £m	Index linked £m	Total £m
Borrowings (excluding preference shares)	1,057.3	282.5	2,429.0	**3,768.8**
Preference share capital				142.6
Total borrowings				**3,911.4**
Cash				(285.3)
Net debt				**3,626.1**
Gearing				**78.5%**
Adjusted gearing				**77.0%**
Full year equivalent nominal interest cost	59.9	8.7	116.1	**184.7**
Full year equivalent cash interest payment	59.9	8.7	64.0	**132.6**
Indicative interest rates				
Indicative weighted average nominal interest rate	5.7%	3.1%	4.8%	**4.9%**
Indicative weighted average cash interest rate	5.7%	3.1%	2.6%	**3.5%**
Weighted average years to maturity	14.5	4.0	13.2	**13.7**

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

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

A reconciliation between the borrowings reported in tables 1C and 1E is shown below:

Reconciliation of borrowings between table 1C and table 1E	
	£m
1C – Current liabilities borrowings	39.4
1C – Non-current liabilities borrowings	3,791.0
Total Borrowings (table 1C)	**3,830.4**
Debt issue costs	16.1
Bond premium deferred	(10.2)
Deferred gilt lock proceeds	(5.0)
Deferred proceeds	(105.2)
Accrued swap accretion	42.7
Borrowings (table 1E)	**3,768.8**

The debt issue costs, bond premium, deferred gilt lock proceeds and deferred proceeds are amortised to the income statement and details are presented in note 19 to our statutory accounts.

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

Notes to the regulatory financial statements for the year ended 31 March 2017

1 Accounting policies

a) Basis of preparation

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

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

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

- *revenue recognition*
- *capitalisation of borrowing costs.*

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

b) Fixed assets

Interest – To meet the requirements of RAG 1.07 the interest capitalised within the statutory accounts under IAS 23 'Borrowing Costs' has been reversed and charged through the income statement.

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

Non-infrastructure assets

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

Infrastructure assets

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

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

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

c) Revenue

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

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

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

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

Within the accrual, adjustments to billing are made for customers who may opt to change to a transitional tariff as part of our Universal Metering Programme, for changes to occupancy dates, and where consumption levels are in excess of certain tolerances. No other amendments are made between revenue and billing.

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

In the statutory accounts, reported under 'IAS 18 – Revenue', revenue is only recognised when it is probable that economic benefits will result to the company. RAG 1.07 requires that no judgment is applied to the probability of collection. As a result of this requirement there is a difference between the revenue reported in the statutory and regulatory accounts. In 2016–17 this difference amounted to £12.4 million.

Charging policy

Water and sewerage charges fall into the following three categories:

1) *Charges which are payable in full.*
2) *Charges which are payable in part.*
3) *Not chargeable (void properties).*

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

Charges payable in full

Charges are payable in full in the following circumstances:

i) Occupied and furnished

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

ii) Unoccupied and furnished

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

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

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

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

iii) Unoccupied and unfurnished

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

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

Charges payable in part

The following charges only are payable in certain circumstances:

- *Metered standing charges – Payable on unoccupied, metered properties which are still connected.*
- *Surface water charge – Payable on unmeasured properties which are temporarily disconnected.*

- *Sewerage unmeasured tariff – Payable on unmeasured, occupied properties where the water supply is disconnected but sewerage is still provided.*
- *Surface water and highway drainage – Payable on furnished properties where the water supply is disconnected.*

Not chargeable

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

Definition and treatment of properties

Occupied properties

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

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

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

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

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

Unoccupied properties

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

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

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

New properties

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

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

d) Revenue disclosures

In accordance with RAG 3.09 we highlight the following comments in respect of turnover for the year:

(i) *The value of billings raised in the year ended 31 March 2017 for consumption in prior years was £158.4 million. The value of these billings was higher than the metered income accrual made at 31 March 2016. The estimation difference was £6.8 million and this has been recognised in the current year's turnover. This difference is well within our view of acceptable tolerances for accounting estimates.*

(ii) *There have been no changes to the methodology for calculating the measured accrual in the year.*

e) Bad and doubtful debts

The bad debt provision is calculated by applying estimated recovery rates, based on past collections experience, to various categories of debt segmented by age and customer type.

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

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

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

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

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

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

The company's bad debt provisioning and write-off policies have remained unchanged and have been consistently applied during the year. There has been no significant variation in the level of bad debt provision or write-off from the previous year.

The value of trade and other receivables of the appointed business increased to £196.5 million (2016: £191.5 million). This increase largely results from an increase of £7.5 million in an inter-company debtor for interest payments with Southern Water Services (Finance) (SWSF). During February and March 2017, we raised final bills to our non-household customers ahead of their transfer to Business Stream. This final billing resulted in a transfer from accrued to billed debt and accelerated some cash receipts, which contributed to reducing our overall debt position by £12.3 million. This reduction was offset by increases in prepayments for certain contracts and in our VAT recoverable from HMRC.

f) Price control segments

The notes to the regulatory accounting statements analysing revenues, operating costs and fixed assets by price control segment have been drawn up in accordance with the guidance provided by Ofwat in RAG 2.06 and our accounting separation methodology statement which is published separately on our website.

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

Operating expenditure

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

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

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

Fixed assets

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

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

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

Revenues

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

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

2 Differences between statutory and regulatory reporting

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

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

Income statement

i) *Income generated from Combined Heat and Power (CHP) processes, which convert methane into electricity, is recorded as revenue within the statutory accounts. For regulatory reporting this income is reported as a negative operating cost. As a result £3.4 million of revenue has been re-classified as a negative operating cost.*

ii) *For statutory reporting, revenue has not been recognised when the flow of economic benefits is not probable. Regulatory reporting requires this revenue to be recognised along with an associated bad debt revised charge. As a result an additional £12.4 million has been recognised in revenue, with a corresponding increase to operating costs.*

iii) *As required by RAG 1.07 section 1.8, grants and contributions received and recognised in the income statement are reported under other income in the Annual Performance Report financial tables. As a result £14.9 million has been transferred from revenue to other income in the income statement. See table 2E for further information.*

iv) *For statutory reporting, borrowing costs associated with capital expenditure are capitalised. Regulatory reporting does not permit interest to be capitalised. As a result operating costs are reduced by £7.1 million, reflecting the removal of depreciation on interest capitalised and the interest charge has been increased by £8.6 million reversing the element of interest capitalised in the year.*

Income statement	Revenue £m	Operating costs £m	Other income £m	Interest expense £m
i) CHP income	(3.4)	3.4	–	–
ii) Revenue recognition	12.4	(12.4)	–	–
iii) Grants and contributions	(14.9)	–	14.9	–
iv) Borrowing costs	–	7.1	–	(8.6)
Total	(5.9)	(1.9)	14.9	(8.6)

Statement of financial position

Statement of financial position	Fixed assets £m	Intangible assets £m	Current trade and other payables £m	Non-current trade and other payables £m	Deferred income £m
i) Borrowing costs	(167.4)	(1.8)	–	–	–
ii) Grants and contributions	–	–	10.3	(17.4)	7.1
Total	(167.4)	(1.8)	10.3	(17.4)	7.1

i) As borrowing costs cannot be capitalised under regulatory reporting, fixed and intangible assets have been reduced by £167.4 million and £1.8 million respectively, reflecting the removal of cumulative borrowing costs capitalised. There is a corresponding reduction to retained earnings.

ii) Grants and contributions relating to requisitions of £10.3 million classified within current trade and other payables in the statutory accounts have been transferred to deferred income for regulatory reporting. In addition the cumulative value of deferred income associated with adopted assets of £17.4 million has been transferred to non-current trade and other payables to ensure consistency across the subsequent regulatory reporting tables.

Statement of cash flows

i) There is a £7.1 million adjustment made to both operating profit and depreciation relating to the removal of capitalised borrowing costs, together with the re-classification of grant and contributions received in the income statement of £14.9 million from operating profit to other income.

3 Corporation tax reconciliation

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

Corporation tax reconciliation	Appointed £m	Non-appointed £m
Profit before tax and fair value movement	152.0	2.6
Tax at the UK corporation tax rate of 20%	30.4	0.5
Permanent differences	3.3	–
Fixed asset timing differences	13.0	–
Other short-term timing differences	(7.8)	–
Pension cost relief in excess of pension charge	(0.1)	–
Group relief received for nil payment	(27.4)	(0.5)
Adjustment in respect of prior years – current tax	–	–
Tax charge for year	11.4	–

Comparison between tax charge and allowance in price limits:

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

Comparison between tax charge and allowance in price limits

	Current tax charge £m	Current tax charge (excluding SWSG loan) £m
i) Final Determination allowance	–	–
ii) Price determination – tax not charged on forecast tax losses	(4.3)	(4.3)
iii) Earnings before interest and tax	5.5	5.5
iv) Net finance costs, including taxable fair value movements	16.9	5.5
v) Depreciation and capital allowances claimed	20.1	20.1
vi) Group relief claimed	(38.8)	(38.8)
Other	0.6	0.6
Current tax before payments for group relief and prior year adjustments	**–**	**–**
vii) Payments for group relief	11.4	–
Appointed current tax charge	**11.4**	**–**

i) *Our customers benefit from there being no allowance for wholesale corporation tax as a result of the price determination current tax allowance being zero. At appointee level, and as a single entity for tax purposes, the wholesale tax losses forecast at the price determination entirely offset the small tax charge for retail activities.*

ii) *For 2016–17 the price determination included taxable losses of £4.3 million and no allowance was provided for these.*

iii) *Actual earnings before interest and tax are higher than those in the Final Determination, mainly due to wholesale efficiencies and lower than anticipated levels of infrastructure maintenance and repair costs charged to operating expenditure, partially offset by additional expenditure in our retail services. Revenues and income were also slightly lower than those in our determination.*

iv) *Net finance costs are lower as a result of lower inflation on inflation-linked financial instruments, lower interest costs, and the inclusion of interest income on the inter-company loan from Southern Water Services Group (SWSG) (see fig. 1 on page 99 of the Annual Report for further explanation). The cash flows relating to the inter-company loan to SWSG are neutral to Southern Water and its customers, given that we receive interest and pay an equal amount of dividend and group tax relief back to SWSG. The effect of removing this loan (consistent with the treatment in the price determination) is shown in the table above.*

v) *Lower capital allowances were claimed as a result of prioritising the use of group losses over capital allowances and the lower level of capital expenditure in 2015–16 and 2016–17 compared to our allowance, as described in table 4B.*

vi) *We were able to use losses from other companies within the Greensands group in order to reduce the current tax charge for Southern Water.*

Payment was made for the losses at SWSG, totalling £11.4 million, but no payment was made for the benefit of the remaining losses received from other companies in the Greensands group. Capital allowances not claimed are available to Southern Water as a deduction against future taxable profits.

vii) *The group relief payment for the year reflects payment at the current tax rate, for the tax losses received on the inter-company interest income from SWSG. Remaining losses are received for nil payment.*

Taxation policy and strategy

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

Our tax policy is consistent with the overall values and strategy of the company and will consider financial risk, reputational risk, and social responsibilities. Our approach to tax planning is to align to business decisions made in the best interests of customers and stakeholders rather than using tax planning to drive or determine business decisions. Our focus is therefore on compliance, and our tax planning is always aligned with our commercial and economic activity.

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

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

A key factor in managing tax is our relationship with HMRC. We meet all statutory and legislative requirements and we manage our tax affairs in an open and transparent way. This extends to us sharing information with HMRC, such as internal audit findings. HMRC share our view of our low risk approach to the management of our tax affairs with an assessment of us as a 'low-risk' company.

Further information is available in our Annual Report on page 92.

Details of factors affecting 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 Balance sheet 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.

Price review and other segmental reporting

2A – Segmental income statement for the 12 months ended 31 March 2017

	Wholesale						
	Water resources £m	Water network + £m	Water total £m	Wastewater network + £m	Sludge £m	Wastewater total £m	Total £m
Revenue – price control	–	165.8	165.8	549.7	–	549.7	**715.5**
Revenue – non price control	–	3.9	3.9	0.8	–	0.8	**4.7**
Operating expenditure	(10.5)	(67.2)	(77.7)	(124.9)	(19.0)	(143.9)	**(221.6)**
Depreciation – tangible fixed assets	(1.7)	(49.6)	(51.3)	(151.5)	(18.5)	(170.0)	**(221.3)**
Amortisation – intangible fixed assets	(3.2)	(0.2)	(3.4)	(7.7)	–	(7.7)	**(11.1)**
Other operating income	–	0.1	0.1	0.1	0.2	0.3	**0.4**
Operating profit/(loss) before recharges	**(15.4)**	**52.8**	**37.4**	**266.5**	**(37.3)**	**229.2**	**266.6**
Recharges from other segments	(0.2)	(4.8)	(5.0)	–	(1.0)	(1.0)	**(6.0)**
Recharges to other segments	–	–	–	10.6	–	10.6	**10.6**
Operating profit/(loss)	**(15.6)**	**48.0**	**32.4**	**277.1**	**(38.3)**	**238.8**	**271.2**

	Retail			
	Household £m	Non-household £m	Total £m	Wholesale and Retail total £m
Revenue – price control	63.5	10.0	**73.5**	**789.0**
Revenue – non price control	–	–	**–**	**4.7**
Operating expenditure	(80.4)	(6.4)	**(86.8)**	**(308.4)**
Depreciation – tangible fixed assets	(2.2)	–	**(2.2)**	**(223.5)**
Amortisation – intangible fixed assets	(3.5)	–	**(3.5)**	**(14.6)**
Other operating income	–	–	**–**	**0.4**
Operating profit/(loss) before recharges	**(22.6)**	**3.6**	**(19.0)**	**247.6**
Recharges from other segments	(3.8)	(0.8)	**(4.6)**	**(10.6)**
Recharges to other segments	–	–	**–**	**10.6**
Operating profit/(loss)	**(26.4)**	**2.8**	**(23.6)**	**247.6**
Surface water drainage rebates				**0.4**

2B – Totex analysis for the 12 months ended 31 March 2017 – Wholesale water and wastewater

	Water resources £m	Water network + £m	Wastewater network + £m	Sludge £m	Total £m
Operating expenditure					
Power	3.2	11.5	27.7	(2.4)	**40.0**
Income treated as negative expenditure	–	–	–	(3.4)	**(3.4)**
Service charges/discharge consents	4.3	–	3.0	–	**7.3**
Bulk supply/bulk discharge	–	0.1	–	–	**0.1**
Other operating expenditure	1.5	44.3	80.7	23.1	**149.6**
Local authority rates	0.8	9.8	13.5	1.7	**25.8**
Total operating expenditure excluding third party services	**9.8**	**65.7**	**124.9**	**19.0**	**219.4**
Third party services	0.7	1.5	–	–	**2.2**
Total operating expenditure	**10.5**	**67.2**	**124.9**	**19.0**	**221.6**
Capital expenditure					
Maintaining the long-term capability of the assets – infrastructure	0.3	14.3	23.5	–	**38.1**
Maintaining the long-term capability of the assets – non-infrastructure	3.3	41.6	121.5	17.4	**183.8**
Other capital expenditure – infrastructure	0.6	13.2	30.5	–	**44.3**
Other capital expenditure – non-infrastructure	2.8	12.9	44.8	0.4	**60.9**
Total gross capital expenditure excluding third party services	**7.0**	**82.0**	**220.3**	**17.8**	**327.1**
Third party services	1.9	1.8	1.4	–	**5.1**
Total gross capital expenditure	**8.9**	**83.8**	**221.7**	**17.8**	**332.2**
Grants and contributions (price control)	–	9.1	11.6	–	**20.7**
Totex	**19.4**	**141.9**	**335.0**	**36.8**	**533.1**
Cash expenditure					
Pension deficit recovery payments	–	–	–	–	**–**
Totex including cash items	**19.4**	**141.9**	**335.0**	**36.8**	**533.1**

2C – Operating cost analysis for the 12 months ended 31 March 2017 – Retail	Household £m	Non-household £m	Total £m
Operating expenditure			
Customer services	19.6	2.0	**21.6**
Debt management	8.7	0.9	**9.6**
Doubtful debts	35.6	1.5	**37.1**
Meter reading	5.3	0.8	**6.1**
Services to developers		0.2	**0.2**
Other operating expenditure	11.2	1.0	**12.2**
Exceptional items	–	–	**–**
Total operating expenditure excluding third party services	**80.4**	**6.4**	**86.8**
Third party services operating expenditure	–	–	**–**
Total operating expenditure	**80.4**	**6.4**	**86.8**
Depreciation – tangible fixed assets	2.2	–	**2.2**
Amortisation – intangible fixed assets	3.5	–	**3.5**
Total operating costs	**86.1**	**6.4**	**92.5**
Debt written off	**14.3**	**2.0**	**16.3**

Retail operating costs reported in table 2C are higher than forecast in the business plan for both household and non-household services by £28.6 million and £1.2 million respectively.

The increase is due to the following factors:

Household

Customer Service costs were £8 million higher than the allowance in the Final Determination. All inbound contact has been transferred to an outsourced partner, with a proactive team retained internally to work with customers experiencing high bill movements and payment scheme changes. This has had a positive impact in terms of reducing levels of contact and complaints year-on-year but has resulted in additional costs in 2016–17. There has been a significant focus in the year on developing processes to improve the experience of our customers and this will continue into 2017–18. The improvements include introducing web chat, enhanced online services, combined water and wastewater bills for those customers receiving services from both Southern and South East Water, ensuring bills are easy to understand and that we proactively contact vulnerable customers to offer tailored tariffs and support.

Debt management costs are higher than the Final Determination allowance by £3.6 million for the year. This is driven by a significant increase in proactive measures to collect outstanding debt from customers and to support those customers with financial difficulties. In 2016–17 there was increased expenditure on litigation, specialist debt advice visits and consultancy. Debt reduction continues to be a priority for the business and in 2017–18 we will be continuing to focus on customer segmentation in order to contact those that need support and to implement tailored collection strategies across our customer base.

There has been a significant increase in the bad debt charge with an £11 million variance compared to our allowance. We have seen continued pressure on debt from customers who have moved out of our supply area and these attract a high provision charge. In addition, dis-engaged customers who continue to default on payment after going through the full end-to-end collection process add a significant cost in this area. With the majority of these customers now having a meter we have seen an increase in the average bill value which adds further pressure in this area.

The depreciation charge for the household retail business is significantly higher than the allowance in the Final Determination. This is because the depreciation charge for legacy assets of £5.5 million is included within the wholesale price control in the Final Determination. Depreciation, in 2016–17, for assets delivered as part of our AMP6 capital programme was £0.2 million. This is lower than the allowance in the Final Determination of £0.8 million.

Non-household

With the non-household market opening for competition from 1 April 2017, there was a significant focus on the non-household retail business and a number of options to consider. After careful consideration of these options, the Board decided to exit this market and the retail non-household business was sold to Business Stream on 1 April 2017.

Customer services includes the costs associated with the final billing process for all non-household customers to 31 March 2017 and the cost of dealing with associated queries around the market opening process. A significant level of data analysis, segmentation and cleansing took place in the year to ensure the correct customers were moved into the open market.

Debt management costs for non-household retail were also higher due to an increased focus on the collection of legacy debt in the year to mitigate the risk of bad debt following the opening of the non-household market. This has had a positive impact on the year-end provision charge for non-household, which was £0.7 million lower than the Final Determination allowance.

General

As well as the specific factors described above, there have been changes to our cost allocations and accounting framework which have affected both household and non-household costs.

The methodology for allocating building services and accommodation costs across business units is different in the current regulatory accounting guidance from the requirements of the business plan and this has resulted in an increased charge to the retail business.

During the first year of this regulatory period, 2015–16, we changed our accounting framework from UK GAAP to Financial Reporting Standards 101 (FRS 101). As a result, certain costs previously capitalised as part of infrastructure renewals expenditure are now treated as operating costs. The jobs previously capitalised included an allocation for the network enquiry cost associated with them. These costs are now treated as operating costs and in accordance with the guidance provided in RAG 2.06 have been included within the retail business units. The impact of the change in accounting framework was not included within retail in our business plan which made the assumption that the changes to infrastructure accounting would only affect wholesale costs. For 2016–17 this resulted in a charge to the retail business of £1.1 million which was not included in our business plan.

2D – Historic cost analysis of tangible fixed assets – Wholesale and retail	Wholesale				Retail		
	Water resources £m	Water network + £m	Wastewater network + £m	Sludge £m	Household £m	Non-household £m	Total £m
Cost							
At 1 April 2016	177.4	1,485.3	5,285.0	517.4	40.2	–	**7,505.3**
Disposals	(0.3)	(2.8)	(3.6)	(0.5)	–	–	**(7.2)**
Additions	0.7	82.8	180.7	17.8	1.0	–	**283.0**
Assets adopted at nil cost	–	–	17.1	–	–	–	**17.1**
At 31 March 2017	**177.8**	**1,565.3**	**5,479.2**	**534.7**	**41.2**	**–**	**7,798.2**
Depreciation							
At 1 April 2016	(64.0)	(398.8)	(1,371.7)	(194.7)	(35.9)	–	**(2,065.1)**
Disposals	0.3	2.8	3.6	0.5	–	–	**7.2**
Charge for year	(1.7)	(49.6)	(151.5)	(18.5)	(2.2)	–	**(223.5)**
At 31 March 2017	**(65.4)**	**(445.6)**	**(1,519.6)**	**(212.7)**	**(38.1)**	**–**	**(2,281.4)**
Net book amount at 31 March 2017	**112.4**	**1,119.7**	**3,959.6**	**322.0**	**3.1**	**–**	**5,516.8**
Net book amount at 1 April 2016	113.4	1,086.5	3,913.3	322.7	4.3	–	**5,440.2**
Depreciation charge for year							
Principal services	(1.6)	(48.9)	(151.4)	(18.5)	(2.2)	–	**(222.6)**
Third party services	(0.1)	(0.7)	(0.1)	–	–	–	**(0.9)**
Total	**(1.7)**	**(49.6)**	**(151.5)**	**(18.5)**	**(2.2)**	**–**	**(223.5)**

The net book value of tangible assets includes £301.6 million in respect of assets in the course of construction.

Although not required by RAG 3.09 ,an intangible asset note is presented below in order to assist with the reconciliation of the capital expenditure presented in tables 2B, 4D and 4E.

During the year certain water resources assets, recorded as tangible at March 2016, have been reclassified as intangible. As a result there is a transfer of £8.1 million from tangible additions to intangible additions. The accumulated depreciation of £3.2 million associated with these assets has also been transferred during the year.

Historic cost analysis of intangible assets – Wholesale and retail							
	Wholesale				Retail		
	Water resources £m	Water network + £m	Wastewater network + £m	Sludge £m	Household £m	Non-household £m	Total £m
Cost							
At 1 April 2016	–	0.3	54.3	–	20.2	–	**74.8**
Disposals	–	–	–	–	–	–	**–**
Additions	8.2	1.1	23.9	–	(0.4)	–	**32.8**
Assets adopted at nil cost	–	–	–	–	–	–	**–**
At 31 March 2017	**8.2**	**1.4**	**78.2**	**–**	**19.8**	**–**	**107.6**
Depreciation							
At 1 April 2016	–	–	(28.6)	–	(5.1)	–	**(33.7)**
Disposals	–	–	–	–	–	–	**–**
Charge for year	(3.2)	(0.2)	(7.7)	–	(3.5)	–	**(14.6)**
At 31 March 2017	**(3.2)**	**(0.2)**	**(36.3)**	**–**	**(8.6)**	**–**	**(48.3)**
Net book amount at 31 March 2017	**5.0**	**1.2**	**41.9**	**–**	**11.2**	**–**	**59.3**
Net book amount at 1 April 2016	–	0.3	25.7	–	15.1	–	**41.1**
Depreciation charge for year							
Principal services	(3.2)	(0.2)	(7.7)	–	(3.5)	–	**(14.6)**
Third party services	–	–	–	–	–	–	**–**
Total	**(3.2)**	**(0.2)**	**(7.7)**	**–**	**(3.5)**	**–**	**(14.6)**

The net book value of intangible assets includes £19.3 million in respect of assets in the course of construction.

2E – Analysis of capital contributions and land sales for the 12 months ended 31 March 2017 – Wholesale	Fully recognised in income statement £m	Capitalised and amortised (in the income statement) £m	Total £m
Grants and contributions – water			
Connection charges	3.6	–	**3.6**
Infrastructure charge receipts	3.6	–	**3.6**
Requisitioned mains	–	0.7	**0.7**
Diversions	–	0.5	**0.5**
Other contributions	–	0.7	**0.7**
Total	**7.2**	**1.9**	**9.1**
Value of adopted assets		–	**–**
Grants and contributions – wastewater			
Infrastructure charge receipts	5.4	–	**5.4**
Requisitioned sewers	–	3.9	**3.9**
Diversions	–	1.4	**1.4**
Other contributions	0.5	0.4	**0.9**
Total	**5.9**	**5.7**	**11.6**
Value of adopted assets		17.1	**17.1**

	Water £m	Wastewater £m	Total £m
Movements in capitalised grants and contributions			
Brought forward	14.5	21.8	**36.3**
Capitalised in year	1.9	5.7	**7.6**
Amortisation (in income statement)	(1.5)	(1.5)	**(3.0)**
Carried forward 31 March 2017	**14.9**	**26.0**	**40.9**

There were no disposals of protected land during the year.

Contributions received in relation to diversions and for adopted assets are held on the statement of financial position and amortised through other income.

Contributions received in relation to requisitions are held on the statement of financial position and released to revenue in the statutory income statement. These are re-classified for regulatory purposes as described below.

Grants and contributions recognised in the statutory income statement as revenue have been reclassified to other income for regulatory purposes in table 1A. These include the amounts of £7.2 million and £5.9 million disclosed above for water and wastewater respectively together with £1.8 million of the capitalised contributions held on the statement of financial position as deferred revenue relating to requisitions.

2F – Household – revenues by customer type	Wholesale charges revenue £m	Retail revenue £m	Total revenue £m	Number of customers 000's	Average household retail revenue per customer £
Unmeasured water only customer	2.2	0.1	**2.3**	16.4	**7.06**
Unmeasured wastewater only customer	88.5	5.7	**94.2**	329.5	**17.41**
Unmeasured water and wastewater customer	43.6	2.1	**45.7**	117.7	**17.65**
Measured water only customer	10.9	1.7	**12.6**	64.8	**26.09**
Measured wastewater only customer	131.1	13.7	**144.8**	557.7	**24.65**
Measured water and wastewater customer	289.2	40.2	**329.4**	809.1	**49.66**
Total	**565.5**	**63.5**	**629.0**	**1,895.2**	**33.53**

2G – Non-household water – revenues by tariff type

	Wholesale charges revenue £m	Retail revenue £m	Total revenue £m	Number of connections 000's	Average non-household retail revenue per customer £
Non-default tariffs					
Total non-default tariffs	**1.0**	**0.5**	**1.5**	**3.0**	**164.94**
Default tariffs					
Unmetered	1.1	0.1	**1.2**	4.2	**18.20**
Metered 0-1 megalitres	9.3	1.3	**10.6**	44.7	**29.38**
Metered 1-5 megalitres	11.2	0.7	**11.9**	4.8	**160.09**
Metered 5-20 megalitres	8.3	0.4	**8.7**	0.8	**466.40**
Metered 20-100 megalitres	6.2	0.1	**6.3**	0.1	**760.49**
Metered over 100 megalitres	3.6	0.1	**3.7**	–	**3,335.33**
Total default tariffs	**39.7**	**2.7**	**42.4**	**54.6**	**49.28**
Total	**40.7**	**3.2**	**43.9**	**57.6**	**55.30**

	Number of customers 000's	Average non-household retail revenue per customer £
Revenue per customer	**50.9**	**62.72**

2H – Non-household wastewater – revenues by tariff type

	Wholesale charges revenue £m	Retail revenue £m	Total revenue £m	Number of connections 000's	Average non-household retail revenue per customer £
Non-default tariffs					
Total non-default tariffs	**2.4**	**0.8**	**3.2**	**4.7**	**160.75**
Default tariffs					
Unmetered	3.9	0.2	**4.1**	8.1	**25.85**
Metered 0-1 megalitres	30.0	2.0	**32.0**	69.3	**28.34**
Metered 1-5 megalitres	31.8	1.4	**33.2**	7.0	**197.66**
Metered 5-20 megalitres	15.2	0.5	**15.7**	0.9	**597.86**
Metered 20-100 megalitres	11.9	0.2	**12.1**	0.1	**1,239.95**
Metered over 100 megalitres	4.0	–	**4.0**	–	**3,551.91**
Metered trade effluent (non-monthly billed)	1.8	–	**1.8**	0.6	**61.96**
Metered trade effluent (monthly billed)	8.2	0.1	**8.3**	0.2	**554.17**
Total default tariffs	**106.8**	**4.4**	**111.2**	**86.2**	**51.43**
Total	**109.2**	**5.2**	**114.4**	**90.9**	**57.14**

	Number of customers 000's	Average non-household retail revenue per customer £
Revenue per customer	**80.7**	**64.37**

2l – Revenue analysis and wholesale control reconciliation for the 12 months ended 31 March 2017	Household £m	Non-household £m	Total £m
Wholesale charge – water			
Unmeasured	15.6	1.1	**16.7**
Measured	109.5	39.6	**149.1**
Third party revenue	–	0.1	**0.1**
Total water	**125.1**	**40.8**	**165.9**
Wholesale charge – wastewater			
Unmeasured	118.7	3.9	**122.6**
Measured	321.7	105.3	**427.0**
Total wastewater	**440.4**	**109.2**	**549.6**
Wholesale total	**565.5**	**150.0**	**715.5**
Retail revenue			
Unmeasured	7.9	0.3	**8.2**
Measured	55.6	8.1	**63.7**
Other third party revenue	–	1.6	**1.6**
Retail total	**63.5**	**10.0**	**73.5**
Third party revenue – non-price control			
Bulk supplies – water			**3.0**
Other third party revenue			**1.5**
Principal services – non-price control			
Other appointed revenue			**0.2**
Total appointed revenue			**793.7**

	Water £m	Wastewater £m	Total £m
Wholesale revenue governed by price control	165.9	549.6	**715.5**
Capital contributions	7.9	9.3	**17.2**
Total revenue governed by wholesale price control	**173.8**	**558.9**	**732.7**
Amount assumed in wholesale determination	177.1	557.5	**734.6**
Adjustment for in-period ODI revenue	–	–	**–**
Adjustment for WRFIM	–	–	**–**
Total assumed revenue	**177.1**	**557.5**	**734.6**
Difference	**(3.3)**	**1.4**	**(1.9)**

Actual wholesale revenue governed by the price control was £1.9 million (0.26%) lower than allowed in the wholesale determination.

When split into service level, the actual wholesale water revenue was lower than allowed revenue by £3.3 million (1.86%), which was offset by the actual wholesale wastewater revenue being higher than allowed revenue by £1.4 million (0.25%).

The lower revenue from water relates to slightly lower consumption from our household metered customers than was assumed when setting tariffs. The higher revenue from wastewater relates to lower consumption from our household metered customers offset by higher consumption from our non-household customers than assumed when setting tariffs.

The overall lower actual revenue than allowed in the wholesale price control will be adjusted via the Wholesale Revenue Forecasting Incentive Mechanism (WRFIM) when setting the 2018–19 wholesale prices.

Independent auditor's report

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

Opinion on Annual Performance Report

In our opinion, Southern Water Services Limited's Regulatory Accounting Statements within the Annual Performance Report:

- *have been properly prepared in accordance with Condition F, the Regulatory Accounting Guidelines issued by the WSRA (RAG 1.07, RAG 2.06, RAG 3.09, RAG 4.06 and RAG 5.06) and the accounting policies (including the company's published accounting methodology statement as defined in RAG 3.09, Appendix 3) set out in note 1.*

Emphasis of matter – basis of preparation

Without modifying our opinion on the Regulatory Accounting Statements within the Annual Performance Report, we draw attention to the fact that the Annual Performance Report has been prepared in accordance with Condition F, the Regulatory Accounting Guidelines, the accounting policies (including the company's published accounting methodology statement, as defined in RAG 3.09, Appendix 3) set out in the statement of accounting policies and under the historical cost convention. The nature, form and content of the Regulatory Accounting Statements are determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment.

The Annual Performance Report is separate from the statutory financial statements of the Company and has not been prepared under the basis of International Financial Reporting Standards as adopted by the European Union ('IFRSs'). Financial information other than that prepared on the basis of IFRSs does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in statutory financial statements prepared in accordance with the Companies Act 2006.

The Regulatory Accounting Statements on pages 8 to 28 have been drawn up in accordance with Regulatory Accounting Guidelines with a number of departures from IFRSs. A summary of the effect of these departures from Generally Accepted Accounting Practice in the Company's statutory financial statements is included in the tables within section 1.

What we have audited

The sections within Southern Water Services Limited's Annual Performance Report that we have audited ('the Regulatory Accounting Statements') comprise:

- *the regulatory financial reporting tables comprising the income statement (table 1A), the statement of comprehensive income (table 1B), the statement of financial position (table 1C), the statement of cash flows (table 1D) and the net debt analysis (table 1E) and the related notes;*
- *the regulatory price review and other segmental reporting tables comprising the segmental income statement (table 2A), the totex analysis for wholesale water and wastewater (table 2B), the operating cost analysis for retail (table 2C), the historical cost analysis of fixed assets for wholesale and retail (table 2D), the analysis of capital contributions and land sales for wholesale (table 2E), the household revenues by customer type (table 2F), the non-household water revenues by tariff type (table 2G), the non-household wastewater revenues by tariff type (table 2H) and the revenue analysis by customer type (table 2I) and the related notes.*

The financial reporting framework that has been applied in their preparation comprises Condition F, the Regulatory Accounting Guidelines issued by the WSRA and the accounting policies (including the accounting separation methodology) set out in note 1 to the Annual Performance Report.

In applying the financial reporting framework, the directors have made a number of subjective judgments, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

We have not audited the outcome performance tables (tables 3A to 3D) and the additional regulatory information in tables 4A to 4I and the cost assessment tables.

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

Respective responsibilities of the WSRA, the Directors and Auditors

As explained more fully in the Statement of Directors' Responsibilities set out on page 7, the directors are responsible for the preparation of the Annual Performance Report in accordance with Condition F, the Regulatory Accounting Guidelines issued by the Regulator and the Company's accounting policies (including the accounting separation methodology).

Our responsibility is to audit and express an opinion on the Regulatory Accounting Statements within the Annual Performance Report in accordance with International Standards on Auditing (UK and Ireland) ('ISAs (UK & Ireland)'), except as stated in the section on 'What an audit of the Annual Performance report involves' below, and having regard to the guidance contained in ICAEW Technical Release Tech 02/16 AAF 'Reporting to Regulators on Regulatory Accounts' issued by the Institute of Chartered Accountants in England & Wales. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

What an audit of the Annual Performance Report involves

An audit involves obtaining evidence about the amounts and disclosures in the Regulatory Accounting Statements sufficient to give reasonable assurance that the Regulatory Accounting Statements within the Annual Performance Report 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; and the reasonableness of significant accounting estimates made by the directors. In addition, we read all the financial and non-financial information in the Annual Performance Report to identify material inconsistencies with the audited sections of the Annual Performance Report 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.

We have not assessed whether the accounting policies are appropriate to the circumstances of the Company where these are laid down by Condition F. Where Condition F does not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the Annual Performance Report are consistent with those used in the preparation of the statutory financial statements of the Company. Furthermore, as the nature, form and content of Annual Performance Report is determined by the WSRA, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

The Company has presented the allocation of operating costs and assets in accordance with the accounting separation policy set out in note 1 and its Accounting Methodology Statement published on the Company's website on 15 July 2017. We are not required to assess whether the methods of cost allocation set out in the Methodology Statement are appropriate to the circumstances of the Company or whether they meet the requirements of the WSRA, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK & Ireland).

Opinion on other matters prescribed by Condition F

Under the terms of our contract we have assumed responsibility to provide those additional opinions required by Condition F in relation to the accounting records. In our opinion:

- *proper accounting records have been kept by the appointee as required by paragraph 3 of Condition F;*
- *the Regulatory Accounting Statements are in agreement with the accounting records and returns retained for the purpose of preparing the Annual Performance Report.*

Other matters

The nature, form and content of the Annual Performance Report is determined by the WSRA. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the WSRA's purposes. Accordingly we make no such assessment.

Our opinion on the Regulatory Accounting Statements within the Annual Performance Report is separate from our opinion on the statutory financial statements of the Company for the year ended 31 March 2017 on which we reported on 4 July 2017, which are prepared for a different purpose. Our audit report in relation to the statutory financial statements of the Company (our 'Statutory audit') was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory audit report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume responsibility for any other purpose or to any other person to whom our statutory audit report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Deloitte LLP.

Deloitte LLP
Statutory Auditor
London, United Kingdom

14 July 2017

Performance summary

3A – Outcome performance table — Wholesale water

Performance commitment		Status	Unit	2015–16 performance level – actual	2016–17 performance level – actual	2016–17 Committed Performance Level met?
W1:	Water asset health		category	Stable	Stable	Yes
W2:	Water use restrictions		number	0	0	Yes
W3:	Leakage (five-year average)		megalitres /day	83.9	88.1	N/A
W4:	Interruptions to supply		mins/prop /year	12	7	Yes
W5:	Drinking water quality – Mean Zonal Compliance (MZC)		%	99.98	99.97	Yes
W5a:	Drinking water quality – discolouration contacts		number/ 1,000 popn	0.80	0.74	Yes
W6:	Low water pressure		number	288	222	Yes
W7:	Distribution input		megalitres /day	520.64	532.28	No
W8:	Per capita consumption (PCC) (five-year average)		litres per head/day	129.7	131.3	N/A

3A – Outcome performance table — Wholesale wastewater

Performance commitment		Status	Unit	2015–16 performance level – actual	2016–17 performance level – actual	2016–17 Committed Performance Level met?
WW1:	Wastewater asset health		category	Stable	Stable	Yes
WW1a:	Category 3 pollution incidents[1]		number	160	143	Yes
WW2:	Internal flooding incidents		number	492	448	No
WW3:	External flooding incidents		number	8,314	8,009	Yes
WW4:	Sewer blockages		number/per km sewer	0.56	0.55	Yes
WW5:	Odour complaints (Portswood and Tonbridge treatment works)		number	N/A	N/A	N/A
WW6:	Wastewater treatment works numeric compliance[1, 3]		%	99.3	99.3	No
WW7:	Proportion of energy from renewable sources		%	17.3	17.0	N/A
WW8:	Bathing waters with 'excellent' water quality (part 1)		number	43	51	No
WW9:	Bathing waters with 'excellent' water quality (part 2 – additional number of bathing waters)		number	0	0	Yes
WW10:	Bathing waters with 'excellent' water quality (part 3)	N/A 2016–17	£m	N/A	N/A	N/A
WW11:	Serious pollution incidents (Category 1 and 2)		number	7	3	Yes
WW12:	Avoiding blocked drains (awareness survey)		%	77.0	79.0	Yes
WW13:	Thanet sewers	N/A 2016–17	N/A	N/A	N/A	N/A
WW14:	Woolston wastewater treatment works	N/A 2016–17	N/A	N/A	N/A	N/A
WW15:	Millbrook sludge	N/A 2016–17	tonnes	N/A	N/A	N/A

3A – Outcome performance table — Retail						
Performance commitment		Status	Unit	2015–16 performance level – actual	2016–17 performance level – actual	2016–17 Committed Performance Level met?
R1:	First-time resolution of customer contacts		%	67.0	67.0	No
R2:	Dealing with customers' individual needs (awareness survey)		%	66.0	66.2	Yes
R3:	Awareness of water hardness measures (awareness survey)		%	57.0	55.7	No
R4:	Where your money goes (awareness survey)		%	60.0	56.5	No
R5:	Billing queries[2]		number	62,726	145,962	No
R6:	Take up of assistance schemes		number	142,040	194,726	Yes
R7:	Value for money (awareness survey)		%	61.0	57.3	No
R8:	Service Incentive Mechanism (SIM)[2]		score out of 100	73	78	N/A

[1] The number of Category 3 pollution incidents and wastewater treatment works compliance remains subject to further assurance.

[2] We reported in our annual performance report 2015–16 that the call categorisation of unwanted and wanted calls was associated with a degree of subjectivity, and that additional processes and controls were required to further mitigate the risk of call mis-categorisation. We stated that we would put in place an action plan to minimise these issues going forward. Within this regulatory year, we are pleased to report that due to the action plan, the accuracy of our reported unwanted contact volumes has improved over the last quarter of 2016–17. Further actions are planned in the 2017–18 year to continue to improve our reported unwanted contact volumes.

[3] Woolston Wastewater Treatment works is undergoing a major redevelopment scheme which will enable it to meet the permit conditions. Until the scheme is complete, the works has limited capability to meet all the permit conditions, on this basis the works is classed as a failed works. The nature of the failure is such that it did not trigger an ODI penalty.

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

Key

	Indicates where we have met or beaten the performance commitment.
	Indicates where we are still on target to deliver the outcomes we promised to customers but we have missed our performance commitment for the year.
	Indicates where we have not met our performance target and have not delivered the outcomes we promised to customers. In one case we incurred a penalty for the shortfall.
N/A 2016–17	These performance commitments do not apply in 2016–17.

No performance commitments incurred a reward or penalty in 2016–17. The only performance commitment that incurred a penalty to date is WW8: Bathing waters with 'excellent' quality (part 1).

3A – Outcome performance table – Notional reward or penalty accrued at 31 March 2017	2016–17 reward or penalty (in-period ODIs)	2016–17 reward or penalty (in-period ODIs) £m	2016–17 notional reward or penalty accrued	2016–17 notional reward or penalty accrued £m	Total AMP6 reward or penalty 31 March 2020 forecast	Total AMP6 reward or penalty 31 March 2020 forecast £m
WW6: Wastewater treatment works numeric compliance[1]	–	–	Penalty deadband	–	–	–
WW8: Bathing waters with 'excellent' water quality (part 1)	–	–	Penalty deadband	–	Penalty	(1.458)

None of our performance commitments have rewards or penalties recoverable or payable in the current AMP period.

Performance summary

3B – Sub-measure performance table

Performance commitment	Status	Unit	2015–16 performance level – actual	2016–17 performance level – actual	2016–17 Committed Performance Level met?
1: Water asset health		category	Stable	Stable	Yes
Number of mains bursts per year		number	1,322	1,996	Yes
Distribution Maintenance Index (TIM)		%	99.96	99.91	Yes
Coliform compliance at Water Supply Works (WSW)		%	100	99.98	Yes
Coliform compliance at Water Service Reservoirs (WSR)		%	100	100	Yes
Turbidity compliance		number	–	–	Yes
1: Wastewater asset health		category	Stable	Stable	Yes
Sewer collapses[3]		number	242	233	Yes
Wastewater Treatment Works (WWTW) population equivalent compliance		%	100	100	Yes
External flooding – other causes		number	7,428	7,614	Yes

[3] During our year end assurance we identified that sewer collapses was reported incorrectly in the 2015–16 data tables. The previously reported figure of 67 should have been 242.

3C – Abstraction Incentive Mechanism (AIM)

During Ofwat's consultation and preparation of the AMP6 reputational AIM guidance in 2015–16, Southern Water first committed to try two AIM schemes during AMP6, subsequently increasing this to four. The company indicated it was unlikely to have any activity until 2017–18. This has proved to be the case. One scheme – a small but innovative (community reward based), targeted water efficiency promotion – was prepared during 2016–17 and commenced on 30 March 2017. We understand this may still be the only water efficiency focused AIM scheme under implementation by any company. Of the other three schemes intended, one should be live during September 2017 but, the company now views the other two (both on the Isle of Wight) as uncertain following the explicit inclusion of concerns around the anticipated alternative sources within version 1 of the Water Industry National Environment Programme (provided by the Environment Agency on March 31). The Isle of Wight is also one of three of our 10 water resources zones most at risk of drought impacts this year.

3D – SIM score table

	Score
Qualitative Performance	
1st survey score	**4.29**
2nd survey score	**4.04**
3rd survey score	**4.28**
4th survey score	**4.28**
Qualitative SIM score (out of 75)	**60.42**
Quantitative Performance	
Quantitative composite score	**145.85**
Quantitative SIM score (out of 25)	**17.71**
SIM Score	
Quantitative composite score	**78.13**

Rewards and penalties for 2016–17

We have 20 wholesale financial Outcome Delivery Incentives (ODIs); based on our final price determination with Ofwat at the start of this AMP period. We are incentivised to drive performance against these performance commitments by Ofwat's financial reward/penalty mechanism. Five of these ODIs could attract either a financial reward or a penalty and the remaining 15 could attract a penalty only. The final outcome is based on the results of our business performance each year for the five years of the AMP.

For 2016–17 our performance against the targets has resulted in us not attracting either rewards or penalties for this financial year. However, on a cumulative basis, that is for the first two years of the AMP (this financial year and last year) we have recorded a net cumulative penalty of £1.458 million. The whole of this penalty relates to our 'bathing waters' performance commitment in 2015–16 where we recorded 43 bathing waters with 'excellent' quality, below the penalty threshold target of 48. The detail of this underperformance was reported in our Annual Report for 2015–16.

In the Strategic Report section of the Annual Report, you will see that we detail our performances against the targets for this year and last year, and we rate our performance using a standard 'green', 'amber', 'red' model.

Overall, our business promises are performing broadly in line with last year. Highlights for the year have been improvements in our customer metrics (SIM and GSS payments) as well as improvements in our wholesale business in relation to customer interruptions, flooding incidents and odour complaints. Further details can be found in our Strategic Report.

We were disappointed in our leakage performance in 2016–17, but remain confident that we will meet our five-year target. In addition the volume of billing queries we received was higher than our targets. We are working hard to address both these issues and further details can be found in our Strategic Report.

In addition, we have had to restate the number of sewer collapses we reported last year as noted on page 34 but this has not impacted our performance against target, which remains 'green' for this year and last year.

Forecast reward/penalties

We expect to meet our performance commitments for the remainder of the period for the majority of our ODIs. Therefore we are not forecasting rewards or penalties, except for our bathing waters performance commitment, for which we have already incurred a penalty.

Although our SIM performance has improved this year, based on current projections, we would expect to incur a penalty for this metric. The scale of any penalty is however uncertain as it is based on relative performance of all companies and we do not yet know how other companies will perform.

For our bathing waters performance commitment we are forecasting that we will meet our targets in the remaining years, however, due to our underperformance in 2015–16, which has already resulted in a penalty of £1.458 million, we are forecasting a cumulative penalty of £1.458 million at 2019–20.

Reporting to customers

The information reported in this table is consistent with the information we have reported to our customers in our Annual Report and Financial Statements.

Assurance of performance commitments

As part of our Final Assurance Plan published on 31 March 2017 we stated that we would obtain independent assurance in relation to our 2016–17 performance commitment reporting. PricewaterhouseCoopers LLP has undertaken this work on our behalf and their statement is provided on page 36.

Independent Limited Assurance Report to the Directors of Southern Water Services Limited

The Board of Directors of Southern Water Services Limited ('Southern Water') engaged us to provide limited assurance on the information described below and set out in Southern Water's Annual Report and Financial Statements 2016–17 for the year ended 31 March 2017.

Disclaimer

- *PwC accepts no liability (including liability for negligence) to each recipient in relation to PwC's report. The report is provided to each recipient for information purposes only. If a recipient relies on PwC's report, it does so entirely at its own risk.*
- *No recipient will bring a claim against PwC which relates to the access to the report by a recipient.*
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- *PwC will be entitled to the benefit of and to enforce these terms.*
- *These terms and any dispute arising from them, whether contractual or non-contractual, are subject to English law and the exclusive jurisdiction of English courts.*

Our conclusion

Based on the procedures we have performed and the evidence we have obtained, except for the matter described in the'basis for qualified conclusion' paragraph stated below, nothing has come to our attention that causes us to believe that the Selected Information for the year ended 31 March 2017 has not been prepared, in all material respects, in accordance with the Reporting Criteria.

This conclusion is to be read in the context of what we say in the remainder of our report.

Basis for Qualified Conclusion

Southern Water is required to provide to the Environment Agency the number and details, of Category 3 pollution incidents, and report wastewater treatment works compliance. We have been unable to obtain the necessary evidence to support the accuracy of the number of:

- *WW1a: Category 3 pollution incidents;*
- *WW1: Wastewater asset health – Wastewater treatment works population equivalent compliance; and*
- *WW6: Wastewater treatment works numeric compliance.*

This is referenced by management on page 33 of the Annual Performance Report.

Selected Information

The scope of our work was limited to assurance over the following information in Southern Water's Annual Report & Financial Statements 2016–17 (the 'Selected Information'):

- *The number of compensation payments made to customers (Guaranteed Standards Scheme)*
- *The number of customers on supportive payment schemes;*
- *Greenhouse gas emissions – $KgCO_2e$*
- *$KgCO_2e$ per person supplied with treated water*
- *$KgCO_2e$ per person supplied with wastewater services*
- *Total odour complaints*
- *3A – Outcome performance table – wholesale water, wholesale wastewater and retail*
- *3B – Sub-performance measure table*
- *3C – Abstract incentive mechanism*
- *3D – Service Incentive Mechanism*
- *4A – Non-financial information*

The Selected Information and the Reporting Criteria against which it was assessed are summarised in our full report which is disclosed online at **southernwater.co.uk/data-assurance-summary** and in Appendix 2 of the Annual Performance Review. Our assurance does not extend to information in respect of earlier periods or to any other information included in Southern Water's Annual Report & Financial Statements 2016–17.

Professional standards applied and level of assurance

We performed a limited assurance engagement in accordance with International Standard on Assurance Engagements 3000 (Revised) 'Assurance Engagements other than Audits and Reviews of Historical Financial Information' and, in respect of the greenhouse gas emissions, in accordance with International Standard on Assurance Engagements 3410 'Assurance engagements on greenhouse gas statements', issued by the International Auditing and Assurance Standards Board. A limited assurance engagement is substantially less in scope than a reasonable assurance engagement in relation to both the risk assessment procedures, including an understanding of internal control, and the procedures performed in response to the assessed risks.

Our Independence and Quality Control

We applied the Institute of Chartered Accountants in England and Wales (ICAEW) Code of Ethics, which includes independence and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

We apply International Standard on Quality Control (UK & Ireland) 1 and accordingly maintain a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements. Our work was carried out by an independent team with experience in assurance.

Understanding reporting and measurement methodologies

The Selected Information needs to be read and understood together with the Reporting Criteria (Southern Water's reporting criteria), which Southern Water is solely responsible for selecting and applying. The absence of a significant body of established practice on which to draw to evaluate and measure non-financial information allows for different, but acceptable, measurement techniques and can affect comparability between entities and over time. The Reporting Criteria used for the reporting of the Selected Information are for the 2017 reporting year.

Work done

We are required to plan and perform our work in order to consider the risk of material misstatement of the Selected Information. In doing so, we:

- *made enquiries of Southern Water's management*
- *re-performed the calculation of the performance level arising from the Selection Information in the year against the Reporting Criteria*
- *performed limited substantive testing on a selective basis of the Selected Information at corporate head office and two other offices to check that data had been appropriately measured, recorded, collated and reported*
- *considered the disclosure and presentation of the Selected Information.*

Southern Water's responsibilities

The Directors of Southern Water are responsible for:

- *designing, implementing and maintaining internal controls over information relevant to the preparation of the Selected Information that is free from material misstatement, whether due to fraud or error*
- *establishing objective Reporting Criteria for preparing the Selected Information*
- *measuring and reporting the Selected Information based on the Reporting Criteria*
- *the content of the Annual Report & Financial Statements 2016–17.*

Our responsibilities

We are responsible for:

- *planning and performing the engagement to obtain limited assurance about whether the Selected Information is free from material misstatement, whether due to fraud or error*
- *forming an independent conclusion, based on the procedures we have performed and the evidence we have obtained*
- *reporting our conclusion to the Directors of Southern Water.*

This report, including our conclusions, has been prepared solely for the Board of Directors of Southern Water in accordance with the agreement between us, to assist the Directors in reporting Southern Water's performance and activities. We permit this report to be disclosed online at **southernwater.co.uk/our-reports** in respect of the 2017 reporting year, to assist the Directors in responding to their governance responsibilities by obtaining an independent assurance report in connection with the Selected Information. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Board of Directors and Southern Water for our work or this report except where terms are expressly agreed between us in writing.

PricewaterhouseCoopers LLP
Chartered Accountants
Gatwick

14 July 2017

Additional regulatory information

4A – Non-financial information for the 12 months ended 31 March 2017		
Retail – household	Unmeasured	Measured
Number of void households ('000s)	19.5	31.9
Per capita consumption (excluding supply pipe leakage) (litres/head/day)	170.2	125.3
Wholesale	Water	Wastewater
Volume (Megalitres/day)		
Bulk supply export	22.2	–
Bulk supply import	2.5	–
Distribution input	532.3	n/a

4B – Wholesale totex analysis	Current year		Cumulative	
	Water £m	Wastewater £m	Water £m	Wastewater £m
Actual totex	161.3	371.8	292.7	703.8
Less: Items excluded from the menu				
Third party costs	4.8	–	8.1	–
Pension deficit recovery costs	–	–	9.1	19.8
Other 'Rule book' adjustments	–	2.0	–	2.0
Total items excluded from the menu	**4.8**	**2.0**	**17.2**	**21.8**
Add: Transition expenditure				
Transition expenditure	–	–	1.5	14.6
Adjusted actual totex	**156.5**	**369.8**	**277.0**	**696.6**
Actual totex – base year prices	**144.5**	**341.4**	**255.7**	**643.2**
Allowed totex – base year prices	**165.6**	**402.9**	**318.5**	**770.2**

Wholesale totex analysis

In 2016–17, our total expenditure (totex) for water of £144.5 million in base year prices (2012–13) was £21.1 million lower than that allowed in our Final Determination (FD) of £165.6 million and our wastewater totex of £341.4 million was £61.5 million lower than the FD allowance of £402.9 million.

Cumulatively our totex for water of £255.7 million was £62.8 million below the FD allowance of £318.5 million and our cumulative wastewater expenditure of £643.2 million was £127.0 million below our allowance.

The principal reasons for these variances are explained in the table and narrative below.

i) *In 2015–16 we received a rebate of historic business rates charges totalling £12.5 million (2012–13 prices) for the water service. This followed the successful appeal of the 2005 revaluation of our water service assets. This results in a favourable variance when compared to our allowed totex.*

ii) *In the first two years of this AMP period our operating costs, excluding the impact of the change in accounting for infrastructure maintenance costs, were £32.3 million lower than our determination (water £27.4 million, wastewater £4.9 million).*

Allowed totex variance				
£m (2012–13 prices)	Current year		Cumulative	
Description	Water	Wastewater	Water	Wastewater
i) Rates rebate	–	–	12.5	–
ii) Operating costs	14.2	9.4	27.4	4.9
iii) Infrastructure costs expensed	3.0	9.5	7.8	24.7
iv) IRE costs transferred to retail	–	1.1	–	2.1
v) Transferred to non-appointed	–	5.5	–	10.3
vi) Capex	2.0	36.0	12.7	85.0
Other (third party)	1.9	–	2.4	–
Total	**21.1**	**61.5**	**62.8**	**127.0**

Cost reductions have been achieved through more efficient use of power, chemicals and employing internal staff instead of contractors. Additionally we have delivered a number of procurement savings when renegotiating external contracts and increases to pay have been generally lower than RPI resulting in a saving when these are re-stated in 2012–13 prices.

iii) *Within our business plan submission we assumed that 75% of gross infrastructure expenditure, previously treated as capital expenditure under UK GAAP, would be treated as wholesale operating expenditure following the transition to IFRS. Having completed the transition in 2015–16 and considered in more detail the accounting treatment of the different activities undertaken, our revised view is that nearer 60% of this expenditure will be expensed.*

The result of this accounting variance from our original plan, along with lower levels of infrastructure repair costs incurred, is a favourable variance in totex to date of £32.5 million in relation to infrastructure costs expensed (water £7.8 million, wastewater £24.7 million). It is anticipated that this variance is largely a result of the timing of delivery of the infrastructure maintenance that will now form part of our overall capital programme.

iv) *As reported in the narrative supporting table 2B, our business plan submission assumed that all infrastructure costs, treated as operating costs following the transition to IFRS, would be wholesale costs. In accordance with RAG 2.06 an element of our infrastructure costs, relating to network enquiries, is treated as a retail cost rather than wholesale. This results in a cumulative favourable variance of £2.1 million when compared to the allowed wholesale totex.*

v) *Our business plan submission included costs within the appointed wastewater business for the haulage and treatment costs of tankered waste. In October 2016, Ofwat issued revised regulatory guidance in RAG 4.06 clarifying that these costs should be classified as part of the non-appointed business. This change in classification results in a cumulative favourable variance of £10.3 million when compared to our allowed wholesale totex.*

vi) *Our capital investment programme is also lower than set out in our business plan and this is largely due to the timing of delivery of our investment programme.*

The delays in the capital investment programme reflect the focus on driving value through an optimised programme and continued development of future years' outperformance plans. It also reflects delays associated with obtaining clarification from the Environment Agency on the AMP6 National Environment Programme, a change in the timing of delivery of certain projects, for example at Testwood and the Thanet sewers and lower levels of capital maintenance than anticipated together with the complex transition to the new planned operating model and delivery partners.

We are confident that we remain on track to deliver the capital investment that we set out in our business plan and a number of key projects are now underway. There is a continuing emphasis on acceleration of the delivery programme to ensure recovery of the programme over the remainder of the AMP.

When comparing our actual totex to that allowed in the Final Determination we are required to make 'rule book' adjustments for certain costs, including fines. Unfortunately, during 2016–17 we were prosecuted for pollution incidents which occurred at Margate in 2012 and 2014. This prosecution resulted in a fine of £2.0 million and this is shown as a rule book adjustment in table 4B on page 39. Since those incidents, we have also made considerable investment to mitigate the risk of future incidents, improve resilience at the site and to ensure that bathing water in the area is cleaner than ever.

4C – Impact of AMP performance to date on RCV

	Water £m	Wastewater £m
RCV determined at FD at 31 March 2017	893.9	3,725.9
RCV element of cumulative totex over/underspend so far in the price control period	(32.7)	(75.6)
Projected 'shadow' RCV	**861.2**	**3,650.3**

Impact of performance on RCV

Due to expenditure in both 2015–16 and 2016–17 being lower than in the Final Determination for both water and wastewater (see commentary for table 4B) our shadow RCV is £32.7 million less for water and £75.6 million less for wastewater compared with the Final Determination amount in 2016–17. However, we expect to recover this over the AMP as we carry out the delayed capital projects.

The RCV element of cumulative totex over/underspend is a calculated value equal to the difference between actual totex and allowed totex for the price control period so far for both water and wastewater (inclusive of transition expenditure and third party costs; net of grants and contributions), multiplied by (1 – the weighted average pay-as-you-go rates for water and wastewater).

There are no ODI adjustments to be made through the RCV.

4D – Totex analysis for the 12 months ended 31 March 2017 – Wholesale water	Water resources		Network +				
	Abstraction licences £m	Raw water abstraction £m	Raw water transport £m	Raw water storage £m	Water treatment £m	Treated water distribution £m	Total £m
Operating expenditure							
Power	–	3.2	–	–	8.4	3.1	**14.7**
Income treated as negative expenditure	–	–	–	–	–	–	**–**
Abstraction charges/discharge consents	4.3	–	–	–	–	–	**4.3**
Bulk supply/Bulk discharge	–	–	–	–	0.1	–	**0.1**
Other operating expenditure	0.4	1.1	0.3	0.3	13.3	30.4	**45.8**
Local authority rates	–	0.8	0.1	–	1.4	8.3	**10.6**
Total operating expenditure excluding third party services	**4.7**	**5.1**	**0.4**	**0.3**	**23.2**	**41.8**	**75.5**
Third party services	0.3	0.4	–	–	1.0	0.5	**2.2**
Total operating expenditure	**5.0**	**5.5**	**0.4**	**0.3**	**24.2**	**42.3**	**77.7**
Capital expenditure							
Maintaining the long-term capability of the assets – infrastructure	–	0.3	0.3	–	–	14.0	**14.6**
Maintaining the long-term capability of the assets – non-infrastructure	–	3.3	–	–	25.9	15.7	**44.9**
Other capital expenditure – infrastructure	–	0.6	3.3	–	–	9.9	**13.8**
Other capital expenditure – non-infrastructure	–	2.8	–	–	12.2	0.7	**15.7**
Total gross capital expenditure (excluding third party)	**–**	**7.0**	**3.6**	**–**	**38.1**	**40.3**	**89.0**
Third party services	–	1.9	–	–	1.3	0.5	**3.7**
Total gross capital expenditure	**–**	**8.9**	**3.6**	**–**	**39.4**	**40.8**	**92.7**
Grants and contributions (price control)	–	–	–	–	0.7	8.4	**9.1**
Totex	**5.0**	**14.4**	**4.0**	**0.3**	**62.9**	**74.7**	**161.3**
Cash expenditure							
Pension deficit recovery payments	–	–	–	–	–	–	**–**
Totex including cash items	**5.0**	**14.4**	**4.0**	**0.3**	**62.9**	**74.7**	**161.3**

Unit cost information (operating expenditure)	Population (thousands)	Licenced volume available	Volume abstracted	Volume transported	Average volume stored	Distribution input volume	Distribution input volume
Volume (Megalitres)		454,554	217,695	83,992	203,826	194,274	194,274
Unit cost (£/Megalitre)		**10.84**	**25.28**	**4.93**	**1.45**	**124.65**	**217.79**
Unit cost (£/population)	2,493.4	**1.98**	**2.21**	**0.17**	**0.12**	**9.71**	**16.97**

4E – Totex analysis for the 12 months ended 31 March 2017 – Wholesale Wastewater

	Network+ Sewage Collection			Network+ Sewage treatment		Sludge			
	Foul £m	Surface water drainage £m	Highway drainage £m	Sewage treatment and disposal £m	Imported sludge liquor treatment £m	Sludge transport £m	Sludge treatment £m	Sludge disposal £m	Total £m
Operating expenditure									
Power	7.3	1.5	1.5	16.7	0.7	–	(2.4)	–	**25.3**
Income treated as negative expenditure	–	–	–	–	–	–	(3.4)	–	**(3.4)**
Abstraction charges/discharge consents	0.5	0.1	0.1	2.3	–	–	–	–	**3.0**
Bulk supply/bulk discharge	–	–	–	–	–	–	–	–	**–**
Other operating expenditure	36.7	6.7	6.7	29.6	1.0	4.6	13.8	4.7	**103.8**
Local authority rates	0.1	–	–	12.9	0.5	–	1.7	–	**15.2**
Total operating expenditure excluding third party services	**44.6**	**8.3**	**8.3**	**61.5**	**2.2**	**4.6**	**9.7**	**4.7**	**143.9**
Third party services	–	–	–	–	–	–	–	–	**–**
Total operating expenditure	**44.6**	**8.3**	**8.3**	**61.5**	**2.2**	**4.6**	**9.7**	**4.7**	**143.9**
Capital expenditure									
Maintaining the long-term capability of the assets – infrastructure	15.9	3.5	3.5	0.6	–	–	–	–	**23.5**
Maintaining the long-term capability of the assets – non-infrastructure	13.5	2.9	2.9	102.2	–	–	17.4	–	**138.9**
Other capital expenditure – infrastructure	19.3	4.2	4.2	2.8	–	–	–	–	**30.5**
Other capital expenditure – non-infrastructure	12.3	2.7	2.7	27.1	–	–	0.4	–	**45.2**
Total gross capital expenditure (excluding third party)	**61.0**	**13.3**	**13.3**	**132.7**	**–**	**–**	**17.8**	**–**	**238.1**
Third party services	1.0	0.2	0.2	–	–	–	–	–	**1.4**
Total gross capital expenditure	**62.0**	**13.5**	**13.5**	**132.7**	**–**	**–**	**17.8**	**–**	**239.5**
Grants and contributions (price control)	8.0	1.8	1.8	–	–	–	–	–	**11.6**
Totex	**98.6**	**20.0**	**20.0**	**194.2**	**2.2**	**4.6**	**27.5**	**4.7**	**371.8**
Cash expenditure									
Pension deficit recovery	–	–	–	–	–	–	–	–	**–**
Totex including cash items	**98.6**	**20.0**	**20.0**	**194.2**	**2.2**	**4.6**	**27.5**	**4.7**	**371.8**

Unit cost information (operating expenditure)

	Population (thousands)	Volume collected	Volume collected	Volume collected	Biochemical Oxygen Demand (BOD)	Biochemical Oxygen Demand (BOD)	Volume transported	Dried solid mass treated	Dried solid mass disposed
Volume (Megalitres)		183,098	39,911	39,911	106,532	15,625	885,607	133,630	133,630
Unit cost (£/Megalitre)		**243.47**	**209.21**	**209.19**	**576.69**	**143.04**	**5.18**	**72.63**	**35.03**
Unit cost (£/population)	4,580.6	**9.73**	**1.82**	**1.82**	**13.41**	**0.49**	**1.00**	**2.12**	**1.02**

4F – Operating cost analysis for the 12 months ended 31 March 2017 – Household Retail

	Household unmeasured				Household measured				
	Water only £m	Wastewater only £m	Water and wastewater £m	Total £m	Water only £m	Wastewater only £m	Water and wastewater £m	Total £m	Total £m
Operating expenditure									
Customer services	0.2	2.3	1.9	**4.4**	0.7	5.8	8.7	**15.2**	**19.6**
Debt management	–	1.5	1.5	**3.0**	0.1	1.3	4.3	**5.7**	**8.7**
Doubtful debts	0.3	6.2	2.2	**8.7**	1.2	10.5	15.2	**26.9**	**35.6**
Meter reading					0.3	2.0	3.0	**5.3**	**5.3**
Other operating expenditure	0.1	1.5	0.8	**2.4**	0.3	2.8	5.7	**8.8**	**11.2**
Total operating expenditure excluding third party services	**0.6**	**11.5**	**6.4**	**18.5**	**2.6**	**22.4**	**36.9**	**61.9**	**80.4**
Third party services operating expenditure	–	–	–	**–**	–	–	–	**–**	**–**
Total operating expenditure	**0.6**	**11.5**	**6.4**	**18.5**	**2.6**	**22.4**	**36.9**	**61.9**	**80.4**
Depreciation – tangible fixed assets	–	0.3	0.2	**0.5**	0.1	0.6	1.0	**1.7**	**2.2**
Amortisation – intangible fixed assets	–	0.5	0.3	**0.8**	0.1	0.9	1.7	**2.7**	**3.5**
Total operating costs	**0.6**	**12.3**	**6.9**	**19.8**	**2.8**	**23.9**	**39.6**	**66.3**	**86.1**

Other operating expenditure includes the net retail expenditure for the following retail activities which are part funded by wholesale

	£m
Household	
Demand-side water efficiency – gross expenditure	**–**
Demand-side water efficiency – expenditure funded by wholesale	**–**
Demand-side water efficiency – net retail expenditure	**–**
Customer-side leak repairs – gross expenditure	**0.7**
Customer-side leak repairs – expenditure funded by wholesale	**–**
Customer-side leak repairs – net retail expenditure	**0.7**

4G – Wholesale current cost financial performance for the 12 months ended 31 March 2017

	Water £m	Wastewater £m	Total £m
Revenue	169.7	550.5	**720.2**
Operating expenditure	(77.7)	(143.9)	**(221.6)**
Capital maintenance charges	(84.3)	(272.1)	**(356.4)**
Other operating income	0.1	0.3	**0.4**
Current cost operating profit	**7.8**	**134.8**	**142.6**
Other income	3.0	13.1	**16.1**
Interest income	10.7	47.4	**58.1**
Interest expense	(30.6)	(135.6)	**(166.2)**
Interest expense related to the unwinding of discounted liabilities	(0.7)	(3.0)	**(3.7)**
Profit before tax and fair value movements	**(9.8)**	**56.7**	**46.9**
Fair value losses on financial instruments	(76.6)	(340.1)	**(416.7)**
Current cost profit before tax	**(86.4)**	**(283.4)**	**(369.8)**

4H – Financial Metrics	Units	Metric
Financial Indicators		
Net debt	£m	3,626.1
Regulated equity	£m	993.7
Regulated gearing	%	78.50
Post tax return on regulated equity	%	15.75
RORE (return on regulated equity)	%	5.04
Dividend yield	%	12.23
Retail profit margin – Household	%	(3.58)
Retail profit margin – Non-household	%	2.22
Credit rating	n/a	Baa2
Return on RCV	%	5.61
Dividend cover	dec	(1.48)
Funds from operations (FFO)	£m	396.1
Interest cover (cash)	dec	3.89
Adjusted interest cover (cash)	dec	2.07
FFO/debt	dec	0.11
Effective tax rate	%	7.49
Free cash flow (RCF)	£m	292.2
RCF/capex	dec	1.05
Revenue and earnings		
Revenue (actual)	£m	789.0
EBITDA (actual)	£m	480.6
Borrowings		
Proportion of borrowings which are fixed rate	%	30.68
Proportion of borrowings which are floating rate	%	7.22
Proportion of borrowings which are index linked	%	62.10
Proportion of borrowings due within 1 year or less	%	–
Proportion of borrowings due in more than 1 year but no more than 2 years	%	8.03
Proportion of borrowings due in more than 2 years but no more than 5 years	%	20.85
Proportion of borrowings due in more than 5 years but no more than 20 years	%	54.04
Proportion of borrowings due in more than 20 years	%	17.08

The Return on Regulated Equity (RORE) provides a representation of the variance in financial performance between the return allowed in the PR14 Final Determination and actual results. The calculation of RORE follows guidance provided by Ofwat, and the variances are further explained below:

RORE summary	2016–17 %	2015–16 %
PR14 base annual RORE	5.64	5.65
i) Company share of totex out-performance	0.99	1.09
ii) Company share of retail cost under-performance	(1.15)	(0.87)
iii) Impact on RCV run-off of totex out-performance	(0.10)	(0.05)
iv) Impact of any ODI penalties or rewards earned in the year	–	(0.08)
v) Interest difference on notional debt	–	(1.04)
Revised annual RORE	5.38	4.70
Cumulative average RORE	5.04	4.70

i) *We share approximately 50% of wholesale totex savings we achieve with customers. In 2016–17 this was a retained post tax saving of £16.7 million, which is equivalent to an increase of 0.99% in RORE.*

This value differs from table 4B as a result of adjustments to remove the effect of any timing differences on delivery of the capital programme and the amount shared with customers.

Prior to the calculation of the amount to be shared with customers, but adjusting for timing differences on delivery of the capital programme as well as a higher proportion of infrastructure maintenance expenditure being treated as capital expenditure, post-tax fast money out-performance for the year equates to £14.1 million and post-tax slow money out-performance to £17.2 million.

ii) *The company share of retail cost under-performance represents the amount by which we are overspending against the PR14 price determination. There is no sharing with customers of the retail expenditure variance with the result that the £19.4 million overspend for 2016–17 (post tax at 20%) reduces RORE by 1.15%.*

iii) *The impact on RCV of totex out-performance is to reduce the level of RCV run-off depreciation. This reflects our slow money out-performance. A financing adjustment is applied, ensuring that any benefit or cost experienced by the company, due to the profile of totex over the five-year period, is shared with customers.*

iv) *The impact of our performance on Outcome Delivery Incentives (ODIs) is £nil for 2016–17. Penalties or rewards are included in the adjusted RORE figures even if they are not payable or receivable until the next AMP. Table 3A provides further details.*

v) *The interest difference on notional debt represents a comparison of the implied real rate of interest allowed for the PR14 price determination against the actual implied real rate of interest, applied to a notional level of gearing (62.5% for 2016–17).*

4I – Financial derivatives for the 12 months ended 31 March 2017

	Nominal value by maturity (net) at 31 March 2017			Total value at 31 March 2017		Total accretion at 31 March 2017	Interest rate (weighted average for 12 months to 31 March 2017)	
	1 to 2 years £m	2 to 5 years £m	Over 5 years £m	Nominal value (net) £m	Mark to Market £m	£m	Payable	Receivable
Interest rate swap (sterling)								
Floating to fixed rate	–	262.5	–	**262.5**	15.0	–	1.4%	0.2%
Floating from fixed rate	195.0	–	–	**195.0**	(9.4)	–	3.0%	6.1%
Fixed to index-linked	–	–	1,318.2	**1,318.2**	1,332.4	42.7	2.0%	4.7%
Total	**195.0**	**262.5**	**1,318.2**	**1,775.7**	**1,338.0**	**42.7**		

Floating to fixed rate derivatives are intended to fix the floating Libor part of the interest cost in order to protect interest cash flows from movement in short-term variable interest rates. This row of the table comprises a £62.5 million Libor fix, taken out in 2003 and maturing 2022, plus a £200 million Libor collar. The collar has yet to fix with the result that there are no cash flows attributable to this derivative. As a result payable and receivable interest rates are diluted by the inclusion of the nominal value of the collar. The actual rates regarding the £62.5 million Libor fix are to pay 5.7% and to receive 0.6%.

Floating from fixed rate derivatives are intended to expose interest cash flows to movement in short-term variable interest rates. This derivative was entered into in 2010 in order to ensure an appropriate portion of our fixed interest rate debt is matched to the movement in short-term interest rates on our cash deposits.

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

The value of the mark-to-market represents forecast cash flows for the duration of the derivatives, discounted by prevailing interest rates. This value is extremely volatile given that market interest rates are constantly moving. The liability shown in the table above of £1,338.0 million associated with the mark-to-market valuations of our derivatives is very high at present given the current low interest rate environment. The risk of this mark-to-market value crystalising is extremely remote given that it can only crystalise under certain conditions of a default of our financing covenants, in which case operations of the company are protected and will continue. Further details are available on page 176 of our Annual Report.

Data assurance summary

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

In addition, we have previously consulted our stakeholders to understand their views on our annual reports and reported information, their feedback has been valuable and we have used this information to improve our processes.

One area of improvement that we made this year is to publish a separate document that details the complete assurance work over our reported information that we have completed for the 2016–17 financial year and the results – both positive and improvement areas.

This document is entitled 'Data Assurance Summary' and is available on our website at: **southernwater.co.uk/our-reports**.

The main assurance areas for the Annual Report are:

Significant Areas for Assurance	Assurance Results for 2016–17
The Company Monitoring Framework following Ofwat's assessment dated 30 November 2016	We have updated our annual reporting relating to our company monitoring framework (which includes details of how we are governed, our approach to risk, performance reporting and commentary on our controls and procedures). These details have also been reviewed by our technical assurers PricewaterhouseCoopers LLP. They are a third party assigned to give an independent view on the non-financial information we report.
The Annual Report including the Statutory and Regulatory Accounts, cost allocation and segmental reporting	The Annual Report and Financial Statements were audited by Deloitte LLP. Their assurance statement is included on page 190 of the Annual Report. The Annual Performance Report (APR), sections 1 and 2 were audited by Deloitte LLP. Their assurance statement is included on page 29. Deloitte LLP also performed assurance activities agreed with us on the financial information presented in section 4 of the APR and no issues were identified.
Ofwat Performance Commitments and Outcome Delivery Incentives (ODIs)	Our technical assurers, PricewaterhouseCoopers LLP completed the assurance of our performance commitments and ODIs and we include their assurance statement on page 36.
Specific assurances related to other regulators' required information (i.e. The Drinking Water Inspectorate, Consumer Council for Water, The Environment Agency) and the 2017 market reform requirements	Each specified requirement is detailed in our Data Assurance Summary
Cost assessment data	As part of our annual reporting to Ofwat this year we have been required to submit a number of additional sets of data in preparation for the next Price Review. Deloitte LLP has performed assurance activities agreed with us on the financial information submitted and PricewaterhouseCoopers LLP have undertaken assurance on the non-financial data submitted. No issues were identified.

Appendices

The information in the appendices has not been audited.

Appendix 1. Transactions with associates

Services supplied to the associated companies by the appointee

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

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

Recharges for services supplied by Southern Water Services Limited	2017 £000	2016 £000
Greensands Investments Limited	**1,000**	1,000

These recharges are based on cost or the market price for providing the service. To the best of the directors' knowledge, all transactions with associated companies have been disclosed.

Allocation of costs between regulated and non-regulated businesses

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

Details of inter-company loans

Loans granted to Southern Water Services Limited	2017 £000	2016 £000
Southern Water Services (Finance) Limited	**3,441,177**	3,172,852

The loans have varying interest rates up to 6.65% with maturity dates ranging from 2019 to 2056. Full details are disclosed in note 19 the statutory accounts. The loans are secured.

One loan amounting to £30.3 million is repayable on demand.

Loans granted by Southern Water Services Limited	2017 £000	2016 £000
Southern Water Services (Finance) Limited	**8,326**	828
Southern Water Services Group Limited (SWSG)	**812,257**	812,257

The loan to SWSG 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%.

Dividends paid by Southern Water Services Limited to group companies

An ordinary dividend of £124.2 million (2016: £79.6 million) was declared for payment to Southern Water Holdings Limited (SWH). Of this £61.0 million was paid during 2016–17 and a final dividend of £63.2 million was paid in April 2017.

A dividend of £45.5 million (2016: £45.5 million) is paid to SWS Holdings Limited to allow SWSG to service its interest obligations on the Southern Water Services Limited/SWSG loan agreement.

Dividends paid by Southern Water Services Limited to group companies	**2017 £000**	2016 £000
Southern Water Holdings (ordinary dividend)	**124,200**	79,600
Southern Water Holdings (for SWSG loan agreement)	**45,493**	45,493

The dividend policy is summarised below:

Distributions may comprise normal dividends, special dividends and shareholder loan payments. Board decisions in respect of annual distributions will reflect consideration relevant to directors' duties at law and under the Ofwat-administered regulatory arrangements.

Distribution proposals submitted to the Board will include an assessment of the proposed distribution on the company's credit rating, headroom under debt covenants, potential impact on the financial flexibility and the ability of the company to deliver its capital programme.

Distribution proposals submitted to the Board will include an assessment of the company's performance against the business plan including expected performance over the balance of the regulatory period.

Comparison of dividend to the PR14 Final Determination

Ordinary dividends calculated for the PR19 Final Determination were at the level of a notional geared company of 62.5% (versus the actual geared company of 77% for 2016–17). In addition to the ordinary dividend for the final determination there are revenue adjustments relating to rewards and penalties associated with actual performance against previous price determinations, plus actual performance of the non-appointed part of our business.

The impact on dividends of revenue adjustments relating to previous price determinations is material for Southern Water given a recovery in this period of a revenue shortfall, in excess of £200 million, in respect of the previous PR09 Final Determination.

The Final Determination ordinary dividend for 2016–17 was £68.4 million (2016: £65.8 million). In addition there were revenue increase adjustments of £39.5 million (2016: £38.9 million) and ordinary dividends for the non-appointed business of £2.6 million (2016: £3.4 million). In total, this amounts to a Final Determination dividend of £110.5 million in 2016–17 (2016: £108.1 million), compared to an actual level of ordinary dividend of £124.2 million in 2016–17 (2016: £79.6 million).

The dividend relating to the SWSG loan agreement was excluded from the PR14 Final Determination. Inclusion of this agreement would have increased customer bills as a result of affecting the tax calculations of the final determination, and the overall effect of this loan agreement is neutral to cash flows of Southern Water.

Asset transfers

There were no asset transfers during the year.

Appendix 2. KPI definitions and status assessment rules

Responsive customer service

Customer satisfaction – Service Incentive Mechanism (SIM) score

Definition:
Ofwat measure of overall customer satisfaction, based on the numbers of unwanted contacts and complaints, together with the response to customer satisfaction surveys.

Status:
- SIM score higher than industry average
- SIM score below industry average
- SIM score below industry average by more than 10%

Reward/penalty: Reward and penalty based on performance relative to other water companies.

Measurement: SIM score is measured and calculated according to Ofwat's guidance in 'Service incentive mechanism – guidance for collating customer service information for calculating the SIM score' (April 2015).

Unit of measure: Score out of a maximum of 100.

First-time resolution of customer contacts

Definition:
Proportion of customer contacts that are resolved on first contact.

Status:
- More than or equal to 80%
- Less than 80% but more than previous year
- Less than 80% and less than previous year

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: First-time resolution of customer contacts is measured using an approach which was developed for Southern Water's business plan and used to calculate the company performance level in 2013–14.

Unit of measure: Percentage of contacts received.

Percentage of customers who feel our service meets their individual needs

Definition:
Proportion of customers agreeing that we meet their individual needs, measured by surveys.

Status:
- Greater than previous year
- Equal to or up to five percentage point lower than the previous year
- More than five percentage points below the previous year

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Percentage performance is calculated from the responses to third party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.

Unit of measure: Percentage of customers surveyed.

Percentage of customers who feel our service meets the needs of their community

Definition:
Proportion of customers agreeing that we meet the needs of their community, measured by surveys.

Status:
- Greater than previous year
- Equal to or up to five percentage points lower than the previous year
- More than five percentage points below the previous year

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Percentage performance is calculated from the responses to third party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.

Unit of measure: Percentage of customers surveyed.

Number of compensation payments made to customers (Guaranteed Standards of Service)

Definition:
Number of payments made against the Guaranteed Standards of Service scheme.

Status:
- Less than or equal to 3,783
- More than 3,783 but fewer than previous year
- More than 3,783 and more than previous year

Reward/penalty: Not applicable.

Measurement: The number of compensation payments made is calculated according to Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 6 Key Outputs Customer Service Standards'.

Unit of measure: Number of payments.

Affordable bills

Customers in genuine hardship with improved support

Definition:
Cumulative number of one-off interventions and/or the number of customers accepted on to each of our schemes and tariffs.

Status:
- More than or equal to 149,900
- Less than 149,900 but forecast for 2019–20 to achieve target of 217,100
- Less than 149,900 but forecast for 2019–20 is below target of 217,100

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Performance is calculated as the number of customers who are enrolled on one of Southern Water's financial assistance schemes as defined in the company's business plan.

Unit of measure: Cumulative number of interventions and/or customers.

Percentage of customers who feel our services provide value for money

Definition:
Proportion of customers who feel they get value for money from our services, measured by surveys.

Status:
- Greater than previous year
- Equal to or up to five percentage points lower than the previous year
- More than five percentage points below the previous year

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Percentage performance is calculated from the responses to third party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.

Unit of measure: Percentage of customers surveyed.

Better information and advice

Water usage (per capita consumption)

Definition:
Average per capita consumption for households each day. Includes measured and unmeasured households.

Status:
- Average for 2016–17 is below 133.7 litres per head/per day
- Average for 2016–17 is above 133.7 but forecast for 2015–16 to 2019–20 is below 133.7 litres per head/per day
- Average for 2016–17 is above 133.7 and forecast for 2015–16 to 2019–20 is above 133.7 litres per head/per day

Reward/penalty: Annual maximum reward £1.375 million, annual maximum penalty £2.192 million.

Measurement: Performance is calculated in accordance with Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 10 Non-financial measures – water delivered'. The unit of measurement is post-Maximum Likelihood Estimation weighted average litres per person/per day on average over the year.

Unit of measure: Litres per head/per day (l/h/d).

Number of unwanted billing queries

Definition:
Number of customer queries related to the understanding of their bills.

Status:
- Less than 49,000 queries and decrease on previous year
- Less than 49,000 queries but more than the previous year
- More than 49,000 queries

Reward/penalty: Reputational only, but high number will decrease SIM score.

Measurement: Numbers of customer queries related to a billing are collated in accord with Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 4 Key Outputs Customer Service 1'.

Unit of measure: Number of billing queries.

Better information and advice continued

Customers who are aware of the causes of blocked drains

Definition: Proportion of customers who are aware of measures to avoid blocked drains, measured by surveys.

Status:

Green	Equal to or greater than 78
Amber	Equal to or less than 77
Red	Less than 71

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Percentage performance is calculated from the responses to third party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.

Unit of measure: Percentage of customers surveyed.

Percentage of customers who are aware of how their money is used

Definition: Proportion of customers with awareness of where their money goes, measured by surveys.

Status:

Green	Greater than previous year
Amber	Equal to or up to five percentage points lower than the previous year
Red	More than five percentage points below the previous year

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Percentage performance is calculated from the responses to third party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.

Unit of measure: Percentage of customers surveyed.

Percentage of customers who are aware of how to deal with hard water

Definition: Percentage of customers who are aware of how to deal with hard water, measured by surveys.

Status:

Green	Greater than previous year
Amber	Equal to or up to five percentage points lower than the previous year
Red	More than five percentage points below the previous year

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Percentage performance is calculated from the responses to third party surveys of a representative sample of customers. The methodology was developed in 2013–14 for Southern Water's business plan and revised in 2015–16.

Unit of measure: Percentage of customers surveyed.

A constant supply of high-quality drinking water

Water quality (Mean Zonal Compliance)

Definition: Compliance with the Drinking Water Inspectorate (DWI) measure for Mean Zonal Compliance (MZC).

Status:

Status	
Green	More than or equal to 99.95%
Amber	Less than 99.95% but greater than 99.93%
Red	Less than or equal to 99.93%

Reward/penalty: Penalty only – annual maximum penalty £0.439 million.

Measurement: Performance is calculated according to the methodology used by DWI for reporting overall compliance with drinking water quality standards set out in the Water Supply (Water Quality) Regulations.

Unit of measure: Percentage.

Number of contacts regarding discolouration per 1,000 population

Definition: Number of customer contacts regarding the discolouration of their drinking water per 1,000 population.

Status:

Status	
Green	Less than or equal to 0.85
Amber	More than 0.85 but less than 0.90
Red	More than 0.90

Reward/penalty: Penalty only – annual maximum penalty £0.173 million.

Measurement: Performance is calculated as the total number of contacts received from customers related to black, brown or orange discolouration of their drinking water per 1,000 population, as reported by the company to the Drinking Water Inspectorate in accordance with the Water Industry (Suppliers' Information) Direction.

Unit of measure: Number per 1,000 population.

Leakage reported

Definition: Total level of leakage, including customer supply-pipe losses.

Status:

Status	
Green	Average of years from 2015–16 to report year is below 87 megalitres per day
Amber	Average of 2015–16 to report year is above 87 but forecast average for 2015–16 to 2019–20 is below 87 megalitres per day
Red	Average of 2015–16 to report year is above 87 and forecast average for 2015–16 to 2019–20 is above 87 megalitres per day

Reward/penalty: Annual maximum reward £0.153 million, annual maximum penalty £1.232 million.

Measurement: Performance is calculated according to Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 10 Non financial measures – water delivered' and for the Ofwat KPI in 'Key performance indicators – guidance', IN 13/03.

Unit of measure: Megalitres per day (Ml/d).

Customer minutes lost supply greater than three hours

Definition: Average minutes lost per property served per year, due to water supply interruptions of greater than three hours.

Status:

Status	
Green	Less than or equal to nine minutes/property/year
Amber	More than nine but less than or equal to 12 minutes/property/year
Red	More than 12 minutes/property/year

Reward/penalty: Penalty only – annual maximum penalty £0.574 million.

Measurement: Performance is calculated according to the guidelines for the Ofwat KPIs in 'Key performance indicators – guidance', IN 13/03. The impact of severe weather conditions is taken into account and any adjustments are independently assured.

Unit of measure: Minutes/property/year.

A constant supply of high-quality drinking water continued

Number of properties with low water pressure

Definition: Number of properties on the DG2 low water pressure register.

Status:
- Less than or equal to 257 properties
- More than 257 but less than 296 properties
- More than or equal to 296 properties

Reward/penalty: Penalty only – annual maximum penalty £0.174 million.

Measurement: Performance is calculated according to Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 2 Key Outputs - Water Service 2' and for the Ofwat KPI in IN 13/03.

Unit of measure: Number of properties.

Number of customers affected by temporary use bans

Definition: The number of properties affected by temporary use bans before two consecutive dry winters. A dry winter is where rainfall is less than 85% of the long-term average.

Status:
- No temporary use bans applied during the year
- Temporary use bans applied following two consecutive dry winters
- Temporary use bans applied in the year, not preceded by two consecutive dry winters

Reward/penalty: Penalty only – annual maximum penalty £16.255 million.

Measurement: Performance is calculated as the number of properties that are affected by temporary use bans before two consecutive dry winters have occurred. A dry winter is defined within the company business plan as less than 85% of the long-term average annual rainfall level.

Unit of measure: Number of properties affected.

Maintain water asset health

Definition: Assessment of water asset health as measured against pre-determined performance levels for mains bursts, Distribution Maintenance Index (TIM), WSW coliform compliance, WSR coliform compliance, and WSW turbidity compliance).

Status:
- Stable. All components above the upper performance level
- Improvement required. One or more components is below the upper performance level but not below the lower performance level
- Significant improvement required. One or more components is below the lower performance level

Reward/penalty: Penalty only – annual maximum penalties, burst mains £1.960 million, coliforms at WSW £0.38 million, TIM £0.904 million, coliforms at WSR £0.244 million, turbidity at WSW £0.761 million.

Measurement: Performance is calculated in accord with guidance for the Ofwat KPIs in 'Key performance indicators – guidance', IN 13/03. Stable performance means that performance for all components of the ODI is better than the upper performance levels stated in the company business plan.

Unit of measure: Rating.

Measurement of components:
- The number of mains bursts in the reporting year is measured according to Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 11: Non-financial measures – water service activities'.
- Distribution Maintenance Index (TIM) is calculated according to the methodology used by DWI for report compliance with drinking water quality standards set out in the Water Supply (Water Quality) Regulations, specifically for iron, manganese and turbidity.
- Coliform compliance at WSWs is calculated as the number water supply works with tests containing zero coliforms expressed as a percentage of the total number of tests taken at works to meet the requirements of the Water Supply (Water Quality) Regulations.
- Coliform compliance at WSRs is calculated as the number of water service reservoirs with no more than 5% of samples, tested to meet the requirements of the Water Supply (Water Quality) Regulations, containing coliforms. It is expressed as a percentage of the number of service reservoirs in supply during the year.
- Turbidity compliance at WSW is calculated according to Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 11a: Non-financial measures – water service serviceability measures'.

Removing wastewater effectively

Number of blockages per km per year

Definition:
Number of blockages in the year per kilometre of sewer.

Status:

- Less than or equal to 0.58 blockages per km
- More than 0.58 but less than 0.59 blockages per km
- More than or equal to 0.59 blockages per km

Reward/penalty: Penalty only – annual maximum penalty £1.004 million.

Measurement: Performance is calculated according to Ofwat guidance in 'June Return Reporting Requirements 2011: Chapter 16 Non-financial measures – Sewerage service activities' and for the Ofwat KPIs in 'Key performance indicators – guidance', IN 13/03.

Unit of measure: Number per km.

Number of internal flooding incidents

Definition:
Number of incidents of internal flooding of properties in the year (all causes, including from formerly private sewers).

Status:

- Less than or equal to 436 for the year
- More than 436 but forecast total for 2015–16 to 2019–20 is less than 2,070
- Forecast total for 2015–16 to 2019–20 is more than or equal to 2,070

Reward/penalty: Annual maximum reward £4.337 million, annual maximum penalty £3.387 million.

Measurement: The number of flooding incidents is calculated according to Ofwat guidance in 'June Return Reporting Requirements 2011: Chapter 3 Key Outputs – Sewerage Service'. Incidents on private sewers are included. The only incidents that are excluded are those associated with 'severe' weather conditions.

Unit of measure: Number of incidents.

Number of external flooding incidents

Definition:
Number of incidents of external flooding in the year.

Status:

- Less than or equal to 9,694
- More than 9,694
- More than 9,694 and the external flooding (other causes) measure contributing to wastewater asset health has not been met

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: The number of flooding incidents is calculated according to Ofwat guidance in 'June Return Reporting Requirements 2011: Chapter 3a Key Outputs – Sewerage Service'. Incidents on private sewers are included. All incidents from all causes are included.

Unit of measure: Number of incidents.

Number of customer complaints regarding odour

Definition:
Number of complaints received from customers related to odour from wastewater works. Note: only odour complaints from Portswood and Tonbridge are included in the associated ODI.

Status:

- Less than or equal to 390
- More than 390 but less than previous year
- More than 390 and more than previous year

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: This Business Promise is a more stringent measure which includes all odour complaints reported by members of the public for all wastewater treatment works and pumping stations during the calendar year. The ODI within the company business plan is a sub-set of odour complaints received for two specified works (Portswood and Tonbridge) where there are improvement schemes to specifically address odour.

Unit of measure: Number of odour complaints.

Removing wastewater effectively continued

Maintain wastewater asset health

Definition:
Assessment of wastewater asset health as measured against pre-determined performance levels for sewer collapses, Wastewater Treatment Works (WWTW) Population Equivalent (PE) compliance and external flooding – other causes.

Status:

Status	
Green	Stable. All components above the upper performance level
Amber	Improvement required. One or more components is below the upper performance level but not below lower performance level
Red	Significant improvement required. One or more components are below the lower performance level

Reward/penalty: Penalty only – annual maximum penalties, external flooding (other causes) £0.601 million, sewer collapses £1.35 million, WWTW PE compliance £14.95 million.

Measurement: Performance is calculated according to guidance for the Ofwat KPIs in ‘Key performance indicators – guidance’, IN 13/03. Stable performance means that performance for all components of the ODI is better than the upper performance levels stated in the company business plan.

Unit of measure: Rating.

Measurement of components:

- The number of sewer collapses is calculated according to Ofwat guidance in ‘June Return Reporting Requirements 2011: Chapter 16 Non-financial measures – Sewerage service activities’.
- Population equivalent served by WWTW compliant with consents is calculated as the total population equivalent for all wastewater treatment works that have complied with their Water Resources Act (WRA) and Urban Wastewater Treatment Directive (UWWTD) look-up table permit conditions as reported by the Environment Agency on MD109.
- The number of flooding incidents is calculated according to Ofwat guidance in ‘June Return Reporting Requirements 2011: Chapter 3a Key Outputs – Sewerage Service’. Incidents on private sewers are included. Only incidents classified as ‘other causes’ are included.

Looking after the environment

Wastewater treatment works compliance

Definition:
Proportion of wastewater treatment works in compliance with their environmental permit as reported by the Environment Agency on MD109.

Status:

Status	
Green	100.0%
Amber	Less than 100.0% but more than or equal to 97.7%
Red	Less than 97.7%

Reward/penalty: Penalty only – annual maximum penalty £14.949 million.

Measurement: Performance is calculated as the percentage of wastewater treatment works that have complied with their numeric consent. This is calculated in accordance with the methodology used by the Environment Agency for reporting on MD109.

Unit of measure: Percentage of works.

Maintain the number of bathing waters with excellent water quality

Definition:
Maintain the number of bathing waters with ‘excellent’ water quality, as defined by the revised Bathing Water Directive, at the 2014–15 level.

Status:

Status	
Green	More than or equal to 54 bathing waters
Amber	Less than 54 but more than or equal to 48 bathing waters
Red	Less than 48 bathing waters

Reward/penalty: Annual maximum reward £1.481 million, annual maximum penalty £1.749 million.

Measurement: Performance is calculated in accordance with the methodology, which is published by Defra, for measuring bathing water quality against the revised Bathing Water Directive. The measure of ‘excellent’ water quality is no more than 100 Intestinal Enterococci cfu/ml and 250 Escherichia coli cfu/ml in at least 19 out of 20 samples.

Unit of measure: Number of bathing waters.

Looking after the environment continued

Number of serious pollution incidents (category 1 and 2)

Definition: Total number of category 1 and 2 pollution incidents related to wastewater assets as reported by the Environment Agency on MD109.

Status:

- Green: Less than six incidents
- Amber: Equal to six incidents
- Red: More than six incidents

Reward/penalty: Pollutions may incur fines for each serious pollution incident.

Measurement: Performance is stated in accordance with the number of pollution incidents, categorised as 1 and 2, reported by the Environment Agency on MD109.

Unit of measure: Number of incidents.

Number of pollution incidents (category 3)

Definition: Number of category 3 pollution incidents related to wastewater assets (including transferred sewer assets but excluding private pumping stations) as reported by the Environment Agency on MD109.

Status:

- Green: Less than or equal to 221 incidents
- Amber: More than 221 but less than 348 incidents
- Red: More than or equal to 348 incidents

Reward/penalty: Penalty only – annual maximum penalty £2.16 million.

Measurement: Performance is stated in accordance with the number of pollution incidents, categorised as 3, reported by the Environment Agency on MD109.

Unit of measure: Number of incidents.

Distribution input

Definition: Average daily amount (megalitres per day) of potable water entering the distribution system.

Status:

- Green: Less than or equal to 525.06
- Amber: More than 525.06 but less than 533.97
- Red: More than 533.97 megalitres

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: Performance is calculated in accordance with Ofwat Guidance in 'June Return Reporting Requirements 2011: Chapter 10 Non-financial measures – water delivered'. The unit of measurement is post-Maximum Likelihood Estimation Distribution Input.

Unit of measure: Megalitres per day (Ml/d).

Renewable energy usage

Definition: Proportion of total energy consumption that is from renewable sources (e.g. biogas, solar and wind).

Status:

- Green: More than or equal to annual target of 14.4%
- Amber: Less than annual target but the forecast for 2019–20 is more than 16.5
- Red: Less than annual target and forecast for 2019–20 less than 16.5%

Reward/penalty: Reputational only, no financial reward or penalty.

Measurement: The percentage of renewable energy generated out of total operational energy used in the financial year is calculated in accordance with methodology developed for Southern Water's business plan.

Unit of measure: Percentage.

Other performance commitments

Greenhouse Gas Emissions

Definition: Scope 1,2 and 3 Greenhouse Gas Emissions expressed as kilograms carbon dioxide equivalent ($KgCO_2e$).	*Reward/penalty:*	Not applicable.
	Measurement:	Greenhouse gas emissions are calculated in accordance with the UK Water Industry Research (UKWIR) Carbon Accounting Workbook, which is a standardised approach to estimating operational greenhouse gases to meet the requirements of Ofwat and Defra for carbon accounting.
	Unit of measure:	Kilograms carbon dioxide equivalent ($KgCO_2e$).

Greenhouse Gas Emissions per person supplied with drinking water

Scope 1,2 and 3 Greenhouse Gas Emissions expressed as kilograms carbon dioxide equivalent ($KgCO_2e$) per person supplied with water.	*Reward/penalty:*	Not applicable.
	Measurement:	Greenhouse gas emissions are calculated in accordance with the UK Water Industry Research (UKWIR) Carbon Accounting Workbook, which is a standardised approach to estimating operational greenhouse gases to meet the requirements of Ofwat and Defra for carbon accounting.
	Unit of measure:	Kilograms carbon dioxide equivalent per person supplied with water ($KgCO_2e$/person).

Greenhouse Gas Emissions per person supplied with wastewater services

Scope 1,2 and 3 Greenhouse Gas Emissions expressed as kilograms carbon dioxide equivalent ($KgCO_2e$) per person supplied with wastewater services.	*Reward/penalty:*	Not applicable.
	Measurement:	Greenhouse gas emissions are calculated in accordance with the UK Water Industry Research (UKWIR) Carbon Accounting Workbook, which is a standardised approach to estimating operational greenhouse gases to meet the requirements of Ofwat and Defra for carbon accounting.
	Unit of measure:	Kilograms carbon dioxide equivalent per person supplied with wastewater services ($KgCO_2e$/person).

Appendix 3. Materiality

This section sets out the information the Board uses in determining whether the company is complying with its regulatory obligations.

In providing the risk and compliance statement, the Board must report on all material or potential material risk. The Board must also report on any regulatory output that is materially different to their Final Determination.

In the previous regulatory reporting framework, confidence grades were used to express the completeness, accuracy and reliability of the information being provided. The company has continued to use confidence grades as a factor within its risk assessment to determine the focus of assurance for information reported in 2016–17. In reaching conclusions regarding materiality, the Board considers the confidence grade definitions as used previously.

Reliability band	Description
A	Sound textual records, procedures, investigations or analysis properly documented and recognised as the best method of assessment
B	As A, but with minor shortcomings. Examples include old assessment, some missing documentation, some reliance on unconfirmed reports, some use of extrapolation
C	Extrapolation from limited sample for which Grade A or B data is available
D	Unconfirmed verbal reports, cursory inspections or analysis

Accuracy band	Accuracy to within +/-	But outside +/-
1	1%	–
2	5%	1%
3	10%	5%
4	25%	10%
5	50%	25%
6	100%	50%
x	Accuracy outside +/- 100%, small numbers or otherwise incompatible	

For our 41 reported non-financial metrics on pages 32 and 34, due to increased stringency in our audits our confidence grades have reduced for five of the measures. In most cases where the confidence grade was reduced, there were no underlying problems with the quality of the data reported. However, category 3 pollution incidents and wastewater treatment works compliance remain subject to further assurance.

The Board will report any shortfall in delivery of an output. In determining the impact of the shortfall the Board considers the impact in terms of three criteria: financial value, customer importance and environmental impact.

Appendix 4.
Glossary of Regulatory Terms

AMP adjustment

The revision in the real value of fixed assets arising periodically from improved information in the five-year Asset Management Plan process.

Appointed business

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

Arm's-length trading

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

Asset Management Plan (AMP)

A plan agreed with Ofwat on a five-yearly basis for the management of water and wastewater assets. The plan runs for a five-year period. AMP6 covers April 2015 to March 2020.

Associate company

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

Capital Incentive Scheme (CIS)

Mechanism introduced by Ofwat to encourage companies to submit challenging and accurate estimation of their capital investment requirements at price reviews.

Final Determination (FD)

The conclusion of discussions on the scale and content of the Asset Management Plan for the forthcoming five-year period. It is accompanied by a determination of the allowable 'K factor' for the period.

Financing adjustment

The impact of general inflation (RPI) on the real value of net finance for the business.

K factor

The annual increase, set by Ofwat, in charges that companies in the water industry can make. The amount by which a company can increase (or must decrease) its charges is controlled by the price limit formula RPI + or – 'K' + 'U'. RPI is expressed as the percentage increase in the Retail Price Index in the year to November before the charging year. 'K' is a number determined by Ofwat for each company, usually at a price review, for each year to reflect what it needs above or below inflation in order to finance the provision of services to customers, and 'U' is the amount of 'K' not taken up by a company in previous years.

Licence

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

Modern Equivalent Asset (MEA)

The cost of an asset of equivalent productive capability to satisfy the remaining service potential of the asset being valued if the asset would be worth replacing, or the recoverable amount if it would not. The gross MEA value is what it would cost to replace an old asset with a technically up-to-date new asset with the same service capability, allowing for any difference both in the quality of output and in operating costs. The net MEA value is the depreciated value taking into account the remaining service potential of an old asset compared with a new asset and is stated gross of third-party contributions.

Non-appointed business

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

Ofwat

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

Outcome Delivery Incentive (ODI)

Performance targets with rewards and/or penalties agreed with customers and Ofwat through the periodic review process.

Periodic review

The price determination process undertaken by Ofwat every five years. Each water and wastewater undertaker submits a business plan covering the five-year period for which Ofwat will determine prices (the ‘K factor’ – see above).

Price limit

The name given to the combination of the Retail Price Index (RPI), ‘K’ and ‘U’.

Regulatory Accounting Guidelines (RAG)

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

Regulatory Capital Value (RCV)

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

Retail Price Index (RPI)

The RPI is compiled and published monthly by the Office for National Statistics. It is an average measure of change in the prices of goods and services bought for the purpose of consumption by the vast majority of households in the United Kingdom.

Service Incentive Mechanism (SIM)

Ofwat’s measure of customer satisfaction based on surveys of customers who have contacted the company and the number of unwanted contacts and complaints received.

Totex

The total of operating costs and capital expenditure in the year.

Working capital

The aggregate of stocks, trade debtors and trade creditors, if material.

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