



Annual Report and Financial statements for the year ended 31 March 2016



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Introduction

Greensands Holdings Limited (GSH or 'the company') is the ultimate parent company of Southern Water Services Limited (Southern Water) and all other group companies, with no minority interests.

The only operating company in the group is Southern Water and the information contained in this Strategic Report is therefore mainly based upon the activities of this company only. This information is fully supported by GSH and has been adopted from the Southern Water Annual Report which is published on the Southern Water website. Sections 1 and 2 that follow contain reviews of GSH and Southern Water for the year to 31 March 2016, respectively.

1) Greensands Holdings Limited

Strategic Report:

The Business

GSH acts as a holding company, with the only trading subsidiary being Southern Water.

This section sets out the financial performance and structure of the group as well as the corporate governance in place at GSH. A summary of the activities, performance and key risks relating to Southern Water are described in section 2 from page 11.

Financial KPIs

Under the group financial structure there is a comprehensive set of covenanted financial ratios. Of these, two are key ratios, namely the ratio of consolidated net debt to Regulatory Capital Value (RCV) and the ratio of consolidated EBITDA to consolidated net cash interest cost.

The net debt used in the net debt to RCV ratio is calculated as consolidated secured short and long-term borrowings less cash and short-term deposits. The RCV of Southern Water is set by Ofwat for five-year periods at periodic reviews and reflects forecast growth in the asset base. It is adjusted at each periodic review for any out-performance, shortfalls in outputs or permitted additional investment and for certain asset disposals. The target for the current five-year regulatory period ending March 2020 is to maintain the ratio of consolidated net debt to RCV at no more than 90 per cent; at 31 March 2016 it was 89 per cent. Lock-up is defined as a restriction on all dividend payments.

The consolidated EBITDA to consolidated net cash interest is targeted to be maintained comfortably above the 2.0 times covenanted level.

Net debt: RCV	%	Consolidated EBITDA to cash interest cover	Times
2014–15 performance:	88	2014–15 performance	3.4
2015–16 performance	89	2015–16 performance	3.2
Covenanted lock-up level	93	Covenanted default level	2.0
Covenanted default level	95		

Group financial performance

The accounting policies of the Group, including any changes in accounting policies in the period, are set out on pages 33 to 42.

Consolidated income statement - summary

The consolidated income statement of GSH is summarised in Table 1 below:

Table 1	Years ended 31 March		Change
	2016 £m	2015 £m	%
Revenue	803.7	826.2	(2.7)
Other operating income	1.7	1.2	41.7
Operating costs	(287.7)	(274.7)	4.7
Depreciation, net of amortisation	(242.0)	(230.2)	5.1
Operating profit	275.7	322.5	(14.5)
Profit on disposal of fixed assets	0.4	1.3	(69.2)
Net finance costs	(270.4)	(270.7)	(0.1)
Fair value losses on derivative financial instruments	(66.9)	(128.0)	(47.7)
Loss before tax	(61.2)	(74.9)	(18.3)
Tax	40.3	(1.2)	-
Loss for the financial year	(20.9)	(76.1)	(72.5)

Operating profit largely reflects the trading results of Southern Water for the year and additional depreciation from the revaluation of assets on acquisition.

Revenue decreased by 2.7 per cent to £803.7 million (2015: £826.2 million) principally because of the application of new price controls at the start of the regulatory period. Our water and wastewater wholesale revenue, which accounts for some 90 per cent of our total revenue, is now subject to an annual revenue cap. Under these revenue caps, the total revenue we were permitted to recover from our main charges in 2015–16 was some three per cent lower than our actual revenue in 2014–15.

Operating costs increased by 4.7 per cent to £287.7 million (2015: £274.7 million) and the major reasons for this movement of £13.0 million are described on the following page and in Table 2.

As a result of the transition to IFRS we are no longer permitted to account for our infrastructure maintenance and repairs using renewals accounting. Consequently, certain expenditure to maintain our infrastructure assets that was previously capitalised under UK GAAP is now treated as an operating cost. Due to the nature of maintenance work, this has the effect of making operating expenditure more volatile, depending on the level of maintenance and repair activity carried out in any one year.

Table 2	
Year-on-year increase/(decrease) in operating costs	£m
Inflation	3.4
Increased bad debt charge	2.6
Infrastructure maintenance expenditure	6.6
Market reform preparation	2.0
Customer services improvement programme	2.9
Change programme	4.0
Refund of rates charges	(13.3)
Insurance proceeds received 2014–15	2.4
Other	2.4
Movement in operating costs	13.0

In 2015–16 we undertook additional planned works on our sewer network in order to reduce the level of pollution and flooding incidents. This additional work, together with the change in accounting treatment, resulted in an increase in operating costs of £6.6 million.

During 2015–16 we have also undertaken a number of specific projects which have resulted in increased operating costs. These include preparations for market reform, which will see the introduction of retail competition for non-household customers, initiatives to improve our customer services performance, such as the creation of a proactive outbound contact team, and an overall change programme aimed at making business improvements to help drive future efficiencies.

These cost increases were offset by a successful appeal against historic rates charges which resulted in the receipt of a refund of £13.3 million.

Depreciation increased by 5.1 per cent to £242.0 million (2015: £230.2 million) as a result of the continuing significant capital investment programme. As we reached the end of our previous five-year capital investment programme, AMP 5, a large number of schemes were commissioned during the year, adding a further £8.0 million to the depreciation charge on top of the full-year impact of schemes commissioned during 2014–15.

Operating profit for 2015–16 decreased to £275.7 million (2015: £322.5 million), a 14.5 per cent reduction as a result of the factors set out above.

The profit on disposal of fixed assets of £0.4 million (2015: £1.3 million) mainly relates to the sale of land, buildings and equipment, surplus to operational requirements.

Net finance costs of £270.4 million decreased by 0.1 per cent (2015: £270.7 million). This is largely driven by higher Eurobond interest of £10.2 million in Greensands Europe and higher net interest payable of £7.7 million following a step up in the interest payable on some of the financial instruments in Southern Water. This was offset by lower indexation of £11.8 million on inflation-linked bonds as a result of lower RPI in 2015–16 and lower interest costs following a refinancing of a facility loan of £6.1 million in Southern Water (Greensands) Financing Plc.

As a result of adopting IFRS, fair value movements on our financial instruments are now recorded through our income statement. During 2015–16, the underlying liability associated with our financial instruments increased, resulting in a loss of £66.9 million being recorded in the income statement (2015: loss £128.0 million).

We have recognised a total tax credit to the income statement of £40.3 million (2015: charge £1.2 million). This differs from the credit that may be expected of £12.2 million, based on the loss before tax of £61.2 million and the current period tax rate of 20 per cent, as described in note 10. This is primarily the result of the treatment of Eurobond interest for which we have not claimed a tax deduction of £11.3m offset by the announcement of the reduction in the rate of corporation tax from 20 per cent to 19 per cent with effect from 1 April 2017 and 18 per cent from 1 April 2020. A credit of £46.9 million is recognised for the impact of these changes on the deferred tax liability of the company.

The loss after taxation for the year amounted to £20.9 million (2015: £76.1 million).

Statement of financial position – summary

The consolidated statement of financial position for GSH is summarised in Table 3 below:

Table 3	As at 31 March	
	2016 £m	2015 £m
Non-current assets	5,946.3	5,948.6
Current assets (excluding cash)	194.2	209.2
Cash and cash equivalents	38.1	230.1
Total assets	6,178.6	6,387.9
Current liabilities	(237.1)	(415.2)
Non-current liabilities	(6,219.7)	(6,136.7)
Total liabilities	(6,456.8)	(6,295.1)
Total net liabilities	(278.2)	(164.0)
Shareholder's deficit	(278.2)	(164.0)

At 31 March 2016 the Group had non-current assets of £5,946.3 million (2015: £5,948.6 million), a reduction of £2.3 million from 31 March 2015. This reduction largely results from a fall in the value of derivative financial instruments. Additions to tangible and intangible assets from the capital investment programme of Southern Water, of £241.1 million, were offset by depreciation of £242.0 million. Total non-current assets as at 31 March 2016 include goodwill arising on acquisition of £85.1 million (2015: £85.1 million).

Current assets decreased to £194.2 million (2015: £209.2 million). This decrease mainly results from a lower level of accrued income and net billed debtors at Southern Water, as a result of the impact of lower charges to customers of £12.8 million.

Current liabilities decreased to £237.1 million (2015: £415.2 million) reflecting the refinancing of a £200.0 million facility agreement with the new long-term facility disclosed in non-current liabilities. This is offset by a second term facility agreement of £50 million, which is due to be repaid this year and is therefore disclosed in current liabilities.

Non-current liabilities increased to £6,219.7 million (2015: £6,136.7 million). This increase largely results from movements in loans, derivative values, the pension liability and the deferred tax liability as described below.

During the year new term facility agreements of £200.0 million and a Class A loan of £60.5 million were arranged. These, along with accrued interest on the Eurobond loan of £95.5 million and an increase in the derivative liability of £65.6 million, were offset by accretion payments of £298.4 million during the year.

In addition, our pension liability reduced by £13.1 million following the payment of a deficit contribution of £30.6 million which offset the impact of market movements on the deficit. Our deferred tax balance also reduced by £43.0 million principally as a result of the announcement of future changes to corporation tax rates.

As at 31 March 2016, the Group had net liabilities of £278.2 million (2015: £164.0 million). Excluding the liability associated with the Eurobonds, which are shareholder loans and included within non-current liabilities, of £890.7 million (2015: £795.2 million), the underlying shareholder equity was £612.5 million (2015: £631.2 million).

Cash flow statement – summary

The consolidated cash flow statement for GSH is summarised in Table 4 below:

Table 4	Years ended 31 March	
	2016 £m	2015 £m
Net cash inflow from operating activities	481.6	513.6
Net cash used in investing activities	(236.0)	(307.4)
Net cash used in financing activities	(437.6)	(169.5)
Net (decrease)/increase in cash and cash equivalents	(192.0)	36.7

Net cash inflow from operating activities has decreased to £481.6 million for 2015–16 from £513.6 million in 2014–15. This decrease results from the impact of the lower charges to customers, reducing our cash inflow from revenues and the payment of lump sum contributions in respect of our pension deficit.

The net cash used in investing activities decreased to £236.0 million for 2015–16 from £307.4 million in 2014–15. This decrease mainly results from the transition between two regulatory periods. Capital schemes relating to the previous regulatory period reached completion and new capital projects associated with our plans for 2015–20 are in the early stages of design and construction and, therefore, incurring lower levels of expenditure.

The net cash used in financing activities increased to £437.6 million (2015: £169.5 million). This increased cash outflow principally results from the payment of accrued indexation associated with derivatives in place on some of our debt of £298.4 million (2015: £5.0 million) and the payment of ordinary dividends of £82.1 million, offset by cash received from new loans of £110.0 million.

Overall these resulted in a net decrease in cash and cash equivalents of £192.0 million (2015: net increase of £36.7 million).

Dividend policy

We aim to deliver a sustainable long-term capital structure, taking into account the interests of all stakeholders. Our shareholders are long-term investors and fully support the strategy adopted.

The group's dividend policy is to propose dividends having given due consideration to the following financial and performance criteria:

1. Assessment of headroom under debt covenants
2. Assessment of the impact on Southern Water's credit rating
3. Assessment of the liquidity position and ability to Southern Water's fulfil licence conditions
4. Assessment of key areas of business risk
5. Assessment of current year and cumulative distributable reserves
6. Directors' duties under law and Ofwat-administered regulatory arrangements

Distribution proposals submitted to the Southern Water board will also include an assessment of its performance against the business plan, including expected performance over the balance of the regulatory period.

Our dividend policy, and the associated financial and performance criteria, is intended to support the credit ratings of Southern Water and ensure continued access to diversified sources of finance.

Taxation

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

All companies within the Southern Water and wider Greensands groups are UK tax resident, ensuring that each company is subject to UK tax. Tax planning is always aligned with our commercial and economic activity. This practice continues to be recognised by HMRC, which assesses us as a 'low-risk' group.

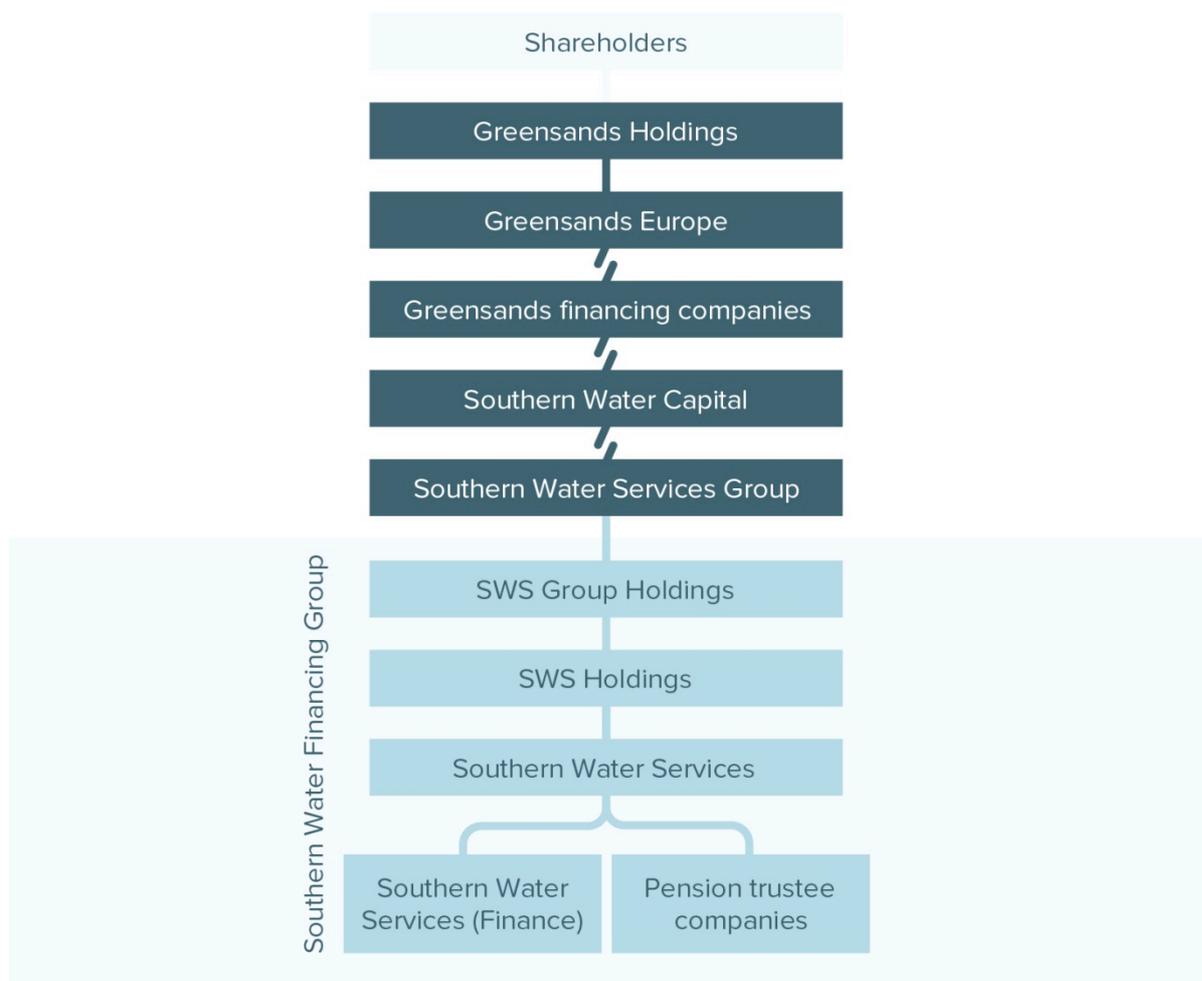
Further information regarding the Southern Water tax position can be found in the Annual Report for Southern Water which is published on its website.

Capital structure, liquidity and other financial matters

Capital structure and borrowing covenants

In September 2007, a consortium of infrastructure investors established the Greensands group of companies for the purpose of the acquisition of 100 per cent of the share capital of Southern Water Capital Limited, the then ultimate parent company of Southern Water (see ownership chart below).

Southern Water ownership structure summary



The acquisition was financed by £1.9 billion of equity and debt and the Group debt structure comprises two Euro Medium-term Note Programmes.

In April 2011, the acquisition borrowing of £441.2 million at the Greensands debt companies was refinanced out of the proceeds of debt issued by a new subsidiary company, Southern Water (Greensands) Financing Plc.

Southern Water carried out a refinancing of its regulated business in 2003 with the aim of reducing its cost of capital through a substantial increase in the proportion of debt finance. At the same time a Common Terms Agreement (the CTA) between the members of the Southern Water Financing Group and its debt investors was entered into. The CTA sets out the arrangements for the ongoing management of Southern Water's debt issuance programme, including a set of financial covenants, trigger events and events of default. Further details can be found in the Southern Water Annual Report.

Interest rate, liquidity and cash management risk

Southern Water hedges its exposure to interest rate risk on at least 85 per cent of its outstanding debt liabilities in respect of Class A and Class B debt for the period to the next periodic review and at least 70 per cent in the next period (on a rolling basis) into either index-linked or fixed rate obligations.

Additional funds are raised as required, to ensure that sufficient cash and/or facilities are available to fund the business for at least the next twelve months and both Southern Water (Greensands) Financing plc and Southern Water have debt covenants to this effect.

The group sets exposure and minimum credit rating limits for deposits of cash balances.

The regulatory framework, under which revenues and the RCV are indexed, exposes the Group to inflation risk. This risk is managed through the use of index-linked instruments within the overall debt portfolio.

An analysis of net debt is included in note 28 to the financial statements.

Credit risk

For Southern Water, 82 per cent of the water and wastewater services revenue is received from household customers. The Water Industry Act 1999 prohibits the disconnection of domestic customers for failure to pay water and wastewater charges. An extensive range of collection and recovery methods is employed, as appropriate to the individual circumstances of the customer, to minimise the risk of non-payment. For non-domestic customers, the right to disconnect supplies for non-payment remains and is exercised as appropriate.

The level of provision against non-collection of charges is reviewed on an annual basis, based on the age profile of the debt and the likelihood of recovery. A material increase in uncollected revenue, compared with that assumed in the setting of price limits, may provide grounds for an interim price determination by Ofwat.

Financing Risk

See page 20.

Rating

Credit ratings for both Southern Water (Greensands) Financing and Southern Water Services are as follows:

Credit rating	Southern Water (Greensands) Financing	Southern Water Services
Standard & Poor's	BB-	Class A debt: A- Class B debt: BBB
Fitch	BB-	Class A debt: A- Class B debt: BBB
Moody's		Class A debt: Baa1 Class B debt: Ba1 Corporate family rating: Baa2

Fitch has also rated Greensands UK Limited long-term issuer default rating at B+.

The group is fully in compliance with all of its covenants and the company has an internal business plan which is expected to stabilise the overall credit rating position.

Corporate Governance

Overview

GSH is essentially a single-purpose entity, being the ultimate holding company for the only operating business in the group, Southern Water. Accordingly, the GSH Board shares and supports the aims of the Board of Southern Water for the long-term success of that company and also its commitment to maintaining high standards of corporate governance. Details of the governance of GSH are listed below, and those of Southern Water can be found in its Annual Report which is published on the Southern Water website.

Chairman

Our independent non-executive Chairman, Robert Jennings is also the Chairman of Southern Water. His role is to unify and lead the Boards in their respective responsibilities, to encourage and facilitate the contributions of Board members and to ensure adherence to the governance principles and processes of the respective Boards.

Board membership

The GSH Board comprises five members in addition to the Chairman. Three of those members are appointed by a shareholder represented by JP Morgan Asset Management, one is appointed by shareholders represented by UBS Asset Management and one is appointed by shareholders represented by Hermes. Another shareholder is entitled to appoint an observer to attend and take part, but not vote, at Board meetings. During the year the Access Group sold its shareholding resulting in the resignation of its Board member. Further details of the Board members can be found on page 23.

Board operation

GSH is party to the shareholder agreement between the shareholders in the Greensands consortium. Under that agreement, the GSH Board members, apart from the Chairman, also comprise the Boards of the six subsidiaries down to Greensands Investments. Two of those directors comprise the Board of Southern Water Capital. Apart from the Chairman, no director of GSH is also a director of Southern Water, although two are alternate directors for the shareholder-nominated directors on the Southern Water Board.

The GSH Board meets at least four times a year on its own. The normal business at such meetings is to agree formally any changes in membership, to note any relevant shareholder activity and to approve formally any transfers of shareholdings. The GSH Board is present with the Southern Water Board at the regular monthly meetings of that Board, to consider the operational and financial performance reports of that company. That financial performance does, of course, represent the principal financial performance of the group.

The GSH Board members are very mindful of the independence of the directors of Southern Water, but can bring additional knowledge, skills and resources of their nominating shareholders and employers, as well as their own personal skills, experience and knowledge of businesses and business sectors similar to that of Southern Water. For compliance with Condition P of Southern Water's Licence, the shareholders who are considered to be the Joint Ultimate Controllers of Southern Water have given undertakings to provide all necessary information to that company, not to cause Southern Water to breach any of its obligations and to ensure that there are not less than three independent non-executive directors on the Southern Water Board. Copies of those undertakings are published on Southern Water's website.

GSH does not have any executive directors nor dedicated management employees.

Apart from the director previously appointed by the Access Group, the GSH directors are not remunerated by GSH for their appointments.

Role of the Company Secretary

The Company Secretary is Joanne Statton who is also Company Secretary of Southern Water. All directors have access to the advice and services of the Company Secretariat team. The Company Secretary is responsible for ensuring that the Board operates in accordance with its governance framework and that there are good information flows to the Board. The appointment and removal of the Company Secretary is reserved to the GSH Board.

Director induction, training and development

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

Board meetings

The Board held four scheduled meetings and one additional meeting during the year. The agenda and papers are sent to the Board members in advance of each meeting. The Board generally holds its meetings where the Board of Southern Water is meeting that month.

The Board has no standing committees.

Table of attendance at Board meetings

Attendance at scheduled Board meetings in 2015–16			
Robert Jennings (Chairman)	5/5	Michael Nagle	5/5
Andrew Truscott	4/5	Paul Moy (resigned 20 July 2016)	3/5
		Bronte Somes as alternate	2/2
Keith Budinger (resigned 4 August 2015)	2/2		
Jeff Woodard (resigned 19 May 2016)	5/5		

Kevin Hall resigned as Company Secretary with effect from 30 November 2015, and Joanne Statton was appointed to the position from 1 December 2015.

Annual General Meeting

As a result of changes in Jersey Company Law, to bring it in line with Company Law in England and Wales, GSH, as a private company, is no longer required to hold an AGM. As a result the Board has decided that it will no longer hold an Annual General Meeting.

2) Southern Water Services Limited

Strategic Report summary:

Southern Water Services is the only operating company of the group. The accounts of Southern Water, containing a full Strategic Report and Corporate Governance report, are published alongside these accounts on the Southern Water website. An overview of the performance of the company is provided below.

The year marks the completion of year one of our five-year business plan for 2015–20 and the company has made a strong start.

The business plan for 2015–20, or AMP6, was based on the most ambitious and extensive programme of customer and stakeholder research in Southern Water's history. The feedback from more than 34,000 people informed the six priorities that have laid the foundations of the company's business objectives. In addition, 26 promises have been made relating to these priorities, against which customers can judge the company's performance.

Looking back on progress at the end of this first year of the five-year plan we are pleased to report that in almost all aspects of Southern Water's business – leakage rates, drinking water quality, wastewater treatment, bathing water quality, health and safety – the performance delivered places the company among the best in the sector.

In areas where the company has faced challenges in the past, such as customer service, there are signs of improvement, although there is more work to be done and the company is committed to building on the progress made.

Performance highlights from the past year include:

Health and safety

Southern Water continues to lead the industry with excellent health and safety performance, achieving the lowest number of injuries in its history. The company achieved an uninterrupted run of no reportable injuries to any member of staff for 427 days. An injury becomes reportable when a person is away from work, or unable to perform their normal work duties, for more than seven consecutive days as the result of their injury.

Leakage

The company beat its regulatory target for the fifth consecutive year by reducing leakage to 84 million litres per day, against a target of 88 million litres. This puts Southern Water at the top of the sector league tables and means that it has had the lowest levels of leakage in the industry for more than 10 years.

Drinking water quality

The drinking water quality is, once again, outstanding. The company has provisionally achieved 99.98 per cent against the Drinking Water Inspectorate's quality measures, subject to confirmation. As a result, of the 10 largest water companies in the UK, we expect Southern Water to be confirmed as sector leader for the 2015 calendar year.

Wastewater treatment

Southern Water achieved 99.3 per cent compliance with current environmental standards at its wastewater treatment works. There were failures at two works and while the company strives for 100 per cent compliance, this performance represents the best in its history. It also places Southern Water alongside the industry leaders.

Bathing waters

The company recorded its best-ever performance for the quality of coastal bathing waters. All but one of the 83 designated bathing sites met the new more stringent requirements under the new European Bathing Water Directive, the lowest failure rate of any region in the UK.

Bathing water quality is affected by many factors in and outside Southern Water's control, which is why it continues to work with partners, such as local authorities and environmental groups, to keep our beaches as clean as they can be. This approach paid dividends in Hastings where the company worked with the council to identify issues with the public and private sewer network to achieve a 'good' classification under the new more stringent bathing water standards.

Pollution incidents

There were 167 pollution incidents in the 2015 calendar year – a reduction of 43 per cent compared with 2014 and the company's best performance in 15 years. In fact, there has been a major improvement in pollution performance over the past five years, with the number of less serious category 3 incidents falling from 466 in 2011 to just 160 in 2015. In addition, the number of serious pollutions fell from 21 in 2011 to seven in 2015.

Improving customer service

Southern Water has continued to improve the quality and responsiveness of customer service but there is certainly more to do. The score against Ofwat's measure of customer satisfaction, the Service Incentive Mechanism (SIM), disappointingly places Southern Water at the bottom of the industry league table for elements of its customer service, for example, call handling times and how customer complaints are dealt with.

This is something the company is determined to address. Indeed, during 2015–16 the foundations for future improvements have been laid which will help the company fulfil its customers' expectations.

The customer service teams have worked hard over the past year to implement significant changes. Since 1 December 2015 more than 80 per cent of calls have been answered within 30 seconds, addressing one of our customers' main frustrations: a desire to have their calls answered quickly and have any problems resolved first time. In addition new systems have been implemented, such as Rant & Rave, which enable customers to give instant feedback so actions can be taken immediately if something has gone wrong.

Most importantly, the number of complaints to Southern Water is now starting to fall. In the last quarter of the year the company received nearly 11 per cent fewer complaints than in the same period the year before.

The aim is to better predict what customers need so that potential issues can be resolved before they become a problem. One way we're doing this is through the new proactive customer contact team. When a problem is identified – such as an unusual increase in a customer's water use – the proactive team contacts them to find out the source of the increase and offer support. The team can then establish whether the increase is due to more people at the property or a previously undetected leak in the pipe network.

The company is confident that measures such as this will help it provide the high quality service its customers expect and deserve, more of the time.

Planning ahead

Through Southern Water we are privileged to provide essential water and wastewater services to the communities we serve so we must think about, and plan for, the longer term. Therefore, at the same time as focusing on the delivery improvements today, the company is also planning and investing to address the challenges of tomorrow.

Climate change, tighter environmental standards and rapid population growth in our area are all combining to place greater pressure on the water and wastewater services provided. Outlined below are some of the innovative ways in which Southern Water is seeking to mitigate these pressures and maintain, or improve, service levels for customers well into the future.

Resilience

Improving the resilience of the water and wastewater services provided while at the same time responding to growth and protecting the environment is a challenge being faced by the whole industry. In the South East, an area of water stress and high environmental sensitivity, the challenge is even more acute.

In order to tackle this, an innovative, industry-leading approach to plan for sustainable supplies of drinking water has been developed. Thousands of future drought scenarios were examined to help create realistic plans and the company's expertise in this area has been critical to the development of a National Water Resources Framework, which will inform national planning for future water resource needs across the country.

A group has also been established to develop a single water resource management plan for our region. This will enable Southern Water to take a holistic look at growth in the region and identify solutions that increase the resilience of its service while protecting the environment.

In addition two specific water re-use schemes are being developed, which will provide a vital resource to support the rivers we abstract from during droughts. The company believes there is potential for water re-use schemes to

play a far greater role in securing water supplies for future generations.

Higher standards

The company's Bathing Water Enhancement Programme is the first in the country that seeks to go beyond minimum performance levels and deliver even higher standards of bathing water quality. This is because customers told us that the standard of bathing water, and associated beach quality, is crucial to the lifestyle and livelihood of the South East.

Working with local authorities, the Marine Conservation Society and a host of other local stakeholders, the company is currently examining how it can move another seven bathing waters in its region to the 'Excellent' standard needed for Blue Flags to be awarded.

Affordability and vulnerability

Southern Water is leading the water sector in supporting customers who are most in need. It has joined forces with organisations such as local authorities, including Brighton & Hove City Council, and consumer debt advice agencies, to provide proactive guidance for customers in financial difficulty.

The company offers a range of tariffs with tailored payment options for those who qualify for extra help. And the company ensures that free water-saving advice – which can contribute to lower bills – is widely available via its website, publications and through external partners such as housing associations.

As the first water company to complete the delivery of a universal metering programme, Southern Water has ensured that the vast majority of its customers, around 90 per cent, now only pay for the water they use. Alongside the metering programme free water-saving audits are provided, in order to help customers save water, energy and money.

Building strong partnerships

A key theme of the 2015–20 business plan is the need to establish better relationships with stakeholders in the region to deliver our targets and promises.

With this in mind, a stakeholder engagement team was introduced in April 2015 to build on relationships with local opinion formers. Since its launch, the team has briefed MPs and organisations such as charities, chambers of commerce and local authorities on the key aspects of the business plan. We hope this will strengthen relationships between Southern Water and different agencies to shape regional and national policy.

A great example is the recent partnership with Natural England to employ water 'catchment rangers' to work with farmers on solutions to the use of nitrates and pesticides which can affect water quality and the health of our rivers.

Southern Water finances

Alongside the delivery of the 26 promises we made in the business plan for 2015–20, Southern Water will also reduce average bills over the five-year period by eight per cent before inflation.

Consequently, the financial results for 2015–16 reflect a reduction in revenues of almost three per cent, to £804 million, down from the £826 million reported in 2014–15.

The reduction in revenues also contributed to a lower operating profit of £284.0 million – a 14.2 per cent reduction from the previous year.

To assist in delivering improved performance for customers, there has also been an increase in operating costs this year. In total, operating costs increased to £286 million from £273 million in the prior year. This increase has been driven by initiatives to improve customer service, such as the creation of a proactive, outbound customer contact team.

Costs were also added this year by a programme of work aimed at introducing more efficient ways of working across the business and by the cost of preparations for the introduction of market reform and retail competition for non-household customers.

Over the past five years, Southern Water's parent company Greensands Holdings and ultimate shareholders have supported the company in strengthening the business by not taking a dividend. This enabled the company to make considerable improvements to its operational performance over AMP 5 (2010–15). In addition, this support meant that gearing, the ratio of debt to equity used to finance the business, could be reduced, in turn reducing

financial risk, strengthening the overall financial position and improving credit ratings.

As a result of these improvements, Southern Water is now in a much stronger position financially and operationally. As a consequence, in 2015–16, it resumed dividend payments.

Future developments

The regulatory landscape is also changing, with the introduction of retail competition for water and sewerage services to non-household customers in England from April 2017. The changes will allow these customers to choose which company provides their water and sewerage retail services.

The purpose of market reform in the water sector is to stimulate innovation and deliver a choice to non-household customers of who provides their retail service.

Water companies will be required to separate the wholesale and non-household retail parts of their businesses to create a level playing field for new entrants to the market. These new companies can provide retail services, but the existing water companies will maintain responsibility for the water and sewerage networks in the region, i.e. the wholesale activities.

More than 100,000 of Southern Water's non-household customers will be affected. Southern Water has a market reform readiness programme which is well under way to deliver the business changes needed to meet the challenge of a new market and continue to deliver its customer promises.

After looking carefully at the options available to us – that will ensure both compliance and a business model that will thrive in the new market – we have decided to sell the Southern Water non-household retail business to Business Stream, a specialist retailer who has been at the forefront of the competitive market in Scotland.

Community pride

Southern Water and its employees are proud to serve our local communities. So, at the same time as providing essential water and wastewater services to the south east of England, it's important that we give something back.

This year, the community engagement team talked to more than 20,000 customers at 22 events where they offered practical advice and help on key issues such as water efficiency, affordability and the correct disposal of fat, oil and grease.

The company and employees also raised more than £182,000 for a number of local charities, including the Air Ambulance Trusts, and provided support for children's hospitals and centres for adults with a range of disabilities. It continues to support the international charity, WaterAid – and supporters across the business raised a grand total of £75,000 for the charity in the past year.

Employees put in more than 24,000 volunteering hours in 2015–16. Their efforts included community gardening, decorating at a local children's hospice and even building nest boxes for endangered dormice.

The Learn to Swim programme continues to go from strength to strength and this year alone it helped more than 30,000 children learn to swim. The scheme celebrates 25 years in 2017 and, to date, it has helped more than 700,000 children develop this life-saving skill.

Southern Water risks

Risk management is a core component of our wider governance and internal control framework, which provides the overarching structure through which the group is managed to achieve its objectives. As Southern Water Services is our only operating company, the risks to the group are principally those faced by Southern Water.

The most significant risks facing us are referred to as ‘the principal risks’. These are risks that are considered by the Executive Management Team and Board of Southern Water to have the greatest potential to affect the achievement of strategic objectives, based on outputs from the “top down” and “bottom up” risk assessment exercises and their ongoing review and monitoring.

The Board of Southern Water is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives.

The strategy for risk management is that all principal risks are identified, assessed and managed to within acceptable levels. To achieve this, the Board and management of Southern Water promote a culture that encourages routine consideration of principal risks in key decisions and supports integration of risk management with critical processes and ways of working.

The Board of Southern Water monitors the risk management and internal control systems which cover all material controls including financial, operational and compliance controls.

The purpose of risk management is not to make Southern Water risk averse, as taking risk is often required in order to achieve overall objectives and be successful. Rather, it is to support better decisions through an improved understanding of risk, which means taking the right risks for the right benefits and returns.



Figure 1: Southern Water Risk management process

The objectives of the risk management strategy are to:

- Identify and understand all the principal risks faced;
- Select and proactively take the risks that give the right returns, and understand their potential impact on Southern Water and the group;
- Take action to manage the risks we do not want to be exposed to, ensuring that resources are effectively and efficiently prioritised and used; and
- Monitor and report the risks being taken against the desired strategic objectives.

Every employee of Southern Water is responsible for helping to effectively manage risk exposures and making the company a more resilient organisation, able to successfully respond to its changing environment.

The company ensures controls are in place so it can take action to minimise the impact of risks. To do this, risks are managed through a central database where they are ranked and assigned to senior managers who are responsible for implementing mitigation plans. Risks are reviewed each month and the highest are escalated to the Southern Water Executive Management Team, the Board and the Audit and Risk Review Committee. Any new risks added to the database with a score above a certain level are passed to a director and Chief Executive Officer for immediate review.

The principal risks Southern Water faces are disclosed below:



Unchanged in the year



Risk reduced in the year



Risk increased in the year

Customer

Customer service 	
<p>Commentary: Increasing customer expectations and rising standards of customer service across the sector mean that financial penalties may be incurred if customer service performance does not continuously improve.</p> <p>The Service Incentive Mechanism (SIM) was developed by Ofwat to incentivise improvements in customer service and compares performance across the water sector.</p> <p>The Southern Water SIM performance for 2015–16 was below average which means that, if improvements are not made over the next four years, the company would face a financial penalty at the next Price Review.</p> <p>Challenging targets have been set by the company and improvement programmes created to deliver these for customers.</p>	<p>Mitigation: Improvements to customer service are being made on a continuous basis. Staff are being provided with increased training and development and the company is carrying out ongoing research to better understand its customers' experiences. Southern Water continues to actively engage with its customers and stakeholders in order to strengthen its links with local organisations such as councils and community groups.</p> <p>Southern Water is improving its customers' experience by providing new facilities for them to manage their accounts online and, where customers do need to speak to the company directly, it has ensured that the opening hours of its contact centre are convenient. Additionally, bills are being redesigned to make them easier to understand.</p>

Bad debt 	
<p>Commentary: The level of customer bad debt, which cannot be recovered and has to be written off as a loss, continues to be a significant issue for the water industry. In the current economic climate, there is a risk that the number of customers who do not pay their bills will increase. This puts an additional burden on customers who do pay their bills.</p> <p>We also note that the result of the recent referendum may adversely affect the economic climate and customers' ability to pay.</p> <p>In 2015–16, the bad debt charge to the income statement increased to £21.5 million (2014–15: £18.9 million).</p>	<p>Mitigation: We understand that some customers may experience financial difficulties, particularly in difficult economic times. Southern Water encourages customers who are struggling to make payments to contact its Affordability team as early as possible. To assist those in difficulty a range of flexible instalment plans and tariffs, including a new social tariff from April 2015, are offered. The company is proactive in collecting payment from its customers and in helping households to pay their bills and debt. When necessary, a leading debt management system, and a panel of Debt Collection Agencies are used to recover overdue payments to keep bad debt to a minimum.</p>

Operational

	
Resilience to drought	
<p>Commentary: The South East is classified as an area of “severe water stress” and changing weather patterns are predicted to pose an increasing challenge for all water companies in the region in future years. Southern Water supplies drinking water to more than one million households across Kent, Sussex, Hampshire and the Isle of Wight and it is critical it is able to maintain access to adequate water resources to continue to do so now and in the future.</p> <p>Mitigation: Through the investment planning process, schemes are identified and developed which are necessary to ensure anticipated demands for water over the next 25 years can be met.</p>	<p>The long-term investment plan sets out the additional water that will be secured across the region to achieve the target for the Security of Supply Index. The company continues to drive down leakage and has finished its Universal Metering Programme which has helped drive consumption down further.</p> <p>Should a drought occur, as in 2012, there is a Drought Plan which would be followed to introduce measures to conserve water and secure additional resources through Drought Permits and Drought Orders and by changing the way in which sources are operated. Southern Water also maintains its Water Resources Management Plan, using an industry-leading approach which allows it to plan to operate under a wider range of droughts than have seen in the past.</p>

	
Preventing flooding of our sites and from our network	
<p>Commentary: Changing rainfall patterns, more frequent storms and rising sea levels could all lead to an increased risk of flooding if volumes overwhelm assets. Excessive rainfall results in high groundwater levels which are not possible to remediate adequately, causing flooding to private land and property, contamination of water supply, infiltration / inundation of sewers and a breach of flood defences and protection. The serious floods in recent years have also highlighted the need to protect water and wastewater treatment works and pumping stations from being put out of action during a flood.</p> <p>Southern Water has met, or improved upon, our business targets this year for sewer blockages, sewer collapses and external flooding, although internal flooding incidents are marginally higher than target.</p>	<p>Mitigation: To help combat this risk, schemes have been prioritised for investment in 2015–20. The company is investing £426 million during this period to provide a reliable and effective wastewater service, part of which will be used to keep the 39,600 kilometres of sewers and 2,385 wastewater pumping stations well maintained. It will also fund the replacement or refurbishment of about 224 kilometres of sewers, with the parts of the network in most need of repair and of most structural use targeted first.</p> <p>The company is also focusing on reducing the risk of blockages, which are a major cause of flooding from sewers. This will include carrying out targeted surveys of sewers using cameras, performing regular sewer cleaning work, and putting more resources into keeping the drainage plans up to date to fully understand how much capacity will be required for the years ahead. Customers will also be provided with better information about the causes of blockages and how they can prevent them. Through investment of £268 million, the company intends to ensure there is no increase in the number of blockages in its sewer network.</p>

Resilient supply of good quality water



Commentary: Southern Water must ensure it can supply enough drinking water to cater for a growing population of more than two million people. Should operational treatment processes fail, the water supply becomes contaminated, or the water distribution network fail:

- There is a risk that water could be supplied to customers that is unfit for consumption, and would require a widespread boil water notice in order to protect public health;
- Large numbers of customers could find their water supply becomes cut off; or
- Harmful chemicals could be released to the environment.

This could cause reputational damage, and lead to prosecution and fines by the Environment Agency or the Drinking Water Inspectorate.

One such issue was experienced in January 2016, when water supply to 4,000 customers on the Isle of Sheppey was interrupted by a burst main. Due to the size of the burst it took several days to repair; the company was able to react quickly and ensure water was provided to the affected customers through rezoning and bottled water, until the construction teams had repaired the burst water mains.

Southern Water met or improved upon all its performance targets for the year in respect of water quality and supply resilience and outperformed its leakage target.

Mitigation: Avoiding incidents is managed by taking a prioritised approach to investing in the maintenance of critical assets and technology and through staff adherence to company processes and procedures. New employees are trained in these processes and procedures and their importance.

In the event of interruption to supply, emergency plans have been developed to ensure continued supply of water to customers, either through use of alternative supply pipes, tankering or provision of bottled water.

The company has provisionally achieved industry-leading drinking water quality compliance of 99.98 per cent. The Business Plan 2015–20 includes schemes to add carbon filters and other more advanced filters at its water treatment works in high risk areas such as Hastings, to help improve the taste and smell of water.

Part of the activities to improve water quality includes upgrades to wells and boreholes, service reservoirs and water supply works, as well as flushing mains and cleaning service reservoirs, which store water underground before it is pumped to customers' taps.

To avoid problems associated with nitrates and pollutants being washed into rivers from high surface run-off after heavy rain, there are processes to stop water abstraction during and after heavy storms. Drinking Water Safety Plans have been completed which identify where and how problems can arise with drinking water quality and cover the entire supply system, from catchment to customers' taps.

Cyber security



Commentary: Southern Water provides water and wastewater services to customers across regional infrastructure, which is considered critical national infrastructure.

As a result, it recognises that operational and enterprise IT systems may be a potential target for cyber threats which could have a significant impact on business reputation and operational assets.

Mitigation: This risk is managed through IT security standards, ongoing monitoring of threats to, and activities on, the IT infrastructure as well as incident management plans.

Investment in cyber threat mitigation strategies continues in response to the changing risk landscape and the company works with the Centre for Protection of National Infrastructure. Over the past 12 months employee campaigns have been undertaken to raise awareness of IT security and data protection risks.

	
Wastewater treatment works failures and pollution incidents	
<p>Commentary: The Southern Water region benefits from a high quality environment, both inland and coastal. We are fortunate to have some extremely rare habitats, as well as some of the best quality river fishing and coastline in the UK.</p> <p>One important factor affecting the long-term quality of the environment is the nature, volume and frequency of permitted discharges into them. There are a number of carefully managed infrastructure assets which are allowed to discharge into the receiving environment.</p> <p>Reliable wastewater services are essential to maintain public health and protect the environment. Ensuring assets operate effectively is critical in minimising the risks to public health and/or the environment from pollution and/or sewer flooding.</p> <p>As well as the potential to cause damage to the environment or distress to customers, incidents like these can also lead to prosecution and fines by the Environment Agency and cause reputational damage.</p> <p>Southern Water has met or improved upon all its business targets for the year in respect of its Wastewater Treatment Works compliance and pollution incidents.</p>	<p>Mitigation: The company continues to operate and maintain its assets effectively.</p> <p>It monitors the functionality and performance of its assets on a continuous basis through a central control room. This, together with a new works management system, has significantly improved the way in which work is dispatched. The company can respond more quickly to asset-related events and deliver the required planned preventative maintenance more efficiently.</p> <p>The majority of the £1.8 billion capital investment programme for 2015–20 is targeted to maintain, enhance and extend wastewater and water sites and networks to reduce the risk of asset failures and asset-related incidents. This investment will help ensure a resilient wastewater service whilst accommodating increases in demand as a result of population growth, meeting new environmental standards and adapting to climate change.</p> <p>In the past year the company has invested £13.2 million at wastewater treatment works and pumping stations to reduce risks at critical sites, and invested £9.3 million in sewer maintenance and rehabilitation.</p> <p>In addition, it started a customer-orientated fats, oils and grease educational programme which is targeted at those catchments with blockage hotspots. It is also increasing customer awareness on how to avoid blocked drains.</p>

	
Health and safety	
<p>Commentary: The health and safety of our employees and the public in the provision of our services is our highest priority. The nature of our work requires that our employees and contractors undertake activities or use equipment which, if uncontrolled, has the potential to cause significant harm. We and our contractors have comprehensive processes and procedures to prevent injury and occupational ill-health. Failure to comply with our Health & Safety Management System could result in death, serious injury or adverse health effects. In addition to the personal impact these would have, we could be liable for prosecution under the Health and Safety at Work and Corporate Manslaughter Acts. In addition, there would be a significant reputational risk arising from the adverse publicity.</p>	<p>Mitigation: We have taken all necessary steps to ensure the potential health and safety risk is suitably mitigated and controlled. We have a clearly defined strategy, safety protocols and standards that are set. These are monitored and reported to the Southern Water Board on a monthly basis and to the tri-annual Board Health and Safety Committee. The Executive Management Team of Southern Water monitors health and safety performance via detailed reports at the monthly Health and Safety Management Review meeting. This group ensures there is an adequate system for meeting our responsibilities to our staff, customers and members of the public. These services have been developed and are continuously reviewed to ensure they meet the needs of the business and our employees at work.</p> <p>Additionally, every employee has ready access to a copy of the corporate policy statement and health and safety processes and procedures. All staff receive suitable health and safety training, and we have a campaign to encourage staff to report 'near misses' or hazards at work to help further reduce the risk of injuries or ill-health.</p>

Financial

Financing our business

Commentary: A significant change in interest rates, a reduction in the availability of credit to the water industry, or a decrease in our credit rating could put our ability to finance the capital investment programme or refinance the existing debt maturities at risk in the future. This is required as a condition of the regulatory licence and borrowing covenants, where a failure to maintain certain credit ratings could lead to a restriction in dividend payments.

As a minimum, Southern Water intends to maintain its current risk profile. Treasury transactions are only entered into to manage inherent risk and support prudent funding, not to speculate.

Southern Water's current credit ratings are:

- Standard & Poor's: Class A debt, A-; Class B debt, BBB
- Fitch: Class A debt, A-; Class B debt, BBB
- Moody's: Class A debt, Baa1; Class B debt, Ba1; Corporate family rating Baa2.

We note that the result of the recent referendum will increase uncertainty in this area for the short term.

Mitigation: We ensure that we maintain sufficient cash reserves and liquidity facilities to finance the operations of Southern Water for at least 18 months.

We also ensure the aggregate nominal value of debt maturities does not exceed 40 per cent of Regulatory Capital Value (RCV) in any single regulatory period (and 20 per cent of RCV in any 24 months). Exposure to interest rate rises on current borrowings is also hedged by a subsidiary company, Southern Water Services (Finance) Limited, and current borrowings are at either fixed rates or index-linked. We ensure that sufficient funds are available for the operational and capital investment programme through ongoing monitoring and forecasting of cash flow and steps are taken to manage this when necessary.

Leverage has been reduced from levels at the start of the AMP5 period (April 2010) and operational performance has improved. This positive action has stabilised credit ratings.

A primary duty of Ofwat when setting prices is to ensure companies can finance their functions. If necessary, a company can apply to reset customer prices in special circumstances during the five-yearly regulatory periods through an Interim Determination of K (IDoK).

Defined benefit pension scheme

Commentary: Southern Water operates a defined benefit pension scheme which has been closed to new entrants from 1 April 2005. The company remains liable for rights earned by past and present members of the scheme. Changes in demographics and fluctuations in investment markets may affect the company's ability to fund pension promises.

Mitigation: A deficit and risk management strategy has been agreed with the Trustees. This is monitored regularly by the company and the Trustees, and mitigating actions are reviewed and implemented as appropriate.

Strategy and Regulation

	
Delivery of our capital investment programme	
<p>Commentary: Southern Water has a capital investment programme of £1.8 billion between 2015 and 2020. Plans are in place to ensure this will be delivered and to ensure focus is maintained to complete all our work on time.</p> <p>If the company is unable to deliver significant parts of the programme on schedule, its ability to provide an excellent service to customers could become compromised, as well as prevent it from fulfilling the promises that have been made in the business plan and lead to possible action by the Environment Agency, Drinking Water Inspectorate or Ofwat.</p> <p>Capital expenditure in the first year of the programme was behind that set out in the business plan thus increasing the risk in this area slightly. The company remains on track to deliver its required outcomes.</p>	<p>Mitigation: The company has transformed its capability during the course of the current capital investment programme to bring significant investment capability in-house. This includes the establishment of an in-house engineering function, a specialist programme management function and asset planning systems, processes and capabilities. Progress against the capital programme is overseen by the Investment Committee and adapted monthly reporting procedures have been adapted to ensure the delivery of the business plan is given the greatest level of focus within the company. The company works closely with its regulators and other interested parties to resolve issues as they arise.</p>

	
Compliance with regulations and legislation	
<p>Commentary: Southern Water is a highly regulated business with three main regulators: Ofwat, the Environment Agency and the Drinking Water Inspectorate. If the standards set by these bodies are not met, we could face fines, legal action and, in the worst case, the loss of the company's appointment as a water and wastewater company.</p>	<p>Mitigation: Procedures are in place to comply with legislation and key procedures have been certified to meet relevant industry standards, including ISO 9001 and ISO 14001.</p> <p>Internal monitoring and assurance is undertaken during the year and annual reporting is supported by external verification through financial and technical auditors to provide assurance on compliance with obligations.</p> <p>Awareness training is provided throughout the company for critical compliance issues, such as the Bribery Act and Competition Law, to ensure everyone understands the legal obligations. All sections of the business review compliance with company procedures through self-assessment every six months and implement improvement plans if necessary.</p>

Regulatory reform



Commentary: During recent years, there has been a significant focus on reform within the water industry, concentrating on the introduction of competition and a greater use of market mechanisms to promote innovation and efficiency. From April 2017, the retail market for non-domestic customers will be opened, which will require structural changes within the company to allow it to continue to comply with regulatory requirements and to manage the anticipated shift in customer base.

The regulatory framework continues to evolve as it is reviewed to ensure that it is fit for the challenges of the future. This includes assessing the costs and benefits of extending retail competition to all residential customers and proposals to move to CPI instead of RPI as the basis for setting price controls.

Mitigation: Southern Water has continued to engage constructively with Ofwat and Defra on the proposals for market reform. During the year it has actively participated in numerous workshops held by Ofwat, Open Water and MOSL. A market readiness programme has been established to co-ordinate the changes required in the business, including a steering group chaired by the Director of Strategy and which includes the Chief Executive and Chief Financial Officers.

During the year the company has taken an active participation in workshops and consultations held by the 'Open Water' programme, which will deliver the market codes, systems and contracts needed to implement the wholesale and retail arrangements outlined in the draft Water Bill.

The Strategic Report was approved by the Board of Directors and signed on its behalf by the Company Secretary.

Joanne Statton
Company Secretary
20 July 2016

Directors' report for the year ended 31 March 2016

The directors of Greensands Holdings Limited (Registered Number: Jersey 98700) present their report and the audited financial statements for the year to 31 March 2016.

Group

Greensands Holdings Limited (the company) was incorporated on 28 September 2007 as the parent company of Greensands Europe Limited, whose subsidiaries include Greensands Investments Limited.

On 15 October 2007, the company became the ultimate parent company of the Southern Water group of companies, via the acquisition of Southern Water Capital by Greensands Investments Limited.

Principal activities of the company

The company's principal activity is that of a holding company for Greensands Europe Limited and its subsidiaries.

Principal activities of the group

The principal activities of the group are the provision of water supply and wastewater services in the south-east of England.

The trading results reflect the performance of the major trading subsidiary Southern Water Services Limited (Southern Water).

Strategic report

The information that fulfils the requirement of the Strategic Report can be found in the Strategic Report sections on pages 2 to 8 and pages 11 to 22.

Future developments

The information regarding future developments of the company can be found in the Strategic Report sections on pages 2 to 8 and pages 11 to 22.

Results and dividends

The statement of other comprehensive income on page 31 shows the group's results and loss for the year. Further details are also available in the Strategic Report section on page 3.

Dividends of £82.1 million were paid during the year ended 31 March 2016 (2015: £nil).

Directors and their interests

The directors who held office during the year ended 31 March 2016 and up to the date of signing the financial statements were as follows:

Robert Jennings	Independent non-executive Chairman
Michael Nagle	
Andrew Truscott	
Paul Ryan	(Resigned as alternate to A Truscott 23 February 2016)
Brian Goodwin	(Appointed as alternate to A Truscott 23 February 2016)
Paul Moy	(Resigned 20 July 2016)
Bronte Somes	(Appointed as director and resigned as alternate to P Moy 20 July 2016)
Jeff Woodard	(Resigned as director 19 May 2016, appointed alternate to B Somes 20 July 2016)
Keith Budinger	(Resigned 4 August 2015)
Craig McAllister	(Resigned as alternate to K Budinger 4 August 2016)
Hamish de Run	(Appointed 28 June 2016)
Randy Daniels	(Appointed 28 June 2016)

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

Research and development

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the group's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £0.7 million (2015: £0.4 million).

Employees

Employee involvement: The group recognises the importance of its employees and is committed to effective two-way communication and consultation.

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

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

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

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

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

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

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

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

Environmental issues

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

The group's environmental performance is reported on pages 11 to 14. The group recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

Political donations

No political donations were made in either year.

Land and buildings

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

Financial risk management objectives and policies

The group intends to at least maintain its present risk profile, as measured by its Southern Water investment grade credit rating. The group does not enter into treasury transactions for the purpose of speculation, but only to manage risk inherent in the business or funding on a prudent basis.

Interest Rate Risk - The group hedges Southern Water's exposure to interest rate risk on at least 85 per cent of its total outstanding debt liabilities in respect of Class A Debt and Class B Debt for the current period to the next Periodic Review and at least 70 per cent in the next period to the subsequent Periodic Review (on a rolling basis) into either index-linked obligations or fixed rate obligations.

Inflation Risk - The regulatory framework, under which revenues and the RCV are indexed, exposes the group to inflation risk. The group manages this risk through the use of index-linked instruments within its overall debt portfolio.

Liquidity risk – The group raises additional funds, as required, to ensure that it has sufficient cash and/or facilities to fund the business for at least the next twelve months.

Cash management risk – The group sets exposure limits for, and deposits cash balances with, organisations whose credit ratings are rated a minimum of Moody's P1, Standard & Poor's A1 or Fitch F1.

Going concern

The directors have undertaken a detailed review of the company's liquidity requirements compared with the cash and facilities available, the financial covenant position including projections based on future forecasts, the current ratings and financial risk and have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements.

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

- The group's business activities, together with the factors likely to affect its future development, performance and position, which are set out in the Strategic Report on pages 2 to 8 and 11 to 22.
- The financial position of the group, its cash flows, liquidity position and borrowing facilities, which are described in the Financial Performance reviews on pages 3 to 6.
- The group has available a combination of cash and committed undrawn bank facilities totalling £418 million at 31 March 2016 (2015: £620.0 million). These funds are sufficient to fund the operating and capital investment activities of the Group for the 12 months from the date of signing the financial statements.
- The group operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities. These limits have been set for the period April 2015 to March 2020.

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

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

Qualifying third party indemnity

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

Directors' responsibilities statement

The directors are responsible for preparing the Strategic Report, the Directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and of

the profit or loss of the group for that period. In preparing these financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently
- Make judgements and accounting estimates that are reasonable and prudent
- State whether applicable IFRS as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the group's transactions and disclose with reasonable accuracy at any time the financial position of the group and enable them to ensure that the financial statements comply with the Companies (Jersey) Law 1991. They are also responsible for safeguarding the assets of the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

The directors consider that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy.

Each of the directors confirm that, to the best of their knowledge:

- The group financial statements, which have been prepared in accordance with IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the group; and
- The Directors' Report and Strategic Report contained in the Annual Report include a fair review of the development and performance of the business and the position of the group, together with a description of the principal risks and uncertainties that it faces.

Responsibility statement

We confirm that to the best of our knowledge:

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

Statement of disclosure of information to auditor

Each of the persons who is a director at the date of approval of this report confirms that:

- (1) so far as the director is aware, there is no relevant audit information of which the group's auditor is unaware; and
- (2) he/she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the group's auditor is aware of that information.

Auditor

Deloitte LLP has indicated its willingness to continue in office.

Approved by the Board of Directors and signed on its behalf by:.



J Statton
Company Secretary
20 July 2016

Financial statements

Consolidated income statement For the year ended 31 March 2016

	Note	2016 £m	2015 £m
Continuing operations			
Revenue	4	803.7	826.2
Other operating income	4	1.7	1.2
Operating costs			
- before depreciation and amortisation		(287.7)	(274.7)
- depreciation and amortisation		(242.0)	(230.2)
Total operating costs		(529.7)	(504.9)
Operating profit	5	275.7	322.5
Profit on disposal of fixed assets		0.4	1.3
Finance income		2.5	1.5
Finance costs		(272.9)	(272.2)
Fair value losses on derivative financial instruments		(66.9)	(128.0)
Net finance costs	9	(337.3)	(398.7)
Loss before taxation		(61.2)	(74.9)
Tax on loss	10	40.3	(1.2)
Loss for the financial year		(20.9)	(76.1)

The notes on pages 33 to 79 form part of these financial statements.

Consolidated statement of other comprehensive income
For the year ended 31 March 2016

	Note	2016 £m	2015 £m
Loss for the year		(20.9)	(76.1)
Other comprehensive income/(expense):			
Items that cannot be reclassified to profit or loss:			
Actuarial loss on pension scheme	29	(14.0)	(37.4)
Movement on deferred tax relating to pension liability	23	2.8	7.5
Total other comprehensive expense for the year, net of tax		(11.2)	(29.9)
Total comprehensive losses for the year attributable to the owner of the company		(32.1)	(106.0)

Consolidated statement of financial position as at 31 March 2016

	Note	Group 2016 £m	Group 2015 £m	Group 2014 £m
Non-current assets				
Goodwill	12	85.1	85.1	85.1
Intangible assets	13	42.0	42.9	34.0
Property, plant and equipment	14	5,806.7	5,806.7	5,746.9
Investments	16	0.1	0.1	-
Derivative financial instruments	22	12.4	13.8	9.5
		<u>5,946.3</u>	<u>5,948.6</u>	<u>5,875.5</u>
Current assets				
Inventories	17	2.4	2.2	2.0
Trade and other receivables	18	191.8	207.0	186.6
Cash and cash equivalents		38.1	230.1	193.4
		<u>232.3</u>	<u>439.3</u>	<u>382.0</u>
Total assets		<u>6,178.6</u>	<u>6,387.9</u>	<u>6,257.5</u>
Current liabilities				
Trade and other payables	19	(188.1)	(211.7)	(244.1)
Borrowings	20	(49.0)	(200.1)	-
Derivative financial instruments	22	-	(3.5)	-
		<u>(237.1)</u>	<u>(415.3)</u>	<u>(244.1)</u>
Non-current liabilities				
Borrowings	21	(4,715.8)	(4,350.6)	(4,438.3)
Derivative financial instruments	22	(936.1)	(1,165.5)	(1,041.7)
Deferred tax liabilities	23	(421.5)	(464.5)	(470.8)
Retirement benefit obligations	29	(102.3)	(115.3)	(90.4)
Provisions for liabilities	24	(0.5)	(0.5)	(0.5)
Other non-current liabilities	25	(43.5)	(40.2)	(29.7)
		<u>(6,219.7)</u>	<u>(6,136.6)</u>	<u>(6,071.4)</u>
Total liabilities		<u>(6,456.8)</u>	<u>(6,551.9)</u>	<u>(6,315.5)</u>
Net liabilities		<u>(278.2)</u>	<u>(164.0)</u>	<u>(58.0)</u>
Equity				
Called up share capital	26	921.9	921.9	921.9
Share premium account	27	4.5	4.5	4.5
Retained earnings		(1,204.6)	(1,090.4)	(984.4)
Total deficit		<u>(278.2)</u>	<u>(164.0)</u>	<u>(58.0)</u>

The financial statements of Greensands Holdings Limited (Registered Number: Jersey 98700) on pages 27 to 79 were approved by the Greensands Holdings Limited Board and authorised for issue on 20 July 2016. They were signed on its behalf by



Mike Nagle
Director

Statement of financial position as at 31 March 2016

	Note	Company 2016 £m	Company 2015 £m
Non-current assets			
Investments	16	1.0	1.0
Other non-current assets	15	1,016.6	1,016.6
		<u>1,017.6</u>	<u>1,017.6</u>
Total assets		<u>1,017.6</u>	<u>1,017.6</u>
Current liabilities			
Trade and other payables	19	(32.0)	(32.0)
Non-current liabilities			
Borrowings	21	(59.2)	(59.2)
		<u>(91.2)</u>	<u>(91.2)</u>
Total liabilities		<u>(91.2)</u>	<u>(91.2)</u>
Net assets		<u>926.4</u>	<u>926.4</u>
Equity			
Called up share capital	26	921.9	921.9
Share premium account	27	4.5	4.5
Retained earnings		-	-
Total equity		<u>926.4</u>	<u>926.4</u>

The financial statements of Greensands Holdings Limited (Registered Number: Jersey 98700) on pages 27 to 79 were approved by the Greensands Holdings Limited Board and authorised for issue on 20 July 2016 and they were signed on its behalf by



Mike Nagle
Director

Consolidated statement of changes in equity**For the year ended 31 March 2016**

	Called up share capital (Note 26) £m	Share premium (Note 27) £m	Retained Earnings £m	Total £m
Balance at 1 April 2014 (UK GAAP)	921.9	4.5	(367.2)	559.2
Effect of restatement due to change in accounting framework (note 34)	-	-	(617.2)	(617.2)
As restated	921.9	4.5	(984.4)	(58.0)
Loss for the financial year	-	-	(76.1)	(76.1)
Other comprehensive expense for the year	-	-	(29.9)	(29.9)
Total comprehensive loss for the year	-	-	(106.0)	(106.0)
Balance at 31 March 2015	921.9	4.5	(1,090.4)	(164.0)
Loss for the financial year	-	-	(20.9)	(20.9)
Other comprehensive income for the year	-	-	(11.2)	(11.2)
Total comprehensive loss for the year	-	-	(32.1)	(32.1)
Equity dividends paid (note 11)	-	-	(82.1)	(82.1)
Balance at 31 March 2016	921.9	4.5	(1,204.6)	(278.2)

Company statement of changes in equity**For the year ended 31 March 2016**

	Called up share capital (Note 26) £m	Share premium (Note 27) £m	Retained earnings £m	Total £m
Balance at 1 April 2014	921.9	4.5	-	926.4
Profit for the financial year	-	-	-	-
Other comprehensive income for the year	-	-	-	-
Total comprehensive income for the year	-	-	-	-
Balance at 31 March 2015	921.9	4.5	-	926.4
Profit for the financial year	-	-	82.1	82.1
Other comprehensive income for the year	-	-	-	-
Total comprehensive income for the year	-	-	82.1	82.1
Equity dividends paid (note 11)	-	-	(82.1)	(82.1)
Balance at 31 March 2016	921.9	4.5	-	926.4

Consolidated statement of cash flows**For the year ended 31 March 2016**

	Note	2016 £m	2015 £m
Cash from operating activities		481.6	513.6
Net cash from operating activities	28	481.6	513.6
Investing activities			
Interest received		2.9	1.3
Purchase of property, plant and equipment		(237.9)	(296.2)
Purchase of intangible assets		(6.8)	(17.7)
Receipt of grants and contributions		5.2	4.9
Sale of property, plant and equipment		0.6	0.3
Net cash used in investing activities		(236.0)	(307.4)
Financing activities			
Equity dividends paid		(82.1)	-
Interest paid		(163.2)	(164.5)
Payment of derivative accretion		(298.4)	(5.0)
Repayments of obligations under finance leases		(0.2)	-
Repayment of loans		(200.0)	-
Issue of new loans		310.0	-
Swap break costs		(3.5)	-
Issue costs of new loans		(0.2)	-
Net cash used in financing activities		(437.6)	(169.5)
Net (decrease)/increase in cash and cash equivalents		(192.0)	36.7
Cash and cash equivalents at beginning of the year		230.1	193.4
Cash and cash equivalents at end of the year		38.1	230.1

Notes to the consolidated financial statements

For the year ended 31 March 2016

1 Accounting policies

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

Basis of preparation

Greensands Holdings Limited is a company incorporated in Jersey (JE98700) under the Companies Act. The address of the registered office is given on page 1. The principal activities of the company and its subsidiaries (the group) and the nature of the group's operations are set out in the Strategic Report on pages 2 to 8.

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs). The financial statements have also been prepared in accordance with IFRSs adopted by the European Union and therefore the group financial statements comply with Article 4 of the EU IAS Regulation. The disclosures required by IFRS 1 'First-time Adoption of International Financial Reporting Standards' showing reconciliations for comparative years between UK GAAP and IFRS are shown in note 34.

The financial statements have been prepared on a going concern basis under the historical cost convention, except for the revaluation of financial instruments, which occurs at the end of each reporting period as explained in the accounting policies below.

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

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

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

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

Basis of consolidation

The group financial statements include the financial statements of the company and all entities controlled by the company (its subsidiaries) made up to 31 March each year.

Control is achieved when the company: has the power over the investee, is exposed, or has rights, to variable return from its involvement with the investee; and has the ability to use its power to affects its returns. The company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of these three elements of control.

The company considers that it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally.

Consolidation of a subsidiary begins when the company obtains control over the subsidiary and ceases when the company loses control of the subsidiary. Specifically, the results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the date the company gains control until the date when the company ceases to control the subsidiary.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with the group's accounting policies. All intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between the members of the group are eliminated on consolidation.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****Adoption of new and revised IFRSs**

As explained above, the group has adopted IFRS for the first time in the current year. As part of this adoption, the following new and revised IFRSs have been adopted in the current year.

<p>Amendments to IAS 1 <i>Presentation of Financial Statements</i></p>	<p>In May 2012 the Annual Improvements to IFRSs 2009 - 2011 made a number of amendments to IFRSs. The amendments that are relevant to the group are the amendments to IAS 1 regarding when a statement of financial position as at the beginning of the preceding period (third statement of financial position) and the related notes are required to be presented. The amendments specify that a third statement of financial position is required when a) an entity applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items in its financial statements, and b) the retrospective application, restatement or reclassification has a material effect on the information in the third statement of financial position. The amendments specify that related notes are not required to accompany the third statement of financial position.</p>
<p>New and revised Standards on consolidation, joint arrangements, associates and disclosures</p>	<p>In May 2011, a package of five standards on consolidation, joint arrangements, associates and disclosures was issued comprising IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IFRS 12 Disclosure of Interests in Other Entities, IAS 27 (as revised in 2011) Separate Financial Statements and IAS 28 (as revised in 2011) Investments in Associates and Joint Ventures. Subsequent to the issue of these standards, amendments to IFRS 10, IFRS 11 and IFRS 12 were issued to clarify certain transitional guidance on the first-time application of the standards.</p> <p>In the current year, the group has applied for the first time IAS 27 (as revised in 2011) Separate Financial Statements and IAS 28 (as revised in 2011) Investments in Associates and Joint Ventures.</p> <p>Neither of these standards has had an impact on the financial statements.</p>
<p>IFRS 13 Fair Value Measurement</p>	<p>The group has applied IFRS 13 for the first time in the current year. IFRS 13 establishes a single source of guidance for fair value measurements and disclosures about fair value measurements. The scope of IFRS 13 is broad; the fair value measurement requirements of IFRS 13 apply to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except for share-based payment transactions that are within the scope of IFRS 2 Share-based Payment, leasing transactions that are within the scope of IAS 17 Leases, and measurements that have some similarities to fair value but are not fair value (e.g. net realisable value for the purposes of measuring inventories or value in use for impairment assessment purposes).</p> <p>IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions. Fair value under IFRS 13 is an exit price regardless of whether that price is directly observable or estimated using another valuation technique.</p>

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****Going concern**

The group's and company's business activities, together with the factors likely to affect the future development and position, are set out in the Strategic report on pages 2 to 22.

The directors have undertaken a detailed review of the group's and company's liquidity requirements compared with the cash and facilities available, the financial covenant position including projections based on future forecasts, the current ratings and financial risk and have a reasonable expectation that the group and company have adequate resources to continue in operational existence for the foreseeable future, being a period of at least 12 months from the approval of these financial statements. For this reason they continue to adopt the going concern basis of accounting in preparing the annual financial statements; further details can be found in the Directors' Report on page 23.

Business combinations

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of assets transferred by the group, liabilities incurred by the group to the former owners of the acquiree and the equity interest issued by the group in exchange for control of the acquiree. Acquisition-related costs are recognised in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and assets or liabilities related to employee benefit arrangements are recognised and measured in accordance with IAS 12 'Income Taxes' and IAS 19 'Employee Benefits' respectively; and
- assets (or disposal groups) that are classified as held for sale in accordance with IFRS-5 'Non-current Assets Held for Sale and Discontinued Operations' are measured in accordance with that Standard.

Goodwill arising in a business combination is recognised as an asset at the date that control is acquired (the acquisition date). Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest (if any) in the entity over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the group's interest in the fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Goodwill is not amortised but is reviewed for impairment at least annually.

For the purpose of impairment testing, goodwill is allocated to each of the group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period. On disposal of a cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2016

Segmental reporting

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

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

Revenue recognition

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

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

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

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

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established (provided that it is probable that the economic benefits will flow to the company and the amount of revenue can be measured reliably).

Provision for impairment of trade receivables

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

Taxation

The taxation charge in the income statement represents the sum of the tax currently payable and deferred tax.

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

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

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

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

Goodwill

Goodwill is initially recognised and measured as set out on page 35.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****Intangible assets**

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

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

Property, plant and equipment

Property, plant and equipment comprises:

- i. Freehold land and buildings – comprising land and non-operational buildings
- ii. Infrastructure assets – comprising a network of systems consisting of mains and sewers, impounding and pumped raw water storage reservoirs, sludge pipelines and sea outfalls
- iii. Plant and machinery – comprising structures at sites used for water and wastewater treatment; pumping or storage where not classed as infrastructure along with associated fixed plant
- iv. Other assets – comprising vehicles, computers, mobile plant and meters
- v. Assets under construction.

All property, plant and equipment is stated in the statement of financial position at cost or at deemed cost on transition to IFRS, less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Further details surrounding the fair value exercise can be found in note 34 (i).

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

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

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

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

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

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

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

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****Property, plant and equipment (continued)**

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

<i>Non-infrastructure assets</i>	<i>Years</i>	<i>Infrastructure assets</i>	<i>Years</i>
Buildings	10–60	Water mains	100–120
Operational structures	15–80	Sewers	80–200
Fixed plant	10–40	Reservoirs	200
Vehicles, computers and mobile plant	3–10	Ancillary structures	10–70

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

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

Impairment of tangible and intangible assets

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

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

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

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

Grants and contributions

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

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

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

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2016

Leased assets

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

The group as lessee

Where the group enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a 'finance lease'. Assets held under finance leases are recognised as assets of the company at their fair value or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. The asset is recorded in the statement of financial position as a non-current asset and is depreciated over its estimated useful life or the term of the lease, whichever is shorter. Future liabilities to the lessor under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the income statement, and the capital element, which reduces the outstanding obligation for future instalments.

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

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

The group as lessor

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

Non-current asset investments

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

Inventories

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

Deferred revenue

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2016

Provisions

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

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

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

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

Retirement benefits

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

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

The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the group, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 29.

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

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

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****Financial instruments**

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

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

Financial assets**(i) Loans and receivables**

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

(ii) Impairment of financial assets

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

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

(iii) Derecognition of financial assets

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

Financial liabilities

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

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

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

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2016

Derecognition of financial liabilities

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

Derivative financial instruments

The group enters into a variety of derivative financial instruments to manage its exposure to inflation risk in line with the group's risk management policy and no speculative trading in financial instruments is undertaken. Further details of derivative financial instruments are disclosed in note 22.

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

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

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

Embedded derivatives

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

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

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****2 Critical accounting judgements and key sources of estimation uncertainty**

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

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

Critical judgements in applying the group's accounting policies

The following are the critical judgements that the directors have made in the process of applying the group's accounting policies and that have the most significant effect on the amounts recognised in financial statements.

(i) Measured income accrual

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

(ii) Revenue recognition and allowance for doubtful receivable

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

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

(iii) Pensions

The group operates a defined benefit scheme as well as a defined contribution scheme. Under IAS 19 'Employee Benefits' the group has recognised an actuarial loss of £14.0 million (2015: loss of £37.4 million). The main assumptions are set out in note 29 of the financial statements.

(iv) Property, plant and equipment

The group recognises property, plant and equipment (PPE) on its water and wastewater infrastructure assets where such expenditure enhances a significant length of the network or increases the capacity of the network, whereas any expenditure classed as maintenance is expensed in the period in which it is incurred. Determining enhancement from maintenance expenditure is a subjective area, particularly when assessing whether the length of network replaced enhances the network. In addition, management capitalises time and resources incurred by the group's support functions on capital programmes.

The estimated useful economic lives of PPE are based on management's judgement and experience. When management identifies that actual useful economic lives differ materially from the estimates used to calculate depreciation, that charge is adjusted prospectively. Due to the significance of PPE investment to the group, variations between actual and estimated useful economic lives could impact operating results both positively and negatively, although historically few changes to estimated useful economic lives have been required.

(v) Financial instruments

The fair value of the financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined using valuation techniques.

The group uses its judgement to select the most appropriate valuation method for each instrument to estimate expected future cash flows, and apply discount rates that reflect counterparty credit risk. The valuation techniques are described in detail in note 22.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****Critical accounting judgements and key sources of estimation uncertainty (continued)****(vi) Taxation**

The tax charge is based on the profit or loss for the period and the tax rates in force at the end of the reporting period. Estimation of the tax charge involves an assessment of the potential tax treatment of certain items, which will only be resolved once finally agreed with the tax authorities.

(vii) Goodwill

An impairment review on goodwill is conducted at least annually. The net asset value of the subsidiaries is used in the impairment review. Therefore any estimations or judgements used in respect to the value of the assets or liabilities of the subsidiaries may affect the outcome of the impairment review.

3 Segmental analysis

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

4 Revenue

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

Continuing operations	2016 £m	2015 £m
Water and sewerage services	759.0	781.9
Other services	44.7	44.3
Total turnover	803.7	826.2
Other operating income	1.7	1.2
Interest receivable (note 9)	2.5	1.5
Total revenue	807.9	828.9

Other operating income includes rents receivable.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2016

5 Group operating profit for the year

Group loss for the year has been arrived at after charging/(crediting):	2016 £m	2015 £m
Depreciation on		
- owned assets	232.0	219.8
- assets held under finance leases	1.3	1.3
	233.3	221.1
Amortisation of intangible assets included in other operating expenses:		
- other	8.7	9.1
Research and development expenditure	0.7	0.4
Rentals under operating leases – vehicles	2.2	2.1
Employee costs (note 7a)	56.3	50.1
Amortisation of grants and contributions (see note 25)	(1.1)	(1.0)
Rates rebate (see note (i) below)	(13.3)	-
Insurance proceeds (see note (ii) below)	-	(2.4)
Fees payable to the company's auditor in respect of:		
- statutory audit of the company's financial statements	0.2	0.2
- other services pursuant to legislation	0.1	0.1
- all other services	0.7	0.5
Total audit and non-audit fess	1.0	0.8

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

Notes

(i) The rates rebate of £13.3 million received in the year ending 31 March 2016 relates to a refund of historic rates charges following a successful appeal

(ii) During the year ended 31 March 2015 the group received insurance proceeds totalling £2.4 million in relation to the storms experienced in the winter of 2013–14.

6 Profit of parent company

The profit for the financial period dealt with in the financial statements of the parent company is £82.1 million (2015: £nil). Consequently, this sum was paid to the shareholders of the company as ordinary dividends (see note 11).

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****7 Employee information**

	2016	2015
	£m	£m
(a) Group employee costs		
Wages and salaries	77.4	69.6
Social security costs	7.1	6.5
Pension costs - Defined contribution	2.3	2.0
- Defined benefit	6.3	6.9
Total employee costs	93.1	85.0
Less: charged as capital expenditure	(36.8)	(34.9)
Charged to the income statement	56.3	50.1

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

(b) Average number of persons employed by activity

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

	2016	2015
	Number	Number
Operations	1,239	1,167
Customer services	378	422
Corporate centre	502	444
	2,119	2,033

8 Directors' emoluments

During the year one director received £10,459 (2015: £30,000) paid by the group for services as a director of Greensands Holdings Limited and one other director received £15,000 (2015: £15,000) paid by one of the ultimate shareholders.

9 Net finance costs

	2016	2015
	£m	£m
Finance revenue		
Interest receivable	2.5	1.5
	2.5	1.5
Finance costs		
Interest payable on loans	(300.2)	(302.9)
Interest rate swap receipts	43.7	51.9
Indexation	(10.0)	(21.8)
Amortisation of issue costs	(5.5)	(3.0)
Amortisation of gilt lock proceeds	0.1	0.1
Amortisation of bond premium	0.6	0.6
Swap break costs	(3.4)	-
Other finance expense (note 29)	(3.9)	(3.8)
	(278.6)	(278.9)
Amounts capitalised on qualifying assets	5.7	6.7
	(272.9)	(272.2)
Fair value losses on derivative financial instruments		
Derivative financial instruments not designated as hedges	(66.9)	(128.0)
	(337.3)	(398.7)

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****9 Net finance costs (continued)**

A large proportion of the payment of interest payable on loans falls due on 31 March. Where this date is not a business day, the interest is paid on the next following business day.

Borrowing costs included in the cost of qualifying assets during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 4.00 per cent to expenditure on such assets (2015: 3.99 per cent).

10 Taxation

	2016 £m	2015 £m
Current tax:		
Current year	0.1	0.1
Adjustments in respect of prior years	-	-
Total current tax charge	<u>0.1</u>	<u>0.1</u>
Deferred tax:		
Origination and reversal of temporary differences	6.9	2.5
Adjustment in respect of prior years	(0.4)	(1.4)
Effect of corporation tax rate change	(46.9)	-
Total deferred tax	<u>(40.4)</u>	<u>1.1</u>
Total tax (credit)/charge on loss	<u>(40.3)</u>	<u>1.2</u>

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

	2016 £m	2015 £m
Loss before tax	<u>(61.2)</u>	<u>(74.9)</u>
Current tax:		
Tax at the UK corporation tax rate of 20 per cent (2015: 21 per cent)	(12.2)	(15.7)
Permanent differences	7.9	10.2
Deferred tax assets not recognised	11.3	8.2
Differences between current and deferred tax rates	-	(0.1)
Impact of tax rate changes	(46.9)	-
Adjustment in respect of prior years – deferred tax	(0.4)	(1.4)
Tax (credit)/charge for year	<u>(40.3)</u>	<u>1.2</u>

Factors that may affect future tax charges:

On 8 July 2015 the UK government announced reductions in the main rate of corporation tax from 20 per cent to 19 per cent from 1 April 2017 and 18 per cent from 1 April 2020. These rate changes were enacted in the Finance Bill 2015 during the year and deferred tax balances have been calculated using these reduced rates. A £46.9 million credit has been recognised in the income statement to reflect the reduction in the deferred tax liability as a result of the rate changes.

On 16 March 2016 the UK government announced a further reduction in the future main rate of corporation tax from the planned 18 per cent, to a rate of 17 per cent, effective from 1 April 2020, although this reduction was not substantively enacted at the statement of financial position date.

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

Group losses of £5.6 million (2015: £5.6 million), with a deferred tax asset of £1.0 million (2015: £1.1 million) have not been recognised in the accounts due to the uncertainty of suitable taxable profits in the foreseeable future on which to utilise these losses.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****10 Taxation (continued)**

Future tax relief of £215.4m (2015: £153.8m) is expected to be available for accrued interest that will be deductible for tax purposes on a paid basis. No deferred tax benefit has been recognised in respect of these interest deductions, as there is uncertainty over the availability of suitable taxable profits against which these may be offset.

The total amount of deferred tax asset un-provided is £39.7m (2015: £31.9m). At present it is not envisaged that the unwinding of the underlying temporary differences will give rise to a tax benefit in the foreseeable future.

Deferred tax liabilities have not been discounted.

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

	2016 £m	2015 £m
Deferred tax		
Arising on income and expenses recognised in other comprehensive income:		
Tax credit on actuarial losses on defined benefit pension scheme	(2.8)	(7.5)
Total income tax recognised in other comprehensive income	(2.8)	(7.5)

11 Dividends

	2016 £m	2015 £m
Amounts recognised as distributions to equity holders in the year:		
Current year interim dividend of £0.032 (2015: £nil) per share	29.2	-
Current year final dividend of £0.057 (2015: £nil) per share	52.9	-
	82.1	-

The current year interim dividend of £29.2 million was paid in September 2015 and the final dividend of £52.9 million was paid in March 2016.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****12 Group goodwill**

Group	£m
Carrying amount at 1 April 2015	85.1
Impairment at 31 March 2016	-
Net book value at 31 March 2016	85.1

Goodwill is reviewed annually for impairment by comparing the underlying statement of financial position value of the group, having adjusted for net debt, with the Regulatory Capital Value (RCV) of Southern Water Services. The excess of value over the RCV is then compared to recent transactions in the water industry to assess whether the book value of the group is supportable.

Other indicators considered are, the financial performance, operating performance and future changes to the operating environment of our only operating company Southern Water Services.

To date no indicators of impairment have been identified.

13 Intangible assets

	Externally generated		
	Assets under construction £m	Computer software £m	Total £m
Cost			
At 1 April 2015	20.2	48.2	68.4
Additions	6.8	0.3	7.1
Transfers	(15.3)	16.0	0.7
At 31 March 2016	11.7	64.5	76.2
Amortisation			
At 1 April 2015	-	25.5	25.5
Charge for the year	-	8.7	8.7
At 31 March 2016	-	34.2	34.2
Net book amount At 31 March 2016	11.7	30.3	42.0
At 31 March 2015	20.2	22.7	42.9

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

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****14 Property, plant and equipment**

The group tangible assets are shown below. The company has no tangible assets.

	Land & buildings £m	Plant & machinery £m	Infra-structure assets £m	Assets under construction £m	Other £m	Total £m
Cost						
At 1 April 2015	1,571.5	2,831.3	2,457.8	254.0	578.5	7,693.1
Additions	1.0	67.8	22.8	124.4	18.3	234.3
Transfers	0.2	87.6	9.9	(125.5)	27.1	(0.7)
Disposals	-	(2.9)	-	-	(8.2)	(11.1)
At 31 March 2016	1,572.7	2,983.8	2,490.5	252.9	615.7	7,915.6
Depreciation						
At 1 April 2015	602.3	945.2	28.7	-	310.2	1,886.4
Charge for the year	41.1	111.6	30.4	-	50.2	233.3
Disposals	-	(2.8)	-	-	(8.0)	(10.8)
At 31 March 2016	643.4	1,054.0	59.1	-	352.4	2,108.9
Net book amount						
At 31 March 2016	929.3	1,929.8	2,431.4	252.9	263.3	5,806.7
At 31 March 2015	969.2	1,886.1	2,429.1	254.0	268.3	5,806.7

Freehold land is stated at a cost of £51.7 million at 31 March 2016 and 31 March 2015 and is not depreciated. Included within additions above is £5.7 million (2015: £6.7 million) of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing Costs'. The cumulative net book value of the borrowing costs capitalised amount to £167.7 million (2015: £168.5 million). The group has elected to apply IAS 23 from 1 April 2003, as permitted by the standard.

Assets held under finance leases

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

	2016 £m	2015 £m
Net book amount at 31 March	5.9	5.1

In accordance with IFRS 1 'First-time Adoption of International Financial Reporting Standards', the group has elected to measure its infrastructure and operational assets at 1 April 2014, being the date of transition to IFRS, at their fair value and to use that fair value as their deemed cost at that date (see note 34).

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****15 Other non-current asset**

	Company 2016 £m	Company 2015 £m
Amounts owed by group undertakings	<u>1,016.6</u>	<u>1,016.6</u>

All amounts due from group undertakings are unsecured, interest free and repayable on demand.

16 Investments

	Group 2016 £m	Group 2015 £m
Other external investments		
At 1 April	0.1	-
Additions	-	0.1
Total investments as at 31 March	<u>0.1</u>	<u>0.1</u>

The investment above represents a non-controlling interest of 7.17 per cent in a private limited company called, Landlord TAP Limited. The company owns a national web portal set up as part of a Water UK initiative to improve data on tenants and thereby increase collections with the aim of reducing customer bad debt.

	Company 2016 £m	Company 2015 £m
Greensands Europe Limited		
At 1 April and 31 March	1.0	1.0
Total subsidiary investments	<u>1.0</u>	<u>1.0</u>

A full list of subsidiaries is disclosed in note 33.

17 Inventories

	Group 2016 £m	Group 2015 £m
Raw materials	1.5	1.5
Work in progress	0.9	0.7
	<u>2.4</u>	<u>2.2</u>

The company does not hold any inventory.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****18 Trade and other receivables**

	Group 2016 £m	Group 2015 £m
Trade receivables	198.5	201.2
Provision for impairment	(111.9)	(110.5)
Net trade receivables	86.6	90.7
Accrued income	80.1	88.8
Prepayments	14.6	16.6
Other receivables	10.5	10.9
	191.8	207.0

The company does not have any trade or other receivables.

Accrued income as at 31 March 2016 includes water and sewerage income not yet billed of £73.1 million (2015: £81.0 million).

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

Provision for impairment

Movements on the doubtful debts provision were as follows:

	Group 2016 £m	Group 2015 £m
At 1 April	(110.5)	(121.5)
Charge for bad and doubtful debts	(21.5)	(18.9)
Amounts written off during the year	20.1	29.9
At 31 March	(111.9)	(110.5)

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

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

	Group 2016 £m	Group 2015 £m
Current	0.7	-
1-2 years	0.9	12.3
2-3 years	9.9	8.9
3-4 years	7.0	5.9
more than 4 years	37.5	30.7
	56.0	57.8

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

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****18 Trade and other receivables (continued)**

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

	Group 2016 £m	Group 2015 £m
Up to 90 days	20.1	23.2
91-365 days	36.4	44.2
1-2 years	30.3	25.9
2-3 years	19.5	14.8
3-4 years	12.5	9.8
more than 4 years	6.7	4.2
	<u>125.5</u>	<u>122.1</u>

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

At 31 March 2016

	Gross £m	Provision £m	Group Net £m
Not due	17.0	-	17.0
Overdue not specifically provided	125.5	(55.9)	69.6
Overdue and specifically provided	56.0	(56.0)	-
	<u>198.5</u>	<u>(111.9)</u>	<u>86.6</u>

At 31 March 2015

	Gross £m	Provision £m	Group Net £m
Not due	21.3	-	21.3
Overdue not specifically provided	122.1	(52.7)	69.4
Overdue and specifically provided	57.8	(57.8)	-
	<u>201.2</u>	<u>(110.5)</u>	<u>90.7</u>

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2016

19 Trade and other payables

	Group 2016 £m	Group 2015 £m
Trade payables	13.7	27.0
Capital creditors and capital accruals	59.3	68.7
Corporation tax	0.1	0.1
Other taxation and social security	2.8	2.4
Other payables	-	0.2
Other accruals and deferred revenue	112.2	113.3
	188.1	211.7
	Company 2016 £m	Company 2015 £m
Amounts owed to group undertakings	32.0	32.0

The directors consider that the carrying values of trade and other payables are not materially different from their fair values.

20 Current borrowings

	Group 2016 £m	Group 2015 £m
Current		
Loans and other borrowings	50.0	201.2
Premium deferred on issue	0.7	0.7
Deferred gilt lock proceeds	0.1	0.1
Debt issue costs	(1.8)	(1.9)
	49.0	200.1

Further descriptions about the above items are given in note 21 'Non-current borrowings'.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2016

21 Non-current borrowings

An analysis of the external loans is shown below:

Loans and other borrowings:	Notes	Group 2016 £m	Group 2015 £m
Class A £350m 6.192% fixed rate 2029	(i), (ii), (iii)	380.4	381.9
Class A £150m 3.706% index linked 2034	(iii), (iv)	253.9	251.1
Class A £35m 3.706% index linked 2034	(iii), (iv)	58.5	57.9
Class A £350m 6.640% fixed rate 2026	(i), (ii)	377.4	379.4
Class A £150m 3.816% index linked 2023	(iii), (iv)	232.0	230.8
Class A £350m 5.000% fixed rate 2021	(i), (ii)	347.8	347.4
Class A £150m 5.000% fixed rate 2041	(i), (ii)	145.6	145.5
Class A £200m 4.500% fixed rate 2052	(i), (ii)	197.1	197.1
Class A £300m 5.125% fixed rate 2056	(i), (ii)	292.6	292.6
Class A £300m 6.125% fixed rate 2019	(i), (ii)	298.8	298.4
Artesian £165m 4.076% index linked 2033	(iii), (iv)	285.0	282.1
Artesian £156.5m 3.635% index linked 2032	(iv)	221.7	219.4
Class A £60m - 0% index linked 2025	(iv), (xii)	60.5	-
Total Class A debt		3,151.3	3,083.6
Class B £250m 4.50% fixed rate 2038	(ii), (v)	247.8	247.4
£250m 8.500% Guaranteed Secured Fixed Rate Notes 2019	(ii)	248.2	248.0
£225m Facility Agreement 2016 – Libor plus 4%	(vi), (xi)	-	201.2
£125m Facility Agreement 2016 – Libor plus 3.25% 2022	(vii)	123.0	-
£75m Facility Agreement 2016 – Libor plus 4% 2025	(vii)	73.8	-
Eurobonds 12% 2021 (note 32)		890.7	795.2
Term Facility Agreement 2014 £150m - 6-month Libor plus 1.95% 2021	(xi)	150.0	150.0
Term Facility Agreement 2016 £50m – 6-month Libor plus 0.5% 2016		50.0	-
Debt issue costs	(viii)	(187.6)	(193.0)
Premium deferred on issue	(ix)	10.9	11.2
Deferred gilt lock proceeds	(x)	5.2	5.3
Obligations under finance leases		1.5	1.8
Total borrowings		4,764.8	4,550.7
Current borrowings		49.0	200.1
Non-current borrowings		4,715.8	4,350.6
Non-current borrowings		Group 2016 £m	Group 2015 £m
Repayments fall due as follows:			
Between one and five years		1,046.3	548.2
After five years not by instalments		3,669.5	3,802.4
		4,715.8	4,350.6
		Company 2016 £m	Company 2015 £m
Loans from group undertakings		59.2	59.2

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****21 Non-current borrowings (continued)**

Class A and Class B loans are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertaking of each of Southern Water Services Limited, Southern Water Services (Finance) Limited (SWSF), SWS Holdings Limited, and SWS Group Holdings Limited. In the case of Southern Water Services Limited, this is to the extent permitted by the Water Industry Act 1991 and the Licence to own and operate water assets.

Notes

- (i) The group has entered into swap agreements that convert Class A fixed rate debt into either floating or index-linked debt in accordance with the group's financial risk management policy.
- (ii) Fixed rate bonds are recognised net of issue costs, discounts and inclusive of premiums (where applicable) on issue and are carried at amortised cost using the effective interest rate method.
- (iii) The bond premiums referred to above also apply to various index-linked bonds. The premiums date back to 2003 when the related bonds were issued and arose when a number of the group's swap instruments were effectively closed out and the resulting loss was rolled forward into the pricing of these bonds. The premiums are carried at amortised cost using the effective interest rate method.
- (iv) The value of the capital and interest elements of the index-linked loans is linked to movements in the Retail Price Index. The increase in the capital value of index-linked loans during the year of £10.0 million (2015: £21.8 million) has been taken to the income statement as part of finance costs.
- (v) The interest rate on the Class B £250 million is fixed at 4.50 per cent until March 2022 when it reverts to Libor plus a margin to be determined.
- (vi) The facility was refinanced in April 2015 and the related swap agreements were closed out. Further details concerning the replacement facilities are explained in note (vii) below.
- (vii) The £200 million refinanced funds were drawn down on 5 May 2015 and have been recognised net of associated issue costs amounting to £3.5 million combined. Both loans are being carried at amortised cost using the effective interest rate method.
- (viii) Debt issue costs represent issue fees paid by SWSF and SWC that are not otherwise accounted for within the amortised cost of specific loans. Where these costs are attributable to a specific instrument they are being amortised over the life of that instrument. The remaining costs are being amortised over the weighted average life of the loans advanced at the time the costs were incurred. As at 31 March 2016 debt issue costs amounted to £187.6 million of which £1.8 million represents the short-term amount which is disclosed separately in note 20.

In addition to the above, swap break costs are included within this balance. These costs originated prior to securitisation when a swap was entered into, to act as a hedge for the future issue of bonds under securitisation. The swap was closed out and break costs were incurred when the bonds were issued in July 2003. The accounting treatment of these costs mirror the amortised cost value of opposing related bonds referred to in note (iii) above. These bonds are inclusive of premiums that compensate the swap break costs suffered.
- (ix) The deferred bond premium represents the additional book value of the Class A Artesian £156.5 million loan issued in 2004. The premium is being amortised over the life of the bond.
- (x) Prior to the issue of the Class A £300 million bond in the year to 31 March 2008, SWSF entered into a gilt lock agreement, resulting in the receipt of £6.3 million, which was advanced to SWS along with the proceeds of the bond issue. The proceeds have been deferred and are being released to the income statement over the life of the loan.
- (xi) Amounts repayable wholly or partly within one year.
- (xii) The Class A £60 million loan is index-linked with an interest rate of 0.00 per cent until August 2025.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****21 Non-current borrowings (continued)**

Repayments fall due as follows:	2016	2015
	£m	£m
Borrowings excluding finance leases:		
Between one and two years not by instalments	-	-
Between two and five years not by instalments	1,044.8	546.4
After five years not by instalments	3,669.5	3,802.4
	4,714.3	4,348.8
On demand or within one year not by instalments	49.0	200.1
	4,763.3	4,548.9
Finance leases:		
Between one and two years not by instalments	1.3	0.7
Between two and five years not by instalments	0.2	1.1
After five years not by instalments	-	-
	1.5	1.8
On demand or within one year not by instalments	-	-
	1.5	1.8
Borrowings including finance leases:		
Between one and two years not by instalments	1.3	0.7
Between two and five years not by instalments	1,045.0	547.5
After five years not by instalments	3,669.5	3,802.4
	4,715.8	4,350.6
On demand or within one year not by instalments	49.0	200.1
	4,764.8	4,550.7

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

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****22 Financial instruments**

The following table provides a comparison by category of the carrying amounts of the group's financial assets and financial liabilities at 31 March 2016 and 31 March 2015.

Financial assets and liabilities by category	Group 2016 £m	Group 2015 £m
Financial assets		
Derivative financial instruments designed as FVTPL*		
- Non-current	12.4	13.8
Held to maturity investments		
- Non-current	0.1	0.1
Trade and other receivables		
- Current (excluding prepayments)	177.2	190.4
Cash and cash equivalents		
- Current	38.1	230.1
Total financial asset	227.8	434.4
Financial liabilities		
Derivative financial instruments designed as FVTPL*		
- Non-current	936.1	1,169.0
Borrowings		
- Current	49.0	198.8
- Non-current	4,715.8	4,351.9
Trade and other payables		
- Current	197.4	211.6
Total financial liabilities	5,898.3	5,931.3

*Fair value through profit and loss.

The below table analyses derivative financial instruments held on the statement of financial position.

Derivative financial instruments	Group 2016 Assets £m	Group 2016 Liabilities £m	Group 2015 Assets £m	Group 2015 Liabilities £m
Derivative financial instruments not designated as hedges:				
Interest rate swaps	12.4	(16.1)	13.8	(20.3)
RPI swaps	-	(920.0)	-	(1,148.7)
Total derivative financial instruments	12.4	(936.1)	13.8	(1,169.0)
Derivative financial instruments can be analysed as follows:				
Current	-	-	-	(3.5)
Non-current	12.4	(936.1)	13.8	(1,165.5)
	12.4	(936.1)	13.8	(1,169.0)

The notional principal amount of the outstanding interest rate swap contracts at 31 March 2016 was £1,513.2 million (2015: £1,513.2 million).

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****22 Financial instruments (continued)**

In accordance with IAS 39 the group has reviewed all contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard. None were identified during the year or previous year.

i) Financial risk management objectives and policies

The principal financial risks to which the group is exposed are interest rate, liquidity and RPI risks. The board has approved policies for the management of these risks.

Interest rate risk

The group's interest rate risk is primarily in relation to its fixed rate borrowings (fair value risk) and floating rate borrowings (cash flow risk). Interest rate derivatives are used to manage the overall interest rate profile within the group policy, which is to maintain a higher proportion of net debt at fixed rates of interest having regard to the prevailing interest rate outlook.

The weighted average effective interest rates at the statement of financial position dates by class of debt were as follows:

	Group 2016 %	Group 2015 %
By class of debt (all classed as financial liabilities)		
Class A	4.97	4.98
Class B	4.74	4.74
Artesian	2.21	2.24
Greensands £250m bond	8.67	8.75
Greensands £225m facility	-	6.47
Greensands £125m facility	4.54	-
Greensands £75m facility	4.97	-

The weighted average interest costs at the statement of financial position dates were as follows:

	Group 2016 %	Group 2015 %
Fixed	8.97	8.80
Floating	3.29	4.98
Indexed	4.57	4.78

Liquidity risk

The group raises funds, as required, to ensure that it has sufficient cash and/or facilities to fund the business of Southern Water Services Limited for the next twelve months.

RPI risk and sensitivity analysis

The principal market risks are interest rates and movements in RPI. Interest rates on the group's loans are currently either fixed or fully effective swap instruments are in place to swap floating rates for fixed. RPI impacts indexation charged on index-linked loans and swaps. These instruments form an economic hedge with the group's revenues and regulatory assets, which are also linked to RPI inflation.

The group also notes that the result of the recent EU referendum will increase uncertainty around these risk areas in the short term.

For further details about group financing matters please refer to the 'Capital structure, liquidity and other financial matters' section of the Strategic Report contained within these financial statements on page 7.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****22 Financial instruments (continued)****ii) Maturity of financial liabilities and financial instruments**

The maturity profile of the group's financial liabilities at 31 March 2016 and 31 March 2015 is disclosed within note 21.

The table below analyses the group's derivative financial instruments into relevant maturity profiles based on the remaining period at the reporting date.

	Within one year £m	Within two to five years £m	Within five to 25 years £m	After 25 years £m	Total £m
At 31 March 2016					
Derivative financial instruments – asset	-	12.4	-	-	12.4
Derivative financial instruments – liability	-	(127.5)	(368.4)	(440.2)	(936.1)
	-	(115.1)	(368.4)	(440.2)	(923.7)
	Within one year £m	Within two to five years £m	Within five to 25 years £m	After 25 years £m	Total £m
At 31 March 2015					
Derivative financial instruments – asset	-	13.8	-	-	13.8
Derivative financial instruments – liability	(3.5)	(157.4)	(344.4)	(663.7)	(1,169.0)
	(3.5)	(143.6)	(344.4)	(663.7)	(1,155.2)

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****22 Financial instruments (continued)****iii) Fair values of financial assets and financial liabilities**

The following table provides a comparison by category of the carrying amounts and the fair values of the group's financial assets and financial liabilities at 31 March 2016 and 2015.

	Group 2016 Book value £m	Group 2016 Fair value £m	Group 2015 Book value £m	Group 2015 Fair value £m
Cash and cash equivalents	38.1	38.1	230.1	230.1
Non-current asset investments	0.1	0.1	0.1	0.1
Non-current derivative financial instruments	12.4	12.4	13.8	13.8
	<u>50.6</u>	<u>50.6</u>	<u>244.0</u>	<u>244.0</u>
Current borrowings	(49.0)	(49.0)	(200.1)	(198.9)
Non-current borrowings	(4,715.8)	(5,373.0)	(4,350.6)	(5,081.0)
Non-current derivative financial instruments	(16.1)	(16.1)	(20.3)	(20.3)
Non-current RPI swaps	(920.0)	(920.0)	(1,148.7)	(1,148.7)
	<u>(5,700.9)</u>	<u>(6,358.1)</u>	<u>(5,719.7)</u>	<u>(6,448.9)</u>

Derivative activity is undertaken by subsidiaries in the group, Greensands Senior Finance Limited, Southern Water (Greensands) Financing Plc and Southern Water Services (Finance) Limited (SWSF), as determined by the board, which considers the overall risk profile of the group and enters into derivatives to mitigate or hedge any risks identified, as appropriate. No derivatives are undertaken for trading purposes, or to benefit from price fluctuations.

No derivative activity is undertaken by the company.

The SWSF business consists of lending to other group companies and raising external finance.

All fair values are based on arm's length transactions in normal market conditions. Where available, market values have been used to determine fair values.

The fair value of the group's long term borrowings has been estimated based on quoted market prices for the same or similar debt where possible. Where prices did not exist, the fair value has been estimated based on the calculations of the present value of future cash flows using the appropriate discount rates in effect at the statement of financial position dates.

For interest rate swap agreements the fair value has been estimated based on market valuations at the statement of financial position dates.

The group has no material un-hedged monetary assets and liabilities denominated in a currency different from the local currency of the particular operation.

Fair values of other non-current liabilities, current trade and other payables, provisions and current trade and other receivables have been estimated as not materially different from book value and have been excluded from the table above. The same can be said for non-current asset investments; however, this balance has been displayed in the table above.

In accordance with IFRS 13 'Fair Value Measurement', the financial instruments carried at fair value on the statement of financial position have been classified as level 2 for fair valuation purposes, being valued by reference to valuation techniques using observable inputs other than quoted prices in active markets for identical assets and liabilities. The future cash flows have been discounted at a rate that reflects credit risk.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****23 Deferred tax liabilities**

Deferred tax is provided as follows:

	Accelerated tax depreciation £m	Revaluation of financial instruments £m	Retirement benefit obligations £m	Other timing differences £m	Total £m
At 1 April 2014	618.3	(153.2)	(18.1)	23.8	470.8
(Credit)/charge to income statement	13.2	(20.7)	0.3	8.4	1.2
Charge to other comprehensive income	-	-	(7.5)	-	(7.5)
At 1 April 2015	<u>631.5</u>	<u>(173.9)</u>	<u>(25.3)</u>	<u>32.2</u>	<u>464.5</u>
(Credit)/charge to income statement	21.6	(9.9)	6.1	(11.1)	6.7
Charge to other comprehensive income	-	-	(2.8)	-	(2.8)
Effect of change in tax rate -income statement	(65.3)	18.4	2.2	(2.2)	(46.9)
At 31 March 2016	<u>587.8</u>	<u>(165.4)</u>	<u>(19.8)</u>	<u>18.9</u>	<u>421.5</u>

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

	2016 £	2015 £
Deferred tax liabilities	609.7	667.1
Deferred tax assets	<u>(188.2)</u>	<u>(202.6)</u>
	<u>421.5</u>	<u>464.5</u>

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****24 Provisions for liabilities**

	Group 2016 £m	Group 2015 £m
Environmental obligations		
Provision as at 1 April	0.5	0.5
Utilised in year	-	-
Provision at 31 March	<u>0.5</u>	<u>0.5</u>

The environmental provision relates to costs for the decommissioning of abandoned sites. No reimbursement is expected. The period over which the provision will be utilised cannot be determined thus the provision is not discounted. Discounting the provision would not materially affect its value.

25 Other non-current liabilities

	Deferred revenue £m	Grants & contributions £m	Group Total £m
At 1 April 2015	14.9	25.3	40.2
Receivable in year	-	4.8	4.8
Released to income statement	(0.4)	(1.1)	(1.5)
At 31 March 2016	<u>14.5</u>	<u>29.0</u>	<u>43.5</u>

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

Deferred revenue of £14.5 million (2015: £14.9 million) relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by the group. The income will be credited to the income statement evenly over the life of the lease. The remaining lease period is 36 years as at 31 March 2016.

26 Share capital

	Group and Company 2016 £m	Group and Company 2015 £m
Allotted, called up and fully paid 921,874,025 Ordinary shares of £1 each	<u>921.9</u>	<u>921.9</u>

27 Share premium account

	Group and Company £m
Balance at 1 April and at 31 March	<u>4.5</u>

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****28 Notes to the cash flow statement**

Cash generated by operations	2016	2015
	£m	£m
Continuing operations		
Operating profit	275.7	322.5
Adjustments for:		
Depreciation of property, plant and equipment	233.3	221.1
Amortisation of intangible assets	8.7	9.1
Difference between pension charge and cash contributions	(31.0)	(16.5)
Amortisation of grants and contributions	(1.1)	(1.0)
Operating cash flows before movements in working capital	485.6	535.2
Increase in inventories	(0.2)	(0.2)
Decrease/(increase) in receivables	12.7	(18.6)
Decrease in payables	(16.5)	(2.8)
Cash from operating activities	481.6	513.6
Net cash generated from operating activities	481.6	513.6
Cash and cash equivalents	2016	2015
	£m	£m
Cash and bank balances	38.1	230.1
	38.1	230.1

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

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****28 Notes to the cash flow statement (continued)**

Analysis of net debt	At 1 April 2015 £m	Cash flow £m	Other non-cash changes £m	At 31 March 2016 £m
Cash and cash equivalents	230.1	(192.0)	-	38.1
Derivative financial instruments	(1,155.2)	298.4	(66.9)	(923.7)
Debt issue costs	193.0	0.2	(5.6)	187.6
Gilt lock proceeds	(5.3)	-	0.1	(5.2)
Borrowings due within one year	(201.9)	150.0	1.2	(50.7)
Borrowings due after one year	(4,534.7)	(260.0)	(100.3)	(4,895.0)
Finance leases	(1.8)	0.2	0.1	(1.5)
Net debt	<u>(5,475.8)</u>	<u>(3.2)</u>	<u>(171.4)</u>	<u>(5,650.4)</u>

**Balances at 31 March 2016
comprise:**

	Current assets £m	Current liabilities £m	Non- current liabilities £m	Total £m
Cash and cash equivalents	38.1	-	-	38.1
Derivative financial instruments	-	-	(923.7)	(923.7)
Debt issue costs	-	1.8	185.8	187.6
Gilt lock proceeds	-	(0.1)	(5.1)	(5.2)
Borrowings due within one year	-	(50.7)	-	(50.7)
Borrowings due after one year	-	-	(4,895.0)	(4,895.0)
Finance leases	-	-	(1.5)	(1.5)
Net debt	<u>38.1</u>	<u>(49.0)</u>	<u>(5,639.5)</u>	<u>(5,650.4)</u>

The non-cash movement of £171.4 million relates to an increase in debt as a result of indexation, and a net movement on loans, which offset against each other, plus the amortisation of loan issue costs, gilt lock proceeds, deferred proceeds and an increase in finance lease obligations.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****29 Pensions**

The deficit associated with retirement benefit obligations has decreased to £102.3 million (2015: £115.3 million) as a result of an increase in the yields of AA-rated corporate bonds which increase the discount rate used to calculate the value of pension scheme liabilities, offset by lower asset returns than expected.

Pension schemes operated

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

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

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

The main risks of the scheme are as follows:

- a) Asset volatility

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

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

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

- b) Changes in bond yields

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

- c) Life expectancy

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

Notes to the financial statements (continued)**For the year ended 31 March 2016****29 Pensions (continued)**

d) Inflation risk

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

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

Contributions made to the defined contribution scheme for the year ended 31 March 2016 amounted to £2.3 million (2015: £2.0 million). No contributions were outstanding at either year-end.

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

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

The principal assumptions in the valuation were as follows:

	2013 SWPS % per annum (pa)
Return on investments: pre-retirement	FI Gilt
Return on investments: post-retirement (pensioner/non-pensioner)	curve + 65 bps
Salary growth	2.5%
Pension increases on the excess over guaranteed minimum pensions (where capped at 5% pa)	2.75%

Notes to the financial statements (continued)**For the year ended 31 March 2016****29 Pensions (continued)**

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

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

Expected employer and employee contributions to the defined benefit scheme for 2016-17 are £6.1 million and £0.2 million respectively under the current Schedule of Contributions.

IAS 19 – assumptions, asset, liability and reserves disclosures

The formal actuarial funding valuation was carried out as at 31 March 2013 and updated to 31 March 2016 by a qualified independent actuary. The major assumptions used by the actuary are set out in the table below.

	2016	2015
	% pa	% pa
Price inflation (RPI)	3.0	3.0
Price inflation (CPI)	2.0	2.0
Rate of increase in salaries (plus an age-related promotional scale)	2.5	2.5
Rate of increase of pensions in payment (MIS* members only) ^{***}	2.0	2.0
Rate of increase of pensions in payment (Old section** members only) ^{***}	3.0	3.0
Rate of increase of pensions in payment (all other members) ^{***}	2.9	2.9
Rate of increase for deferred pensions (MIS* members only) ^{***}	2.0	2.0
Rate of increase for deferred pensions (all other members) ^{***}	2.9	2.9
Discount rate	3.6	3.4

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

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

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

Notes to the financial statements (continued)**For the year ended 31 March 2016****29 Pensions (continued)**

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. For 2015–16, the company has used the post-retirement mortality assumptions based on the standard SAPS mortality tables together with future improvements in line with CMI 2014 improvements with a long-term improvement rate of 1.25 per cent per annum.

	2016	2015
	Years	Years
Longevity at age 65 for current pensioners		
Male	23.0	23.0
Female	25.1	25.1
Longevity at age 65 for future pensioners		
Male	24.8	24.7
Female	27.0	27.0

The assets and liabilities in the schemes and the expected rates of return at 31 March 2016 and 31 March 2015 were:

	Value	Value
	at 2016	at 2015
	£m	£m
Equities	171.5	282.2
Government bonds	196.2	159.1
Non-government bonds	266.3	208.8
Cash	40.1	23.9
Total market value of plan assets	674.1	674.0
Total value of plan liabilities	(776.4)	(789.3)
Accrued deficit in the plan	(102.3)	(115.3)
Related deferred tax asset	19.8	25.4
Net pension liability	(82.5)	(89.9)

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

Reconciliation of the present value of the scheme liabilities	2016	2015
	£m	£m
At 1 April	789.3	671.9
Current service cost	5.4	4.8
Interest expense	26.4	29.8
Member contributions	0.2	0.2
Actuarial (gain)/loss on liabilities:		
due to changes in demographic assumptions	10.0	(1.7)
due to changes in financial assumptions	(27.1)	109.8
Benefits paid	(27.8)	(25.5)
Scheme liabilities at 31 March	776.4	789.3

Notes to the financial statements (continued)

For the year ended 31 March 2016

29 Pensions (continued)**Sensitivity analysis of the scheme liabilities**

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

	Change in assumption	Impact on scheme liabilities (%)	Impact on scheme liabilities (£m)
Discount rate	+/- 1%	-/+ 15	-/+ 116
Rate of inflation*	+/- 1%	+/- 13	+/- 101
Rate of increase in pensions in payment	+/- 1%	+/- 11	+/- 85
Mortality	+/- 1yr	+/- 3	+/- 23

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

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

Reconciliation of the value of the scheme assets	2016 £m	2015 £m
At 1 April	674.0	581.5
Interest income	22.5	25.8
(Loss)/gain on assets above interest	(31.1)	70.7
Employer contributions	37.2	23.4
Member contributions	0.2	0.2
Benefits paid	(27.8)	(25.5)
Administrative expenses	(0.9)	(2.1)
Bid value of scheme assets at 31 March	674.1	674.0

The total (loss)/return on scheme assets was (£9.5) million (2015: £94.4 million).

Total cost recognised as an expense	2016 £m	2015 £m
Current service cost	5.4	4.8
Net interest cost	3.9	4.0
Administration expenses	0.9	2.1
Total income statement expense before deduction for tax	10.2	10.9

Analysis of the amounts recognised in other comprehensive income	2016 £m	2015 £m
Actual return less expected return on pension scheme assets	(31.1)	70.7
(Loss)/gain due to changes in demographic assumptions	(10.0)	1.7
Gain/(loss) due to changes in financial assumptions	27.1	(109.8)
Total loss recognised in OCI before adjustment for tax	(14.0)	(37.4)

The cumulative amount of actuarial losses recognised in other comprehensive income is £193.5 million (2015: £179.5 million).

Notes to the financial statements (continued)

For the year ended 31 March 2016

29 Pensions (continued)

Analysis of the movement in the scheme's deficit during the year	2016 £m	2015 £m
Deficit in the scheme at 1 April	(115.3)	(90.4)
Employer's contributions	37.2	23.4
Employer's current service cost	(5.4)	(4.8)
Financing charge on net statement of financial position	(3.9)	(4.0)
Administration expenses	(0.9)	(2.1)
Actuarial loss	(14.0)	(37.4)
Deficit in the scheme at end of year	(102.3)	(115.3)

30 Contingent liabilities

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

Neither the company nor the group had any contingent liabilities for capital claims at the year-end (2015: £nil).

31 Financial commitments

(a) Capital commitments are as follows:

	2016 £m	2015 £m
Contracted for but not provided for in respect of contracts placed	<u>193.8</u>	<u>113.3</u>

(b) The group as lessee

	2016 £m	2015 £m
Lease payments under operating leases recognised as an expense in the year	3.9	3.8

As at 31 March 2016 and 2015, the group had annual commitments under non-cancellable operating lease agreements in respect of vehicles and land and buildings for which the payments fall due as follows:

	Land and buildings		Other	
	2016 £m	2015 £m	2016 £m	2015 £m
Expiring within one year	1.7	1.6	0.2	0.2
Expiring between two and five years	6.3	6.2	0.4	0.4
Expiring after more than five years	14.5	16.1	0.1	-
	<u>22.5</u>	<u>23.9</u>	<u>0.7</u>	<u>0.6</u>

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

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****32 Related party transactions**

Balances and transactions between the company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the group and its associates are disclosed below.

The major shareholders in Greensands Holdings Limited as at 31 March 2016 are IIF International SW UK Investments Limited (managed by JP Morgan Investments Inc.) and The Northern Trust Company. Subsequent to the reporting date, The Northern Trust Company has sold its shareholding in Greensands Holding Limited (for further details please see note 35).

The transactions and balances with the group's related parties (i.e. the shareholders) are summarised below.

	2016	2015
	£m	£m
Eurobond interest		
IIF Int'l SW UK Investment Ltd	29.8	24.9
Phildrew Nominees Ltd	15.0	13.3
National Nominees Ltd	7.4	5.0
STC Funds Nominee Pty Limited	-	2.7
The Northern Trust Company	22.4	19.9
Sky Brace Investments Ltd	4.5	4.1
Sumaya Investments Ltd	4.5	4.1
Nambawan Super Limited	-	0.4
JP Morgan Nominees Australia	-	1.3
Hermes GPE Infrastructure Fund LP	3.7	3.3
SW Holdings LP	1.9	1.1
Simcoe Yeoman Water Ltd	6.3	5.1
Total Eurobond interest payable to related parties	95.5	85.2
Loans and other borrowings greater than one year:		
Eurobonds – Shareholder loans		
IIF Int'l SW UK Investment Ltd	112.4	105.3
Phildrew Nominees Ltd (UBS IIF)	20.1	20.1
Phildrew Nominees Ltd (UBS IINF)	2.8	2.8
Phildrew Nominees Ltd (UBS II4F)	22.2	22.2
Phildrew Nominees Ltd (UBS IIUSTEF)	11.1	11.1
National Nominees Ltd - Motor Trades Association of Australia Super Fund	21.4	16.8
STC Funds Nominee Pty Limited as trustee of the SW Unit Trust	-	11.2
National Nominees Ltd – Prime Super	6.5	4.2
The Northern Trust Company (as custodian for Future Fund Investment Company No.2 Pty Ltd)	84.2	84.2
Sky Brace Investments Ltd	17.1	17.1
Sumaya Investments Ltd	17.1	17.1
Nambawan Super Limited as trustee for the Nambawan Superannuation Fund	-	1.7
JP Morgan Nominees Australia	-	5.6
Hermes GPE Infrastructure Fund LP	14.0	14.0
SW Holdings LP	7.0	4.8
Simcoe Yeoman Water Ltd	23.9	21.6
Accrued interest	530.9	435.4
Total Eurobonds – Shareholder loans	890.7	795.2

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****33 Subsidiaries**

As at 31 March 2016 the company held 100 per cent of the ordinary share capital of Greensands Europe Limited. Greensands Europe Limited's principal subsidiaries are listed below and are included within these consolidated financial statements.

Company	Registered address	Activity
Greensands UK Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water (Greensands) Financing plc	Southern House, Yeoman Road, Worthing	To raise debt finance
Greensands Junior Finance Limited	Southern House, Yeoman Road, Worthing	To raise debt finance
Greensands Senior Finance Limited	Southern House, Yeoman Road, Worthing	To raise debt finance
Greensands Investments Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water Capital Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water Investments Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water (NR) Holdings Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water (NR) Limited	1 Exchange Crescent, Conference Square, Edinburgh	Non-trading activities
SWS Group Holdings Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
SWS Holdings Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water Limited	Southern House, Yeoman Road, Worthing	Intermediate parent company for Southern Water(NR) Group
Southern Water Services Limited	Southern House, Yeoman Road, Worthing	Supply of Water and Wastewater Services
Southern Water Services Finance Limited*	Ugland House, PO Box 309, George Town, Grand Cayman	To raise debt finance
Southern Water Services Group Limited	Southern House, Yeoman Road, Worthing	Non-trading activities
Southern Water Industries Limited	Southern House, Yeoman Road, Worthing	Dormant
Bowsprit Holdings Limited	Southern House, Yeoman Road, Worthing	Dormant
Monk Rawling Limited	Southern House, Yeoman Road, Worthing	Dormant
Bowsprit Property Development Limited	Southern House, Yeoman Road, Worthing	Property development
EcoClear Limited	Southern House, Yeoman Road, Worthing	Dormant
Southern Water Executive Pension Scheme Trustees Limited	Southern House, Yeoman Road, Worthing	Dormant
Southern Water Pension Trustees Limited	Southern House, Yeoman Road, Worthing	Dormant
Southern Water Retail Services Limited	Southern House, Yeoman Road, Worthing	Dormant

*The country of incorporation for this company is the Cayman Islands.

All of the above subsidiary companies are wholly-owned by ordinary shares.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****34 Explanation of transition to IFRS**

This is the first period the group has presented its financial statements under IFRS. The last financial statements prepared under the previous UK accounting framework were for the year ending 31 March 2015. The date of transition was 1 April 2014 and all comparative information in these financial statements has been restated to reflect the group's adoption of IFRS, except where otherwise required or permitted by IFRS 1.

The following disclosures are required in the period of transition.

Reconciliation of statement of financial position at 1 April 2014:

Notes	UK GAAP £m	Property, plant and equipment £m i	Borrowing costs £m ii	Financial instruments £m iii	Other £m iv	Restated under IFRS £m
Derivative financial asset	-	-	-	9.5	-	9.5
Goodwill and intangible assets	85.1	-	-	-	34.0	119.1
Property, plant and equipment	5,607.5	4.9	168.5	-	(34.0)	5,746.9
Other non-current assets	-	-	-	-	-	-
Investments	-	-	-	-	-	-
Current assets and liabilities						
Cash and cash equivalents	193.4	-	-	-	-	193.4
Other current assets	188.6	-	-	-	-	188.6
Current liabilities	(250.2)	-	-	9.3	(3.2)	(244.1)
Non-current liabilities						
Borrowings	(4,819.8)	-	-	378.8	2.7	(4,438.3)
Derivative financial instruments	-	-	-	(1,041.7)	-	(1,041.7)
Deferred tax liabilities	(313.5)	(7.8)	(33.7)	154.4	(270.2)	(470.8)
Retirement benefit obligations	(72.3)	-	-	-	(18.1)	(90.4)
Provisions for liabilities	(0.5)	-	-	-	-	(0.5)
Other non-current liabilities	(59.1)	29.4	-	-	-	(29.7)
Total net liabilities	559.2	26.5	134.8	(489.7)	(288.8)	(58.0)
Capital and reserves:						
Called up share capital	921.9	-	-	-	-	921.9
Share premium account	4.5	-	-	-	-	4.5
Retained earnings	(367.2)	26.5	134.8	(489.7)	(288.8)	(984.4)
Total deficit	559.2	26.5	134.8	(489.7)	(288.8)	(58.0)

Notes to the consolidated financial statements (continued)
For the year ended 31 March 2016

34 Explanation of transition to IFRS (continued)

Reconciliation of statement of financial position at 31 March 2015:

	UK GAAP	Property, plant and equipment	Borrowing costs	Financial instrum ents	Other	Restated under IFRS
Notes	£m	£m i	£m ii	£m iii	£m iv	£m
Derivative financial assets	-			13.8		13.8
Goodwill and intangible assets	78.8				49.2	128.0
Property, plant and equipment	5,637.0	44.1	168.5		(42.9)	5,806.7
Investments	0.1					0.1
Current assets and liabilities						
Cash and cash equivalents	230.1					230.1
Other current assets	205.5				3.7	209.2
Current liabilities	(417.8)			5.8	(3.3)	(415.3)
Non-current liabilities						
Borrowings	(4,743.2)			389.8	2.8	(4,350.6)
Derivative financial instruments	-			(1,165.5)		(1,165.5)
Deferred tax liabilities	(336.2)	(12.1)	(33.7)	173.7	(256.2)	(464.5)
Retirement benefit obligations	(90.0)				(25.3)	(115.3)
Provisions for liabilities	(0.5)					(0.5)
Other non-current liabilities	(56.3)	16.1				(40.2)
Total net liabilities	507.5	48.1	134.8	(582.4)	(272.0)	(164.0)
Capital and reserves:						
Called up share capital	921.9					921.9
Share premium account	4.5					4.5
Revaluation reserve	-					-
Retained earnings	(418.9)	48.1	134.8	(582.4)	(272.0)	(1,090.4)
Total deficit	507.5	48.1	134.8	(582.4)	(272.0)	(164.0)

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2016

34 Explanation of transition to IFRS (continued)

Reconciliation of loss for the year ended 31 March 2015:

	UK GAAP	Property, plant and equipment	Borrowing costs	Financial instruments	Other	Restated under IFRS
Notes	£m	£m i	£m ii	£m iii	£m iv	£m
Revenue	828.6	7.4	-	-	(9.8)	826.2
Other operating income	0.2	1.0	-	-	-	1.2
Operating costs	(529.9)	17.6	(6.7)	-	14.1	(504.9)
Operating profit	298.9	26.0	(6.7)	-	4.3	322.5
Profit on disposal of fixed assets	1.3	-	-	-	-	1.3
Net finance costs	(293.5)	-	6.7	(112.2)	0.3	(398.7)
Loss before taxation	6.7	26.0	-	(112.2)	4.6	(74.9)
Loss on profit on ordinary activities	(24.1)	(5.2)	-	20.2	7.9	(1.2)
Loss after taxation from continuing operations	(17.4)	20.8	-	(92.0)	12.5	(76.1)
Other comprehensive loss						
Items that cannot be reclassified to profit or loss:						
Actuarial loss on pension scheme	(42.9)	-	-	-	5.5	(37.4)
Movement on deferred tax in relation to pension liability	8.6	-	-	-	(1.1)	7.5
Total other comprehensive loss for the year, net of tax	(34.3)	-	-	-	4.4	(29.9)
Total comprehensive loss for the year	(51.7)	20.8	-	(92.0)	16.9	(106.0)

Notes to the reconciliations

(i) Property, plant and equipment (IAS 16 and IAS 38)

Infrastructure assets

Previously, Southern Water Services Limited's water and wastewater assets were accounted for in accordance with the renewals accounting provisions of Financial Reporting Standard 15 'Tangible Fixed Assets'. Under renewals accounting, the water and wastewater infrastructure networks were assumed to be single assets. Expenditure on infrastructure assets relating to increase in capacity or enhancements to the networks and on maintaining the operating capability of the networks in accordance with defined standards of service was capitalised. The depreciation charged was the estimated level of annual expenditure required to maintain the operating capability of the networks. Grants and contributions relating to the maintenance of the operating capability of the infrastructure network were taken into account when determining this charge. Grants and contributions relating to the enhancement of the infrastructure network were deducted from the costs of fixed assets.

Renewals accounting is not permitted under International Accounting Standard 16 'Property, Plant and Equipment' (IAS 16). The carrying value of infrastructure assets, in Southern Water has therefore been revalued at fair value. This does not change the overall group valuation as the assets of Southern Water were re-valued at fair value on acquisition in 2007.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****34 Explanation of transition to IFRS (continued)****(i) Property, plant and equipment (IAS 16 and IAS 38) (continued)**

The infrastructure network has been broken down into a number of significant parts based on the type of pipe or structure and its location. Broadly this has resulted in the following significant parts: impounding reservoirs, local and trunk mains, wastewater tunnels and outfalls, sewers and ancillary structures. These have all been assigned residual values of nil and are being depreciated over 10 to 200 years.

From 1 April 2014, infrastructure expenditure that meets the recognition criteria for property, plant and equipment has been capitalised at cost and depreciated over its expected life. Expenditure relating to repair or maintenance has been expensed.

Historic infrastructure receipts previously presented as deductions from infrastructure cost under UK GAAP have been transferred to reserves on transition to IFRS on the basis that they do not relate to a specific asset. From 1 April 2014, these receipts have been recorded as revenue.

From 1 April 2014, infrastructure grants and contributions previously presented as deductions from infrastructure cost under UK GAAP have been allocated to deferred income and amortised over the expected useful lives of the related assets.

Under UK GAAP, no value was recognised for assets transferred or adopted from developers or other third parties at nil consideration. IFRIC 18 'Transfers of Assets from Customer' requires that when an item is transferred from a customer, and it meets the definition of an asset, then it should be recognised at fair value within property, plant and equipment. The deferred credit arising on the adoption of the asset is recognised as other income over the life of the relevant asset.

There are no significant differences between UK GAAP and IFRS in respect of all other fixed assets, including water and water recycling non-infrastructure assets, other than the separate classification of certain assets as intangibles rather than tangible assets in accordance with IAS 38 'Intangible Assets'.

Impact

Reclassifying the historic infrastructure receipts under IFRS has resulted in an increase in net assets of £81.2 million and a decrease of £29.4 million in deferred creditors as at 31 March 2014, with a further net £5.5 million transferred to the income statement for 2014–15.

Under UK GAAP the difference between the cumulative infrastructure renewals expenditure and that charged to the income statement as depreciation (IRC) was held as a prepayment in fixed assets of £76.3 million. As this value does not represent an asset under IFRS it has been written off to reserves on transition.

At 31 March 2015, the value of adopted assets recognised in accordance with IFRIC 18 since the date of transition was £6.9 million, with a corresponding credit to other non-current liabilities. In addition grants and contributions received of £4.4 million were transferred to deferred creditors.

As at 31 March 2015, under IFRS, the annual depreciation charge of infrastructure assets (excluding the fair value depreciation) plus the maintenance costs expensed together with changes to the infrastructure assets qualifying for capitalisation was £20.8 million lower than the total of renewals expenditure recorded under UK GAAP.

(ii) Borrowing costs

Under IFRS, Southern Water Services Limited is required to capitalise an element of borrowing costs that is directly attributable to the acquisition, construction or production of qualifying assets as part of the costs of that asset. Borrowing costs are capitalised when incurred for the construction of any qualifying assets during the period of time that is required to complete and prepare the asset for its intended use.

Previously, under UK GAAP, borrowing costs were fully expensed as incurred. The change in policy under IFRS has been applied retrospectively with an effective date of 1 April 2003 reflecting the point at which Southern Water was securitised and financed by loans.

Impact

As a result of the retrospective application of IAS 23 'Borrowing Costs', net assets increased by £134.8 million for the year ended 31 March 2014. During 2014–15 borrowing costs of £6.7 million were capitalised and a total of £6.7 million of capitalised borrowing costs was charged as depreciation.

Notes to the consolidated financial statements (continued)**For the year ended 31 March 2016****34 Explanation of transition to IFRS (continued)****(iii) Financial instruments**

Under IFRS, the group must apply IAS 39 'Financial Instruments: Recognition and Measurement' (IAS 39).

The most significant aspect of applying IAS 39 is in relation to derivatives, principally interest rate swaps on index linked bonds that are held to protect against the company's exposure to inflation risk.

Under IAS 39, the fair value of these derivatives must be recognised on the statement of financial position, with fair value movements being recognised in the income statement unless cash flow hedge accounting is applied. This has the potential to introduce considerable volatility to the income statement and the statement of financial position.

Also under IAS 39, the general treatment of debt is for it to be carried at amortised cost, such that borrowings are stated at net proceeds received after the inclusion of premiums and the deduction of issue costs. Under UK GAAP, the issue costs of debt instruments are amortised at a constant rate over the life of the instrument, whereas under IFRS, the costs are amortised using the 'effective interest rate' method.

The deferred bond premium resulting from the refinancing in 2003 has been transferred to reserves since under IFRS this is now included in borrowings and amortised using the 'effective interest rate'.

Impact

As a result of applying IAS 39, a net liability for derivative financial instruments of £1,155.2 million was recorded at 31 March 2015 (31 March 2014: £1,032.2 million) including £3.5 million recorded in current liabilities. In addition, the capitalised RPI on fixed rate swaps was transferred from borrowings to derivative financial instruments at 31 March 2015 £282.4million (31 March 2014: £260.6 million) and also the impact of recording debt at amortised cost reduced borrowings by £5.6 million at 31 March 2015 (31 March 2014: £7.1 million).

The effect of removing the deferred bond premium has been to reduce current borrowings by £9.3 million at 31 March 2015 (31 March 2014: £9.3 million) and non-current borrowings by £101.8 million (31 March 2014: £111.1 million).

(iv) Other

Other adjustments arising from the transition relate to goodwill, pensions, deferred tax and revenue.

Under IFRS goodwill is no longer amortised and in the year to 31 March 2015 the value of amortisation was £6.3 million and this has been added back to the value of goodwill at 31 March 2015, and reflected in the operating costs for the year to 31 March 15.

The pension deficit is presented at its gross value, with the associated deferred tax asset of £25.4 million at 31 March 2015 (31 March 2014: £18.1 million) being transferred to offset the deferred tax liability. In 2014–15 finance costs relating to the pension deficit increased by £3.4 million. This change results from the revised presentation of administrative expenses and changes to the calculation for finance costs under IAS 19 'Employee Benefits'. These changes reclassify £2.1 million as operating costs, reducing the finance charge offset by an increase in the finance charge of £5.5 million. The increase in the finance charge of £5.5 million is offset by an equal movement through the statement of other comprehensive income.

As a result of differences in the treatment timing and temporary differences, an adjustment has been made in Southern Water Services accounts to deferred tax for assets that previously qualified for industrial buildings allowance of £23.7 million at 31 March 2015 (31 March 2014: £24.6 million). Further deferred tax has been increased by £257.1 million at March 2015 (31 March 2014: 263.7million) largely following the increase in the fair value of assets in Southern Water Services Limited.

In 2014–15, both revenue and the bad debt provision have been reduced by £13.3 million on the basis that it is probable that economic benefits will not be received from these charges. In addition, a further £3.5 million of income from electricity generation, previously offset within operating costs, has been reclassified as revenue. Fees associated with arranging a new loan facility of £3.7 million which had been expensed have been transferred to current assets to be amortised over the life of the facility.

Notes to the consolidated financial statements (continued)

For the year ended 31 March 2016

34 Explanation of transition to IFRS (continued)

(iv) Other (continued)

In 2014-15 intangible assets of £42.9 million (31 March 2014: £34.0 million) have been presented as a separate item on the statement of financial position. Previously these assets were recorded within property, plant and equipment. Upon transition to IFRS these assets have been identified as meeting the recognition criteria of IAS 38 'Intangible Assets'.

In addition to the adjustment referred to above, another ramification of adopting IAS 39 has meant that fixed rate bond instruments must be carried at amortised cost using the effective interest rate method. As a result debt issue costs previously capitalised and held separately on the statement of financial position are now deducted from the related debt instruments with effective interest being charged to the income statement. Previously these debt issue costs were amortised on a straight-line basis in accordance with the life of the related loan. This has resulted in £1.6 million (31 March 2014: £1.6 million) of long-term debt being reclassified as due within one year.

(v) Cash flow

The changes made to the cash flow statement reflect the presentational impact of the transition adjustments outlined above.

35 Post balance sheet events

Following careful consideration of the options available to the group regarding the opening of the non-household retail market, the group has entered into a transaction to dispose of SWS' non-household retail business function with effect from 1 April 2017. A reasonable estimate of the financial effect cannot currently be made as the terms of the sale are subject to conditions at 31 March 2017.

In addition to the above, one of its major shareholders of Greensands Holdings Limited (GSH), being The Northern Trust Company sold their share in GSH, the ultimate parent company, after the reporting date. The shares were acquired by existing shareholders under the pre-emption arrangements on 19 May 2016.

Independent auditor's report to the members of Greensands Holdings Limited

We have audited the financial statements of Greensands Holdings Limited for the year ended 31 March 2016 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated and Company Statements of Financial Position, the Consolidated and Company Statements of Changes in Equity, the Consolidated Statement of Cash Flows and the related notes 1 to 35. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB).

This report is made solely to the company's members, as a body, in accordance with Article 113A of the Companies (Jersey) Law 1991. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

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

Scope of the audit of the financial statements

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

Opinion on financial statements

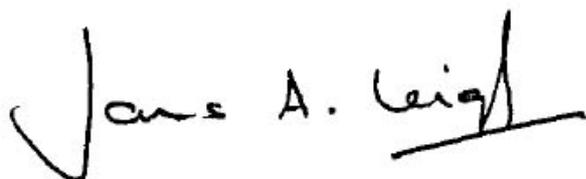
In our opinion the financial statements:

- give a true and fair view of the state of the group's and the company's affairs as at 31 March 2016 and of the group's loss for the year then ended;
- have been properly prepared in accordance with IFRSs as issued by the IASB; and
- have been properly prepared in accordance with the Companies (Jersey) Law 1991.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies (Jersey) Law 1991 requires us to report to you if, in our opinion:

- proper accounting records have not been kept by the parent company, or proper returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations we require for our audit.



James Leigh (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants
London, United Kingdom
29 July 2016