

# Kemble Water Holdings Limited

Annual report and consolidated financial statements

For the year ended 31 March 2016



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## Contents

	Page
Introduction	2
Directors and advisors	3
Chairman's review	4
Strategic report	6
Directors' report	19
Statement of Directors' responsibilities in respect of the annual report and financial statements	22
Independent auditor's report to the members of Kemble Water Holdings Limited	23
Consolidated income statement	24
Consolidated statement of comprehensive income	24
Consolidated statement of financial position	25
Company statement of financial position	26
Consolidated statement of changes in equity	27
Company statement of changes in equity	27
Consolidated statement of cash flows	28
Company statement of cash flows	29
Accounting policies	30
Significant accounting judgements and key sources of estimation uncertainty	40
Notes to the Group financial statements	42
Notes to the Company financial statements	71
Glossary	77

## Introduction

Kemble Water Holdings Limited ("the Company") is the ultimate parent company of the Kemble Water Holdings group of companies ("the Group") The principal activity of the Company is to act as the holding company of the Group and it does not carry out any activities beyond this role

The principal activity of the Group is the appointed supply of water and wastewater services to customers in London, the Thames Valley and surrounding area, delivered entirely through its wholly owned indirect subsidiary, Thames Water Utilities Limited ("TWUL" or "Thames Water"), in accordance with TWUL's Licence of Appointment References to "our" or "we" in this report relates to the activities of the Group including TWUL

In addition, the Group operates the following separately managed businesses

- A property business, which manages the Group's property portfolio and the sale of land and other property that is no longer required by the appointed business, and
- A commercial water retail business, which has been set up mainly to take advantage of the opening of the water industry to competition

As the performance of the Group is dependent largely on its appointed activities, this report makes reference to the performance of TWUL in order to provide appropriate explanation as to the performance of the overall Group

The Group's management structure separates the Directors of the Company, who are all Non-Executives, and have no role to play in the day to day running of the appointed business (although certain matters require the approval of the Company's board having regard to the interests of its shareholders) In addition to their responsibilities to TWUL, the Executive Directors of TWUL also carry out work on behalf of the Group There are controls in place to ensure that the day to day management of the appointed business is separated from the commercial water retail business

Unless otherwise stated, all current year data included in this report is for the year ended 31 March 2016 ("2016")

## Directors and Advisors

### Directors

Sir P Mason KBE – Chairman  
E Beckley  
R Blomfield-Smith  
J Divoky  
R Greenleaf  
G Lambert  
P Noble  
A Osorio  
G Tucker  
C Van Heijningen  
Y Wang

### Registered auditor

KPMG LLP  
Chartered Accountants  
15 Canada Square  
London  
E14 5GL

### Company secretary and registered office

D Hughes  
  
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Vastern Road  
Reading  
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## Chairman's review

We set ourselves ambitious targets for the 2015-2020 regulatory period ("AMP6") and we are really pleased with what we achieved in the first year. We laid solid foundations across the Company, putting us in a strong position to deliver our performance commitments for our customers.

After a comprehensive and competitive process, in August 2015 Bazalgette Tunnel Limited secured a licence to deliver the Thames Tideway Tunnel, a landmark construction project which will transform London and its rivers. The award-winning Thames Water team responsible for the project worked with many stakeholders to overcome significant regulatory, legal, financial and risk management hurdles to get the project ready for the competitive tender process and deliver the best outcome for customers and the environment.

To improve our network and deliver a better service, our capital investment programme in 2015/16 exceeded £1 billion for the 11<sup>th</sup> consecutive year and we plan to invest around £4.5 billion during AMP6. Despite our high level of sustained investment, our customers benefit from the third lowest average annual combined bill in England and Wales at £367. Bills are now expected to remain at the same level, before inflation, until at least 2020, even with the costs associated with the Thames Tideway Tunnel and our massive investment programme.

### The changing industry

The industry is facing significant change. Ahead of the non-household market opening up to competition in April 2017, the spotlight is on our entire business as it gets ready for the biggest structural change in the water industry since privatisation. Thames Water Utilities Limited will transfer its responsibility to serve non-household customers and compete nationally to another dedicated Group company, which will trade as Thames Business Services. The Board has given its full support to pursue this strategy. With less than a year to go, Thames Business Services is on track to be both competitive and fully compliant with the requirements of market opening. Thames Water Utilities Limited will remain the wholesaler providing drinking water and sewage services.

Although we are at the beginning of the second year of this regulatory period, we welcome Ofwat's early engagement on its plans for 2020 and beyond, including Water 2020. There is potential for competition to be introduced in the treatment and disposal of sewage waste from our treatment works. There is also the possibility for greater trading of existing water resources between water companies, involving long-distance transfers, and the introduction of competition in the supply of new water resources, where resource owners can compete with us to sell water directly to retail companies.

We will need to understand what makes a commercial business viable in these markets. This brings with it opportunities to excel and deliver more value for our customers. In the face of significant reform we are remaining focussed on our primary role of providing safe and reliable drinking water and wastewater services with good customer service. The introduction of competition for household customers is under active consideration and in the event that the Government decides to proceed with this proposal, we will work with stakeholders to develop robust plans that will address the considerable challenges that this bold move would present the industry.

Throughout this period of change, it is vital that investor and customer confidence is maintained. Ensuring the value of our business assets, the regulatory capital value ("RCV") as agreed with Ofwat, remains predictable and transparent will allow finances to be raised in the most economical way. This will encourage stable investment, which benefits customers through lower and more stable bills. With this in mind, we welcome Ofwat's commitment to protect the RCV to the end of AMP6, but seek further clarity beyond 2020.

### Review of the year

Once again, it has been a busy year for Thames Water. We mobilised our eight2o and Infrastructure Alliances, launched our new smart meters to households in London and successfully reduced our pollution incidents by 49% in just one year. We also met our leakage target – close to our lowest ever – for the tenth consecutive year, meaning we have reduced leakage by more than a third since 2004, and achieved our main drinking water quality target for the ninth year in a row.

Our Service Incentive Mechanism ("SIM"), the customer service measure set up by Ofwat, improved in the year from 72.6 to 76.7. While this was a strong improvement and more than the industry average increase, we still remain in the lower quartile of the household league table. We are focussing our efforts on securing a further improvement in our performance in 2016/17 and I am pleased to note that in the first two months, performance has continued to improve.

Our 'zero incidents, zero harm, zero compromise' approach to health and safety continues to deliver positive results. In 2015/16 we saw a 28% reduction in 'lost time injuries' following the roll-out of an array of new initiatives, meaning there has now been a 50% reduction in work related injuries and illnesses in the last three years.

28 January 2016 was a historic day for us as the Mayor of London, Boris Johnson, officially commissioned the Lee Tunnel, the UK's first super sewer, to protect the River Lee from 16 million tonnes of raw sewage per year. As London's deepest tunnel, costing nearly £700 million, it was declared 'storm ready' by the Environment Agency in January.

Total Group profit after tax for the financial year has increased from £144.3 million to £470.5 million, driven principally through the following factors

- Revenue growth of 2.2% principally due to allowed annual price increases in conjunction with a slight rise in water consumption attributable to population growth,
- An increase in the sale of property held by the Group,
- Fair value gains on the Group's financial investments, and
- A tax credit of £85.9m principally arising due to a reduction in deferred corporation tax rates from 20% to 18%

Dividend payments received by the Company from TWUL in the year of £82.4 million (2015: £169.9m) have funded either Group external debt service payments or working capital requirements for certain companies within the Group. The Group has not paid a dividend or interest to shareholders in respect of the current year (2015: £100.0m)

In addition to the water, wastewater and other related services provided by TWUL we have continued to focus on and grow the commercial activities outside of TWUL. Total revenues for these businesses have increased from £7.0 million to £7.8 million largely driven by a growth in the commercial services business, which now provides services to over 1,300 sites across Scotland.

### **Future outlook**

The Group's successful performance reflects our people's dedication, hard work and commitment and I thank everyone for their significant contribution.

We have ended the year well positioned to positively engage with the evolving regulatory landscape. With the dynamic shifts in our operating environment and the evolving needs of customers and stakeholders, I expect the upcoming period to be no less challenging. However, I maintain absolute confidence in the Group's ability to thrive in these changing times.



**Sir Peter Mason KBE**  
Chairman

9 June 2016

## Strategic report

The Directors present their strategic report of the Kemble Water Holdings Limited Group for the year ended 31 March 2016

### Business review

#### Principal Activities

The principal activity of the Group is the appointed supply of water and sewerage services through its wholly owned indirect subsidiary, TWUL. The Company's principal activity is to act as the holding company of the Group.

The three main segments to the TWUL business are:

- Retail.** comprising both the household and non-household Operating Companies and provides certain customer-facing activities including billing and revenue collection within the Thames Valley region,
- Water** responsible for all aspects of raw water abstraction and treatment as well as the distribution of high quality drinking water to household and non-household customers, and
- Wastewater** responsible for all aspects of wastewater collection, treatment and safe disposal

Whilst the appointed supply of water and wastewater services provides approximately 98% of the Group's gross revenues, TWUL also manages certain non-appointed activities including:

- property searches, including the provision of information required by property developers,
- sale of gravel and other aggregates extracted through day-to-day operations, and
- treatment of trade effluent and other septic waste

In addition, outside of TWUL, the Group operates a property business to manage and optimise the value of the Group's property portfolio, and a commercial water retail business incorporated to take advantage of the opening of the water industry to competition.

#### Business strategy

The Group's strategy is as follows:

- For the appointed business of TWUL, the aim is to deliver safe reliable services for customers while ensuring reasonable returns for shareholders. This means keeping customers' bills as low as possible whilst investing efficiently in assets to ensure its customers' needs are met now and in the future. From a shareholder perspective, this means meeting and outperforming our regulatory outputs and financial settlement to provide the returns they require and expect.
- Outside of the appointed business, the Group continues to provide property search services to conveyancers and homebuyers. The Group also retains a property services arm which focuses on the development and enhancement of the value of land and sites that are no longer required for the appointed business, including disposal to third parties.
- The Group participates in the wider business retail market through Thames Water Commercial Services Ltd ("TWCSL") which acquired retail licenses for England, Wales and Scotland.

## Principal risks and uncertainties

As the Group's principal activity is the delivery of appointed water and wastewater services, the risks of the Group are largely the same as with those of the main subsidiary entity, TWUL

Managing the risks that could prevent the achievement of TWUL's objectives is a core element of day to day business activities. This is undertaken using a practical and flexible framework which provides a consistent and sustained approach to risk evaluation. TWUL's approach reflects its status as a regulated utility providing essential services and operating as part of the Critical National Infrastructure for the UK.

### The risk management framework

Under the framework, responsibility for effectiveness of the Group's risk management policy sits with the KWH Board, with oversight on behalf of the Board performed by the Group Audit Committee ("GAC")

The principal, key corporate risks are reported to the Board each month

### Approach to risk management

The systems of internal control and risk management are designed to manage, rather than eliminate, the risk of failure to meet business objectives and can only provide reasonable, not absolute, assurance against material misstatement or loss.

Risk owners throughout the business identify and assess risks and carry out risk mitigation actions. In doing so, they are supported and challenged by the R&CC. As part of a continuous improvement approach, this year the levels of integration and performance in the enterprise risk management processes have been enhanced. This includes implementation of a corporate risk management tool, a new risk and controls policy and revised processes. The risk management process covers strategic, legal and regulatory, financial and operational risks, all linked to the corporate objectives. Assessment of risk considers the likelihood of the risk materialising and the potential impact it might have. This enables implementation of effective controls to manage risks and consider further mitigation plans where necessary. The Group's risk management approach considers risks arising in all parts of the business using both a bottom up and top down approach.

As the Group's performance is largely dependent upon the appointed business within TWUL the following risk assessments are largely an extract from the business review contained within the TWUL annual report and financial statements.

### Legal and Regulatory Environment

Risk description	Risk impact	What we are doing to manage the risk
<p>Failure to adapt to changes in the regulatory landscape due to the introduction of competition</p>	<p>The Water Act (2014) will enable non-household customers to choose their retail provider for water and sewerage services in England from April 2017. To facilitate the new market, Ofwat has set separate price controls for retail and wholesale activities.</p> <p>If TWUL fails to make adequate preparations to operate in the new marketplace it could face challenges which could lead to a financial penalty and reputational damage.</p>	<p>Compliance with regulatory obligations and competition law remain key areas of focus and TWUL is working closely with Ofwat and the Market Operator Services Limited (MOSL) to prepare the business for these changes.</p> <p>TWUL has a business transformation programme in place that is intended to meet all open market requirements on 1 April 2017.</p> <p>As part of the market readiness programme TWUL is required to submit 'Assurance Letters' to the Regulator at specified intervals between now and market opening in April 2017. An Assurance Plan has been developed that includes external assurance and the first letter was submitted in February 2016.</p>



Risk description	Risk impact	What we are doing to manage the risk
Failure to comply with key regulation and legislation	TWUL is a highly regulated business with defined requirements from three main regulators Ofwat, the Environment Agency and the Drinking Water Inspectorate as well as legal obligations Any non-compliance with applicable laws and regulations could result in prosecution, financial penalties and fines, or in a worst case scenario loss of the Company's operating licence	The Group has a clear understanding of regulatory and key legal obligations Compliance with legislation is monitored through internal audit and assurance programmes Legislative compliance also features strongly in the annual control self-certification process

**Customer Service**

Risk description	Risk impact	What we are doing to manage the risk
Failure to improve and maintain service levels	<p>Customers and stakeholders will become dissatisfied if TWUL is unable to deliver the level of service expected</p> <p>In the period 2015-2020 Outcome Delivery Incentives ("ODIs") have been introduced Performance is linked to financial penalty or reward in some cases</p> <p>Some of the largest potential penalties TWUL may incur are attached to the service incentive mechanism ("SIM"), used by Ofwat to assess the Company's relative customer service performance Other key areas of focus are leakage, supply interruptions or incidences of low pressure caused by a lack of asset or system resilience, sewer flooding and sewage treatment works compliance</p>	<p>Focus in 2015/16 has been on improving interaction with customers and resolving issues as quickly as possible This has yielded positive results in 2015/16 but TWUL recognises that it has more to do to meet stakeholders' increasing expectations</p> <p>The Group manages incidents and events that do arise through Executive led response teams to minimise the impact to customers and to the environment</p>

**Operations, assets and people**

Risk description	Risk impact	What we are doing to manage the risk
Loss of data or interruptions to key business systems	<p>The volume and complexity of cyber security threats are increasing and constantly evolving The Group takes security seriously and considers it a high priority to protect the systems used to hold and process data</p> <p>Loss or misuse of data could result in breaches of legislation, including, but not limited to, data protection legislation or the payment card industry data security standards (PCI-DSS) standards, which could have an adverse impact on operational assets, and/or lead to significant fines and damage to the reputation of the Group</p>	The Group has used industry experts to review the level of maturity in this area and to benchmark the security framework The Company has developed a Cyber Security Improvement Programme designed to improve the IT and physical security controls and established a Thames Water Security Board chaired by the Chief Executive

Risk description	Risk impact	What we are doing to manage the risk
<p>Inability to economically and efficiently deliver services and capital projects through alliance partnerships</p>	<p>TWUL has a capital investment programme of £4.5 billion to deliver between 2015 and 2020. Failure to deliver the capital programme to time, cost and quality measures could result in us failing to achieve operating performance efficiency and cost benefits as well as increased delivery costs or a failure to meet obligations.</p>	<p>TWUL has established alliance partnerships with market leading organisations to provide a collaborative approach to proactively manage delivery, mitigate risk and achieve business benefit across services.</p> <p>The business is focused on delivering a range of projects that should reduce totex on a sustainable basis.</p>
<p>Inability to provide water or treat waste due to failure of key assets and/or processes</p>	<p>The provision of safe and reliable water and wastewater services are essential to maintain public health and protect the environment.</p> <p>A failure at one of TWUL's major assets could significantly impact the safety of the workforce and the public, as well as interrupting supply to customers and breaching environmental and regulatory targets.</p> <p>Within the PR14 Final Determination the waste infrastructure below ground assets were classified as deteriorating.</p> <p>Ofwat could make financial adjustments at PR19 if corrective actions do not restore service to the required reference levels for each of their serviceability measures.</p>	<p>The business plan for 2015-2020 includes an investment programme aimed at maintaining/improving the resilience of the network and operational sites in order to reduce the risk of failure and incidents.</p>
<p>The environments in which the Company operates, and the work it undertakes, exposes the workforce, business partners and the community to hazards that could harm their health, safety and wellbeing.</p>	<p>The health, safety and wellbeing of employees, partners, and the public are the priority. The Group has a zero tolerance approach: zero harm, zero incidents and zero compromise.</p> <p>Failure to comply with company policies and procedures could result in serious injury or loss of life which would have tragic implications for individuals and their families and communities.</p> <p>This could also result in prosecution under the Health &amp; Safety at Work Act and/or the Corporate Manslaughter Act.</p>	<p>The Group has developed a strong safety culture, with a clearly defined strategy, safety protocols and standards that are set, monitored and reported to the Board and the Executive.</p> <p>The Group works closely with partners and suppliers to ensure it operates in a safe environment and continues to introduce initiatives based on emerging risk areas to reinforce the Group's ambition of zero harm, zero incidents and zero compromise.</p> <p>Some of the initiatives TWUL has introduced in 2015/16 include:</p> <ul style="list-style-type: none"> <li>• implementation of the AMP6 health and safety engagement strategy across the supply chain,</li> <li>• the introduction of the Institute of Occupational Health managing safety course for all supervisors,</li> <li>• a revised drug and alcohol policy, mobile phone use policy, personal protective equipment standards implemented across Thames Water and contractors, and</li> <li>• the introduction of animated incident learning to provide a visual understanding of incidents and what's being done differently.</li> </ul>

**Financing the business**

Risk description	Risk impact	What we are doing to manage the risk
<p>Inability to finance the Group and maintain target credit ratings</p> <p>The Group is required to comply with various financial ratios</p>	<p>TWUL has a debt funding requirement of c £3.5 billion in AMP6 (2015 - 2020)</p> <p>Changes in interest rates, or the lack of available credit, or a fall in credit ratings could put at risk the Group's ability to efficiently finance the investment programme, or finance debt maturities when they become due</p> <p>An increase in the cost of funding may put pressure on key financial covenants and potentially lead to restricted dividend payments</p> <p>Poor operational/financial performance could lead to a downgrade in ratings</p>	<p>The Group's capital structure and ability to source debt funding is underpinned by a focus on the maintenance of strong investment grade credit ratings. The funding strategy is resilient and approved by the Board annually.</p> <p>This Group is funded predominantly by debt in the form of long-term bonds and loans, predominantly in fixed or inflation-linked form, diversified by source and maturity.</p> <p>Focus is on maintaining stable credit ratings and a strong liquidity and cash position.</p>
<p>Inflation rates</p>	<p>Water companies earn a return on their Regulatory Capital Value ("RCV"), which is adjusted by the Retail Price Index ("RPI"). In times of low inflation or deflation, the return on this investment will decrease relative to the cost of funding, reducing cash flow and shareholder value.</p> <p>Falling inflation or deflation could lead to pressure on covenants due to reduced headroom between RCV and the financing structures in place especially for instruments which are not linked to RPI.</p>	<p>In order to reduce the impact of low inflation or deflation, around half of TWUL's debt is linked to RPI.</p> <p>TWUL maintains headroom versus key financial covenants in order to manage such risk. The Company forecasts covenant headroom to the end of the regulatory period on a monthly basis.</p>
<p>Increased cost of pension commitments</p>	<p>Changing demographics and fluctuations in investment markets affect funding requirements for pension commitments. The net deficit on the defined benefit schemes as at 31 March 2016 was £253.9 million – the 2016 valuation is underway.</p>	<p>In recent years TWUL has reduced benefits available and kept the affordability of pension schemes under review. It has agreed a pensions strategy aimed at fully reducing the pensions deficit by 2025 and containing future pension costs. The strategy and associated mitigating action plans will be monitored on an ongoing basis and investment performance will be kept under review to ensure the schemes are managed effectively and remain sustainable.</p>
<p>Increasing levels of bad debt which cannot be recovered. The law prohibits the disconnection of a water supply from certain premises including domestic dwellings as a method of enforcing payment.</p>	<p>Rising customer debt levels continue to be an issue for TWUL. TWUL's area covers London and the Thames Valley where the proportion of people in rented accommodation is higher than other parts of the UK. This, the Company believes, increases revenue loss due to non-payment of debt, as people move property more frequently leaving debt behind, which places an additional burden on those who do pay.</p> <p>The bad debt as a percentage of regulated revenue for 2015/16 is 3.2% (2014/15 3.6%).</p> <p>Failure to adequately manage cash collection processes has a detrimental impact on TWUL's results.</p>	<p>TWUL is transforming its credit management arrangements. TWUL has:</p> <ul style="list-style-type: none"> <li>• invested in a new debt management system,</li> <li>• improved the quality of data and established new data sources,</li> <li>• invested in staff training. This has led to better identification of, and support for, those customers who want to pay the bills but find they are unable to do so, and</li> <li>• put in place a new strategy for collection through debt collection agencies and increased litigation where necessary.</li> </ul> <p>TWUL is implementing a new customer relationship management and billing system.</p>

## Financial performance

We have seen a solid start to this AMP6 regulatory period and are in a strong financial position to support the delivery of our performance commitments for our customers

Our three major alliances, which have been set up as part of our cross company transformation programme, provide a platform for us to streamline our business and drive cost savings. For every £1 less than the totex allowance set by Ofwat in our Final Determination ("FD") that we spend because of efficiency, 50 pence is returned back to the customer. Our totex spend for 2015/16 was £31 million below the FD level, and we are on track to deliver efficiencies which will benefit customers in the form of lower bills in future years.

We have invested more than £1 billion, for the 11th year in a row, into our business, to enhance our resilience and deliver major capital projects. These include the Deephams sewage treatment works upgrade, the Lee Tunnel and development works for the Thames Tideway Tunnel before Bazalgette Tunnel Limited ("BTL") took over responsibility for delivery. As 2015/16 was a year of significant change for TWUL, and given uncertainty relating to the Thames Tideway Tunnel (now resolved by appointment of BTL to deliver) the KWH Board agreed that no external dividends would be paid in respect of 2015/16.

To support our capital investment programme, we have maintained a robust balance sheet, a prudent level of gearing and stable credit ratings. This allows us to raise capital more cost effectively and provides us with greater ability to access the debt markets.

In the interest of being transparent about our finances we have published, in October 2015, an update to 'Our Finances Explained' on our website.

### Financial key financial indicators (KPIs)

	2016 £m	2015 £m
Group revenue	2,046.8	2,002.2
Group operating expenses	1,456.1	1,433.2
Net finance expenses	351.5	366.5
Profit before tax	384.6	39.0
Capital expenditure excluding intangibles	1,198.8	1,369.2
Net debt	11,171.5	10,639.5
Dividends payable	-	63.1

#### Group revenue

Group revenue for the year has increased by 2.2% to £2,046.8 million. This is as a result of inflation, a marginal increase in domestic consumption from population growth and the re-profiling of revenue from later years of AMP6 into the year ended 31 March 2016 to avoid volatility in bills.

Revenue is shown after a deduction of £37.7 million, which is 1.8% of revenue (2015: £36.6m, 1.8%) relating to amounts billed in the year and now considered to be irrecoverable from our customers.

#### Group operating expenses

Group operating expenses have increased by 1.6% from the previous year, which is at a lower rate than the growth in revenue. This demonstrates the positive effect of our cost control measures, which have led to operational efficiencies.

After adjusting for the one-off £10.0 million pension curtailment gain reflected in the prior year results, employment costs have increased by £2.8 million to £242.7 million. This is primarily as a result of the increase in front line staff to improve customer service, with our average staff numbers rising by 5.1% from the previous year.

A reduction of £10.5 million in bad debt costs recognised within operating expenses has primarily resulted from improved household cash collection rates as we implement a new debt management system and transform our cash collection processes.

Maintenance and running costs for our waste and water businesses have risen by £18 million as we strive to take a more proactive approach to network maintenance, reduce response times when issues arise and improve customer service.

#### Group net finance expense

The business is funded, partly through external borrowing in the form of public and private bonds issued in the debt capital markets and bank loans from relationship banks. We are required to pay interest on any amounts that we borrow. The Group's net interest payable, excluding the effect of capitalised interest costs of £114.4 million (2015: £86.4m) has increased by £13.0 million (2.9%) from the previous

year as a result of new borrowings undertaken in the year. Our strong credit rating means that we continue to obtain financing at favourable interest rates.

The Group has approximately £977.9 million of derivative financial instruments (face value), which include £219.4 million of forward starting interest rate swaps that have fixed a significant element of the cost of debt that we expect to borrow between 2016 and 2020. During the year a fair value gain of £22.7 million was recorded, compared to a fair value loss of £246.9 million in the previous year, driven by lower forecast RPI (inflation) rates.

#### Profit before tax

A summary of the movement in profit before tax has been provided below.

	<b>2016</b>
	<b>£m</b>
Profit before tax for the year ended 31 March 2015	<b>39.0</b>
Increase in revenue	<b>44.6</b>
Increase in operating expenditure	<b>(22.9)</b>
Increase in profit on sale of property, plant and equipment	<b>32.1</b>
Increase in other operating income	<b>7.2</b>
Decrease in net interest payable	<b>15.0</b>
Movement in fair value gain on financial instruments	<b>269.6</b>
<b>Profit before tax for the year ended 31 March 2016</b>	<b>384.6</b>

#### Capital expenditure

We continue to invest heavily in improving and maintaining our network and infrastructure to ensure that our customers always have a safe and reliable service. Capital expenditure for the year totalled £1,198.8 million (2015: £1,369.2m), which included progress on key projects as follows:

	<b>2016</b>
	<b>£m</b>
Thames Tideway Tunnel – development and interface works	<b>128.4</b>
Lee Tunnel – commissioned in 2016	<b>80.9</b>
Deephams Sewage Treatment Works upgrade	<b>68.6</b>
Our new Customer relationship management and billing (“CRMB”) system	<b>22.4</b>
Counters Creek – West London sewer flooding alleviation scheme	<b>15.7</b>

Spend on the Thames Tideway Tunnel represents development costs, including acquiring land and engineering costs, incurred prior to the appointment of Bazalgette Tunnel Limited in August 2015. Subsequent to this, our costs will be limited to the cost of work required to connect our network to the tunnel and land acquisition costs. Capital expenditure relating to the Thames Tideway Tunnel has reduced by £201.3 million compared to the previous year.

#### Net debt and cash flow

Net debt, the total of external borrowings less cash at bank and in hand, has increased by £532.0 million. This is largely due to increased borrowings required to fund our extensive capital investment programme. The cash balance has remained stable year-on-year and the decrease in cash generated by operating activities has been largely offset by a reduction in capital expenditure.

#### Dividends

The Company has £1,991.6 million of share capital and in addition to this the shareholders own, in direct proportion to their shareholdings, £310.4 million of bonds issued by the Company’s immediate subsidiary, Kemble Water Eurobond Plc. The Group considers these bonds as part of the shareholder’s investment in the Group and the interest on these bonds takes priority over the payment of a dividend by the Company.

TWUL has paid dividends in the year of £82.4 million (2015: £169.9m) which has been used by companies within the Group to either fund working capital requirements or for the payment of interest on external borrowings. The Group has paid dividends totalling £1.5 million (2015: £61.6m) in the year, all of which were declared in the previous year. The Board of Directors have not declared any interim dividends in the year and do not recommend the payment of a final dividend. Consequently the shareholders of the Group have not received any distributions for amounts relating to the current year (2015: £100.0m, comprising dividend payments made by Kemble Water Holdings Limited of £63.1m and interest payments made by Kemble Water Eurobond plc of £36.9m).

## **Pension**

The Group is the sponsoring employer to three material pension schemes, for which the triennial actuarial valuations (dated 31 March 2013) have been updated for this year end on behalf of the Group by independent and professionally qualified consulting actuaries PricewaterhouseCoopers LLP. This valuation shows that the net pension liability, representing the net surplus and deficits of all schemes to which the Group is a sponsoring employer, decreased to £253.9 million (2015: £348.2 million) in the year ended 31 March 2016. This reduction has been primarily caused by the use of a higher discount rate in the actuarial calculation, driven by higher yields on AA-rated corporate bonds, which is consistent with other companies that operate a defined benefit scheme.

There is a recovery plan in place, as agreed between the Directors of the individual sponsoring companies within the Group and Scheme Trustees, to restore each scheme to a fully funded position. The March 2013 actuarial valuation has committed the Group to making additional contributions to the two schemes operated by TWUL on an annual basis. These additional amounts, calculated by a qualified and independent actuary working on behalf of the Scheme Trustees, are intended to restore the funding level of the two schemes by 2020 and 2025 respectively. Recovery payments under this plan have averaged £20 million per year across the two schemes.

The updated triennial valuation, dated 31 March 2016, is expected to be finalised by the scheme actuary in June 2017. This valuation will include an updated funding recovery plan which will be agreed between the Scheme Trustees and the TWUL Company Directors. The Group intends to work closely with the Scheme Trustees throughout this process and remain committed to maintaining a strong and viable pension scheme for active members.

## **Taxation**

This year, the Group has paid around £160 million in taxes, including central and local government business rates, PAYE and national insurance.

Our capital investment of over £1 billion per year has resulted in capital allowances, which delay our corporation tax payments. Similar to previous years, this means we have not paid any corporation tax during the year. The capital allowances regime means that our customer bills are £12 lower than they would otherwise be and remain the third lowest combined bill in the UK. The capital allowance scheme has benefits for the wider economy by promoting investment in infrastructure.

The UK corporation tax rate is due to fall from 20% to 18% from 1 April 2020, which has had the effect of reducing the Company's deferred tax liabilities in the income statement by £118.7 million. This represents a reduction in the level of corporation tax payable in future years and therefore does not constitute a refund from HMRC. Ultimately this will benefit our customers in the form of lower bills in future years.

## **Relationship with Bazalgette Tunnel Limited ("BTL")**

From 2016/17, TWUL will begin to collect revenue on behalf of BTL. As the cash is collected, we will pass it over to BTL. This non-appointed revenue will be excluded from our key performance indicators, which is consistent with our banking covenants.

The cash collected and paid over to BTL during the period of construction will represent a prepayment for the use of the tunnel once the project is complete. As a result of this unique arrangement and the resultant accounting treatment, Group's revenue will increase and during the construction of the Tunnel there will be no associated costs reflected in the Group's income statement. This will increase the Group's profits during the construction phase (2016-2022) but such profits will not be supported by cash.

The Directors will ensure that the underlying results of the Group reported are not distorted by the accounting arrangements.

## **Adoption of new accounting standards**

These financial statements are our first full-year set of financial statements prepared in accordance with European Union ("EU") International Financial Reporting Standards ("IFRS"). Details of how the transition to IFRS has affected our financial statements, which were previously reported under UK GAAP (UK Generally Accepted Accounting Practice), are shown in notes 31 and 37 to the financial statements.

## Financing and financial risk management

The Group's operations expose it to a variety of financial risks. Treasury activities are managed internally by the Group's treasury function with financial risks managed within a framework agreed annually by the Board.

### Debt financing

A summary of the Group's net debt by the different types of debt is as follows:

	2016 £m	2015 £m
Securitised Class A debt	8,836.7	8,546.8
Securitised Class B debt	1,086.6	946.6
Subordinated debt	818.1	736.5
Net debt (covenant basis)	10,741.4	10,229.9
Shareholder loans	310.4	310.4
Other	119.7	99.2
<b>Kemble Water Holdings Group net debt</b>	<b>11,171.5</b>	<b>10,639.5</b>

Other net debt items include the following:

- cash held in companies that are excluded from covenant calculations,
- amortised debt fees that are excluded from the covenant calculation definitions, and
- fair value adjustments made to the Thames Water Group's borrowings on acquisition by the Kemble Water consortium.

TWUL, as the principal trading subsidiary of the Group, is the entity that generates substantially all of the cash needed by the Group to service borrowings made against the Regulatory Capital Value ("RCV"). For the debt held outside the securitised group, TWUL's dividends are passed up the Group structure to provide funding for debt held at the Group level.

Within the securitised group, TWUL is an obligor, underwriting all the securitised debt which at 31 March 2016 was £10.7 billion (2015: £10.2 billion). In addition to the debt TWUL holds directly, TWUL also, through the on-lending arrangements for borrowings in its subsidiaries, services the debt held in those companies.

Subordinated debt is issued outside of the securitised group. The Group has adequate cash and available facilities outside of TWUL to enable it to service the debt for at least twelve months from the date of these financial statements.

### Credit rating

The principal trading company of the Group, TWUL, maintains investment grade credit ratings as assigned by the rating agencies Moody's and Standard & Poor's ("S&P"). The ongoing assessment of these two rating agencies provides an external valuation of performance and prospects.

In February 2016, Moody's affirmed the Baa1 rating of TWUL and maintained the outlook for its credit rating as stable, citing the low business risk profile of Thames Water and the relatively stable and predictable cash flows generated under a well-established and transparent regulatory framework as drivers behind the rating. Whilst TWUL is protected from the main construction risk of the Thames Tideway Tunnel – a credit positive, Moody's continues to recognise that TWUL is exposed to reputational and financial challenges associated with the Thames Tideway Tunnel project.

In their most recent credit opinion in September 2015, S&P assigned ratings of A- (Class A) and BBB (Class B) and maintained a negative outlook. S&P has recognised a number of positive developments since 2014, particularly in relation to mitigating the risk associated with the Thames Tideway Tunnel project, but has concerns over infrastructure serviceability, customer service and the level of bad debt expense. These are areas on which we continue to focus, and whilst we have seen improvements during the year, we are committed to delivering further improvements over the course of AMP6.

Moody's rating for the KWF company debt remains at B1 (Stable) and Fitch at BB- (Stable).

### Covenant compliance

The money we collect from customer bills does not quite cover the amount we spend on maintaining and improving our network each year. We supplement this with external finance (debt) from banks, pension funds, insurance companies and other entities – all of which are independent of our shareholders. Our gearing ratio, which is the consolidated net debt to Regulatory Capital Value ("RCV") ratio, has

increased at Kemble Water Finance Limited (the company in the Group where all external Group debt is consolidated) from 86.3% to 87.6% as a result of increased borrowing during the year to fund our investment programme

Kemble Water Finance Limited has entered into guaranteed consolidated debt obligations with its creditors, it is required to maintain certain ratios within certain financial limits. During the year ended 31 March 2016, our gearing of 87.6% was well below our mandated maximum of 92.5%. Our interest cover (the ratio of our profits to interest payable) at 1.6x was well above the minimum level mandated of 1.05x.

### **Funding and treasury policy**

The funding policy is to maintain a broad portfolio of debt (diversified by source and maturity in order to protect the Group against risks arising from adverse movements in interest rates) and to maintain sufficient liquidity to fund the operations of the business for a minimum of a 15-month forward period on an on-going basis. Derivative financial instruments are used to an extent to manage interest rate risk, inflation risk and foreign exchange risk. All funding and treasury transactions are undertaken and managed by the central treasury function.

Financial derivatives used include cross currency swaps and interest rate swaps that are used solely to manage risks associated with our normal business activities. The treasury function is managed as a cost centre, not a profit centre. No material open or speculative positions are taken and the operation of the treasury function is governed by specific company policies and procedures that set out specific guidelines for the management of liquidity, credit and market risks associated with the financing activities of the Group.

Treasury policy and procedures are incorporated within the financial control procedures of the Group. The key objectives of the funding strategy are to retain our investment grade credit rating, provide liquidity for our ongoing obligations and keep customer bills low. The Board reviews the Group's exposure to these risks and actively oversees the treasury activities, reviewing treasury policy and approving the treasury strategy and funding plan on an annual basis.

### **Market risk**

Market risk is the risk that changes in market variables, such as inflation, foreign currency rates and interest rates, will affect the Group's income or the value of its holdings in financial instruments.

Debt issued by the Group includes RPI linked loans and these instruments are exposed to movements in the RPI index. The principal operating company of the Group, TWUL, is an appointed water and wastewater company with RPI linked revenues. Therefore the Group's index linked borrowings form a partial economic hedge as the assets and liabilities partially offset each other. The Group also uses derivatives to manage inflation risk on non-index linked borrowings.

The Group's foreign currency risk exposure results from debt raised in currencies other than Sterling. The Group uses currency swaps to hedge the foreign currency exposure of bonds issued in a foreign currency. All hedges are undertaken for commercial reasons with the objective of minimising the impact of exchange rate fluctuations on net assets and profits. The Group has no material unhedged monetary assets and liabilities denominated in a currency different from the local currency of the Group.

Interest rate risk arises on interest-bearing financial instruments. Floating rate borrowings are exposed to a risk of change in interest cash flows due to changes in interest rates. The Group uses interest rate swaps which economically hedge future cash flows, protecting against interest rate movements.

In mid-2014 the principal operating company of the Group, TWUL, executed £2.25 billion of forward-starting pay fixed/receive floating interest rate swaps of a five to seven year maturity with various financial institutions to fix the future interest costs of an element of the anticipated new debt issuance in AMP6. This protects the Company against adverse movements in underlying interest rates by matching projected future debt issuance against a derivative instrument with a fixed cash flow. Derivatives are revalued to fair value at the end of each reporting period.

### **Credit risk**

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's trade receivables, short-term investments and cash flows receivable from counterparties to the derivative financial instruments.

Under the terms of the whole business securitisation agreement, counterparties to the Company's short term investments and derivative transactions have to meet minimum credit rating criteria as assigned by both Moody's and S&P. In respect of the derivative counterparties there is also a mechanism for the counterparty to post collateral when amounts due to the Company under outstanding derivative contracts exceed a contractually agreed threshold amount or the counterparty fails to meet the necessary credit rating criteria.

TWUL has a statutory obligation to provide water and sewerage services to customers within its region. Due to the large area served by the Company and the significant number of household and business customers within this area, there is considered to be no concentration of trade receivables credit risk, however, TWUL's credit control policies and procedures are in place to minimise the risk of bad debt arising from its trade receivables.



### **Liquidity risk**

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group manages long-term liquidity by maintaining continuity of funding through access to different market and debt instruments, raising funds in the capital markets and ensuring that diverse debt maturity profiles are maintained. The Group also maintains a level of committed liquidity facilities provided by a range of financial institutions.

### **Actuarial Risk Management**

The defined benefit schemes are exposed to actuarial risks including investment risk, inflation risk and longevity risk.

The trustees of the pension schemes have taken a number of steps to control the level of investment risk within the schemes over the last year, including reducing the schemes' exposures to higher risk assets and increasing the level of protection against adverse movements in interest rates and inflation. The trustees of these schemes continue to review the risk exposures in light of the longer term objectives of the respective schemes.

### **Viability statement**

The Directors have assessed the viability of the Group over a three year period to 31 March 2019. In making this assessment, the Directors have considered the current position of the Group, its ability to effectively and efficiently manage its finances, the current regulatory regime, its continued access to the debt markets, and ability to maintain a strong investment grade credit rating, whilst having regard to the principal risks and uncertainties as described on pages 7 to 10.

As part of the Group's recurring price review process, five year Company Business Plans ("CBPs") are developed, the latest of which covers the five year period ending 31 March 2020. As part of the Group's financial resilience assessment, management has designed a number of 'stress tests' which subject the Group's existing model, that underlies the Group's planning processes, to a number of different scenarios and tests its sensitivity to these. The stress tests consider factors where the likelihood of them occurring, either individually or in combination, is less than remote. These include:

- Fluctuations in interest rates
- Fluctuations in inflation rates
- Increase in operating expenditure
- Inability to secure new finance and/or delays in raising finance
- Unforeseen maintenance and capital expenditure

Management have prepared a detailed methodology statement that sets out the approach taken to assessing the long-term viability of the Group, details the variables tested and considered their effect on the financial covenants of the Group. Taking account of the range of scenarios, the Directors believe that the Group has sufficient mitigating actions available to it to address the particular circumstances and events identified, should they arise.

The Directors consider that a three year period is reasonable given the nature of the industry in which the Group operates and to more closely align with the regulatory planning process given the changes in the regulatory framework that are being proposed. Taking into account the Group's current position and its principal risks, the directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the next three years.

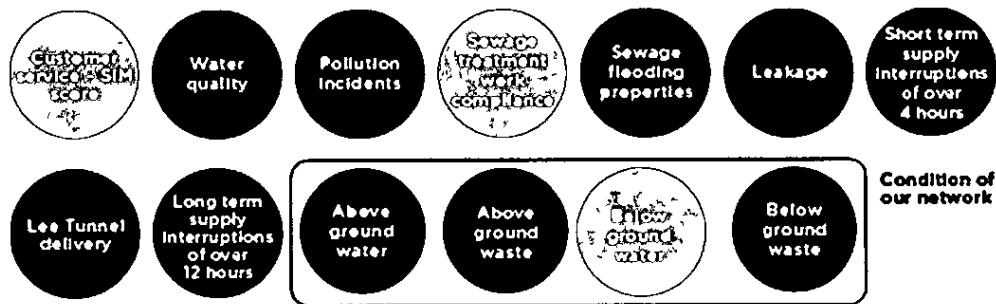
## Annual Performance Review - Summary

We worked closely with our customers to set 55 ambitious performance commitments for the 2015-2020 AMP6 regulatory period across our business areas - water, waste and retail - and for the Thames Tideway Tunnel. These commitments are designed to deliver what is important to our customers in the most cost effective way.

This report provides a summary of our performance against these targets, highlighting those that our customers have said they value most and those which we feel best reflect our performance in the year. The summary dashboard below gives an overview of these metrics, which is then assigned a red, amber or green rating to show how we have performed in the year against the relevant target.

The ratings definitions can be summarised as follows:

- Green** ● Performance at or above our Committed Performance Level ("CPL")
- Amber** ○ Performance within the range allowed, without a penalty (the "deadband") if defined, or within 5% of our CPL, or where asset health is assessed as marginal
- Red** ● Performance below the deadband (if defined) or more than 5% below our CPL, or where asset health is assessed as deteriorating



A detailed review of our performance against each of these metrics has been provided within our Annual Performance Report which has been published on our website. The commentary provided in the remainder of this report represents an overview of the key messages contained within the Annual Performance Report.

### Overview

Once again, it has been a busy year for Thames Water. To minimise the costs for our customers, we ran a comprehensive and competitive process to identify the best company to deliver the Thames Tideway Tunnel. This resulted in Bazalgette Tunnel Limited ("BTL") securing a licence in August 2015 to deliver the Thames Tideway Tunnel, a landmark construction project which will transform London and its rivers. The award-winning Thames Water team responsible for the project worked with many stakeholders to overcome significant hurdles and deliver the best outcome for our customers and the environment.

We launched our new smart meter programme to households in London. This will enable our customers to track their water usage and pay for what they use. We have successfully reduced our pollution incidents by 49% in just one year reflecting our commitment to reducing our environmental impact. We also met our leakage target, close to our lowest ever, for the tenth consecutive year, meaning we have reduced leakage by a third since 2004, and achieved our main drinking water quality target for the ninth year in a row.

For some performance commitments, where we exceed the performance levels, we are able to earn Outcome Delivery Incentive ("ODI") financial rewards but we will also incur penalties for underperformance. These reward and penalty mechanisms were set in consultation with our customers with both rewards and penalties affecting revenues in future AMPs. In 2015/16 we outperformed our target for water supply interruptions of over 4 hours, earning an ODI reward of £3.1 million. Due to three significant bursts, we didn't meet our target for customers without water for over 12 hours, and incurred a penalty of £4.7 million. We also received a penalty of £11.7 million for sewer flooding.

Our internal control procedures identified a problem with the way we had been recording sewer flooding leading to a higher than expected level of sewer flooding in 2015/16. We have put in place a plan to improve our performance and bring it back to the performance commitment level.

We have investigated and confirmed the number of additional sewer flooding incidents in AMP5, over and above those originally reported, and we are ensuring that all affected customers have been compensated. The impact for AMP5 is an increase in the regulatory penalty of £10 million, which reduces the level of revenue we can charge in future years. We are working hard to exceed the targets our customers have set us, to earn our rewards and avoid further penalties in the future.

We made significant progress in improving our customer satisfaction score received from customers in 2015/16. It increased from 4.18 to 4.44 in our water business, from 4.36 to 4.50 in our wastewater business and from 4.17 to 4.22 in the retail business. As a consequence our Service Incentive Mechanism ("SIM") score, which is monitored by Ofwat, has increased from 72.6 to 76.7 out of 100 in 2015/16. Despite the improvement, there is still more to do as we remain behind many of our fellow water companies, which have also kept moving forward.

Providing an exceptional product – clean and safe drinking water – is fundamental to our business and our customers continue to benefit from some of the highest quality water, both within the UK and globally. In 2015/16 we outperformed our key drinking water target set by the drinking water inspectorate ("DWI"). To ensure we provide a consistently high quality product to our customers we perform more than 400,000 water quality tests on water samples each year, an average of more than 1,000 per day.

We exceeded our target for customers without water for more than 12 hours and therefore our asset health is assessed as marginal. A major factor contributing to this was significant bursts in Enfield, Flaxlands (Swindon) and Slough. To minimise the impact of significant bursts in the future we have taken steps to improve our network monitoring systems and response to emergencies.

Our performance in reducing water supply interruptions of more than 4 hours was strong, beating our target and earning an ODI reward of £3.1 million. We achieved this by optimising pressures throughout our water network to reduce bursts and replacing old mains, targeting those that are most likely to leak or burst to reduce future disruption and inconvenience to our customers. We have replaced 1,700 miles of pipes since 2004.

We outperformed our leakage target for the tenth year in a row. Despite some significant challenges, we achieved an average leakage level for the year of 642.460 MI/d (committed performance level of 649 MI/d).

Although we have achieved a year-on-year reduction in the level of energy we take from the grid (energy imported less energy exported) for our water business, it was still slightly higher than our performance commitment target. We achieved a net 12 GW/h reduction, but we missed the target by 1%. This was mainly due to treating and pumping more water to meet demand for population growth that was much higher than expected.

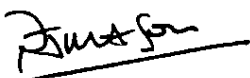
We remain committed to reducing our energy consumption and meeting our commitments in future years. Our plans include the continued upgrade, replacement and optimisation of our pumps, providing and transporting water in less energy intensive ways and increasing our on-site renewable energy generation. In 2016 Europe's largest floating solar panel array was installed on our Queen Elizabeth II reservoir which enables us to part power our Hampton water treatment works using solar power.

Greenhouse gas emissions from our water business were 284.8 kT CO<sub>2</sub>e (2015: 266.2 kT CO<sub>2</sub>e) and from our wastewater business were 468.5 kT CO<sub>2</sub>e (2015: 402.0 kT CO<sub>2</sub>e). As emissions from electricity make up 88% of our total greenhouse gas emissions, the best way for us to reduce emissions in our water business is by reducing grid electricity consumption. This performance commitment is directly linked to our level of net energy imported, so is affected by the same increased treatment and pumping of more water to meet demand. We therefore missed our emissions target in 2015/16. Alongside with actions to reduce our net energy imported, our recovery plan includes a new renewable energy source for our largest sewage treatment works, which will replace energy imported from the grid, and we remain committed to achieving our ambitious target of self-generating 33% of our own renewable energy by 2020.

We achieved a dramatic 49% reduction in the number of pollution incidents in the year ended 31 December 2015 compared to 2014. In part this reflected drier weather in 2015/16, but increased investment and improvements to our monitoring and site operations were also major factors. We have also invested in training and the resources within our waste control centre and improved response times.

99.13% of our sewage treatment works achieved their discharge compliance target in 2015/16. This is our best performance for three years. We did not meet our performance commitment, but our performance was within the range allowed before an ODI penalty is due. To achieve our commitment during AMP6 we have improved online monitoring and reporting, made faster responses, enhanced training and coaching of our operatives in the field and increased capital investment.

Approved by the Board of Directors on 9 June 2016 and signed on its behalf by



Sir Peter Mason KBE  
Chairman

## Directors' report

The Directors present their annual report and the audited financial statements of Kemble Water Holdings Limited (the "Company") and the audited consolidated financial statements of its group ("the Group") for the year ended 31 March 2016. The Directors consider that the annual report and financial statements, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess both the Group's and Company's performance and strategy.

The Directors have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity, and details of these risks and their management or mitigation can be found in the Strategic Report.

The registered number of the Company is 05819262 (England and Wales).

### Principal activity

The Group's principal activity is the appointed supply of water and wastewater services to customers in London, the Thames Valley and surrounding area, delivered through its wholly owned subsidiary Thames Water Utilities Limited ("TWUL" or "Thames Water") in accordance with TWUL's licence of appointment.

Details of the associated and subsidiary undertakings of the Group at 31 March 2016 has been provided in the notes to these financial statements.

### Future outlook

The future outlook of the Group is discussed in the Strategic Report.

### Directors

The Directors who held office during the year ended 31 March 2016 and to the date of this report were:

Sir Peter Mason KBE - Chairman

E Beckley

R Blomfield-Smith (Appointed 27/04/2015)

D Buffery (Resigned 07/07/2015)

J Divoky (Appointed 02/10/2015)

R Greenleaf

G Lambert

P Noble

A Osorio (Appointed 26/11/2015)

T Richon (Appointed 07/07/2015, Resigned 18/01/2016)

K Roseke (Resigned 27/04/2015)

G Tucker (Appointed 17/04/2015)

C Van Heijningen (Appointed 18/01/2016)

Y Wang

L Webb (Resigned 02/10/2015)

During the year under review, none of the Directors had significant contracts with the Company or any other body corporate other than their contracts of service (2015: none). Directors are allowed to appoint an alternative Director to represent them if they are unable to attend a meeting. The following Directors have formally appointed alternate Directors to represent them when they are unavailable:

<b>Director</b>	<b>Alternate Director</b>
G Tucker	C Deacon (Resigned 22/01/2016) P Mulholland (Appointed 22/01/2016)
P Noble	P Hofbauer
Y Wang	F Sheng
J Divoky	L Webb (Appointed 16/10/2015)
R Blomfield-Smith	D Rees (Resigned 18/01/2016)
D Buffery	R Bakker (Resigned 18/01/2016)
L Webb	C Pham (Resigned 02/10/2015)

## Directors' indemnities

The Group has made qualifying third party indemnity provisions for the benefit of its Directors and for the benefit of other persons who are directors of associated companies of the Group and these remain in force at the date of this report

## Dividends

The Company declared no dividends in the current financial year (2015 £63.1m of which £1.5m was paid in April 2015) and the Directors do not recommend the payment of a final dividend (2015 £nil)

## Operations outside the United Kingdom

There are no active operations conducted outside the United Kingdom. The Group has two wholly owned subsidiary entities incorporated in the Cayman Islands. These companies act solely as a financing vehicle for Thames Water Utilities Limited and their operations are conducted entirely within the UK. These companies are (and have always been) resident in the UK for tax purposes.

## Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position, the financial position of the Group, its cash flows, liquidity position and borrowing facilities are set out in the Strategic Report.

The Directors believe, after due and careful enquiry, and noting that the Group is in a net current liabilities position as at the year end, that both the Group and Company have sufficient resources for their present requirements and is able to meet their liabilities as they fall due for the foreseeable future. For these purposes the foreseeable future is taken to mean a period of at least twelve months from the date of approval of these financial statements. This is based upon a review of the Group's financial forecasts for the forthcoming financial year, consideration of the Group's compliance with its covenants and the cash, current asset investments and available facilities.

On this basis the Directors consider it appropriate to prepare the financial statements on a going concern basis.

## Financial risk management

The Company has access to the Chief Executive and the Executive Team of Thames Water Utilities Limited, who also manage the wider Kemble Water Holdings Group on a day-to-day basis on behalf of the Directors of individual group companies. The Board receives regular reports from all areas of the business. This enables prompt identification of financial and other risks so that appropriate actions can be taken in the relevant group companies.

The Company's operations expose it to a variety of financial risks and information on the use of financial instruments by the Group to manage these risks is disclosed in the Strategic Report.

## Adoption of international accounting standards

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU"). These are the Company and Group's first full IFRS financial statements and IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied. The Company and Group's previously reported results of the year ended 31 March 2015 have been restated, the effective date of transition to IFRS being 1 April 2014.

An explanation of how the transition to IFRS has affected the reported financial position, financial performance and the cash flows of the Company and Group is provided in the notes to the financial statements. This note includes reconciliations of equity and total comprehensive income for comparative periods and of equity at the date of transition from previous reported numbers prepared under United Kingdom Generally Accepted Accounting Practice ("UK GAAP") to IFRS.

## Political donations

No political donations were made by the Group or Company during the year (2015 £nil).

## Employees

At Thames Water we aim for a workforce that is representative of the communities in which we operate. Our policies and practices comply with current legislation. Alongside this, our values protect and support our people by creating an inclusive work environment, where people are treated with respect and are supported throughout recruitment, induction, career development and progression. Our current diversity profile shows across our total workforce, 32.5% are female and 67.5% are male, which remains broadly consistent across our management grades.

The Group is committed to fulfilling its obligations in accordance with the Disability Discrimination Act 1995. The Group has policies and procedures in place that aim to ensure both job applicants and employees with disabilities have equality of opportunity, are treated fairly and have a safe and practical workplace, free from discrimination, bullying, harassment or victimisation.

Through disability and attendance management policies, support and training is provided for employees who become disabled during the course of their employment so that they continue to work in a position appropriate to their experience and abilities.

The average number of employees within the Group is shown in the notes to the financial statements. In support of our talent pipeline, in this financial year, we took on 24 graduates, 12 apprentices and 43 trainees. Providing opportunities for people to learn and grow is fundamental to ensuring we have skilled people to benefit our customers and in the past year our colleagues completed over 20,000 hours of training and development. This includes 12,000 hours of health and safety training.

We seek to promote a culture of honesty and integrity in everything we do and will not tolerate acts of fraud, dishonesty, bribery, corruption or theft of assets or data. Our code of conduct, alongside our honest and ethical behaviour policies, expresses our approach to business activities and how we work providing a clear, ethical and legal framework for our employees, customers and stakeholders. Our contractors and alliance partners have agreed to follow the provisions of this code.

### **Research and development**

The Group's research and development programme consists of a portfolio of projects designed to address technical needs across the range of water cycle activities. Research and development activities deliver innovative technical solutions through a research programme aligned with business needs to address challenges for AMP6 and also provide specialist technical support to the business. Expenditure on research and development totalled £3.1 million for the year (2015: £4.0m).

### **Disclosure of information to the auditor**

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware, and each Director has taken all the steps that they ought to have taken as Director to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

### **Auditor**

Pursuant to Section 487 of the Companies Act 2006, the auditor will be deemed to be reappointed and KPMG LLP will therefore continue in office.

Approved by the Board of Directors on 9 June 2016 and signed on its behalf by



Sir Peter Mason KBE

**Chairman**  
Clearwater Court  
Vastern Road  
Reading  
Berkshire  
RG1 8DB

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## Statement of Directors' responsibilities in respect of the annual report and financial statements

The Directors are responsible for preparing the annual report and 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 they have elected to prepare the financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU") and applicable law.

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 the Company and of the profit or loss 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 estimates that are reasonable and prudent,
- state whether they have been prepared in accordance with IFRSs as adopted by the EU, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for ensuring such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

# Independent auditor's report to the members of Kemble Water Holdings Limited

We have audited the financial statements of Kemble Water Holdings Limited for the year ended 31 March 2016 set out on pages 24 to 76. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

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

## Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 22, 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

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at [www.frc.org.uk/auditscopeukprivate](http://www.frc.org.uk/auditscopeukprivate).

## Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 March 2016 and of the Group's profit for the year then ended,
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU,
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006, and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## Opinion on other matters prescribed by the Companies Act 2006

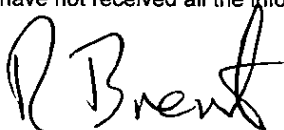
In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements. Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic Report and the Directors' Report:

- we have not identified material misstatements in those reports, and,
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

## Matters on which we are required to report by exception

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

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



**Robert Brent (Senior Statutory Auditor)**  
for and on behalf of KPMG LLP, Statutory Auditor

Chartered Accountants  
15 Canada Square  
London  
E14 5GL  
9 June 2016



## Consolidated income statement

For the year ended 31 March

	Note	2016 £m	2015 £m
Revenue	1	2,046.8	2,002.2
Operating expenses	2	(1,456.1)	(1,433.2)
Profit on the sale of property, plant and equipment		48.5	16.4
Other operating income	4	74.2	67.0
<b>Operating profit</b>		<b>713.4</b>	<b>652.4</b>
Finance income	5	107.5	119.4
Finance expense	6	(459.0)	(485.9)
Net gains/(losses) on financial instruments	7	22.7	(246.9)
Share of results of associates	11	-	-
<b>Profit on ordinary activities before taxation</b>		<b>384.6</b>	<b>39.0</b>
Taxation on profit on ordinary activities	8	85.9	105.3
<b>Profit for the year</b>		<b>470.5</b>	<b>144.3</b>

## Consolidated statement of other comprehensive income

For the year ended 31 March

		2016 £m	2015 £m
<b>Profit for the year</b>		<b>470.5</b>	<b>144.3</b>
<b>Other comprehensive income</b>			
<i>Items that will not be reclassified to the income statement</i>			
Net actuarial gains/(losses) on defined benefit pension schemes	23	113.2	(127.1)
Deferred tax on net actuarial (gains)/losses	19	(30.8)	25.4
<i>Items that may be reclassified to the income statement</i>			
Losses on cash flow hedges		(65.0)	(154.4)
Deferred tax on losses on cash flow hedges	19	8.7	30.8
<b>Other comprehensive income/(expense) for the year</b>		<b>26.1</b>	<b>(225.3)</b>
<b>Total comprehensive income/(expense) for the year</b>		<b>496.6</b>	<b>(81.0)</b>

All of the Group's activities above are derived from continuing activities

The accounting policies and notes on pages 30 to 76 are an integral part of these financial statements

As permitted by Section 408 of the Companies Act 2006, no income statement is presented for the parent Company. For the year ended 31 March 2016 the Company generated a profit after taxation of £268.2 million (2015 profit of £244.7m)

## Consolidated statement of financial position

As at 31 March

	Note	2016 £m	2015 £m	As at 1 April 2014 £m
<b>Non-current assets</b>				
Intangible assets	9	66 4	57 7	65 4
Goodwill	12	1,468 1	1,468 1	1,468 1
Property, plant and equipment	10	14,025 1	13,307 3	12,415 8
Trade and other receivables	14	3 8	-	-
Retirement benefit surplus	23	6 1	5 7	5 5
Derivative financial assets	18	366 6	271 6	88 8
		<b>15,936 1</b>	<b>15,110 4</b>	<b>14,043 6</b>
<b>Current assets</b>				
Inventories and current intangible assets	13	22.0	9 9	6 1
Assets held for sale		1.0	0 2	0 3
Trade and other receivables	14	570 2	526 8	527 0
Short term investments	18	289.5	277 1	489 0
Cash and cash equivalents	15	567 3	571 7	443 3
		<b>1,450 0</b>	<b>1,385 7</b>	<b>1,465 7</b>
<b>Current liabilities</b>				
Trade and other payables	16	(814 5)	(893 5)	(751 1)
Borrowings	17	(1,037 4)	(951 9)	(573 0)
Derivative financial liabilities	18	(42 4)	(85 7)	-
		<b>(1,894 3)</b>	<b>(1,931 1)</b>	<b>(1,324 1)</b>
<b>Net current (liabilities)/assets</b>		<b>(444 3)</b>	<b>(545 4)</b>	<b>141 6</b>
<b>Non-current liabilities</b>				
Trade and other payables	16	(362 2)	(335 2)	(311 9)
Borrowings	17	(11,005 4)	(10,414 6)	(10,355 0)
Derivative financial liabilities	18	(1,302 1)	(1,337 4)	(845 0)
Deferred tax	19	(963 6)	(1,021 3)	(1,180 2)
Provisions for liabilities and charges	20	(100 0)	(100 7)	(99 9)
Retirement benefit obligations	23	(260 0)	(353 9)	(247 2)
		<b>(13,993 3)</b>	<b>(13,563 1)</b>	<b>(13,039 2)</b>
<b>Net assets</b>		<b>1,498 5</b>	<b>1,001 9</b>	<b>1,146 0</b>
<b>Equity</b>				
Called-up share capital	21	1,991 6	1,991 6	1,991 6
Cash flow hedge reserve		(179 9)	(123 6)	-
Retained earnings		(313 2)	(866 1)	(845 6)
<b>Total equity</b>		<b>1,498 5</b>	<b>1,001 9</b>	<b>1,146 0</b>

The accounting policies and notes on pages 30 to 76 are an integral part of these financial statements

The financial statements were approved by the Board of Directors on 9 June 2016 and signed on its behalf by



Sir Peter Mason KBE  
Chairman

Company registered number 05819262 (England and Wales)

## Company statement of financial position

As at 31 March

	Note	2016 £m	2015 £m	As at 1 April 2014 £m
<b>Non-current assets</b>				
Investment in subsidiaries	32	10	10	10
<b>Current assets</b>				
Intercompany loans receivable	33	3,678.5	3,343.3	3,096.7
Cash and cash equivalents		-	1.5	-
<b>Current liabilities</b>				
Trade and other payables	34	(132.7)	(67.2)	(0.7)
<b>Net current assets</b>		<b>3,545.8</b>	<b>3,277.6</b>	<b>3,096.0</b>
<b>Net assets</b>		<b>3,546.8</b>	<b>3,278.6</b>	<b>3,097.0</b>
<b>Equity</b>				
Called-up share capital	21	1,991.6	1,991.6	1,991.6
Retained earnings		1,555.2	1,287.0	1,105.4
<b>Total equity</b>		<b>3,546.8</b>	<b>3,278.6</b>	<b>3,097.0</b>

The accounting policies and notes on pages 30 to 76 are an integral part of these financial statements

The financial statements were approved by the Board of Directors on 9 June 2016 and signed on its behalf by



Sir Peter Mason KBE  
Chairman

Company registered number 05819262 (England and Wales)

## Consolidated statement of changes in equity

For the year ended 31 March

	Share capital £m	Cash flow hedge reserve £m	Retained earnings £m	Total equity £m
<b>At 1 April 2014</b>	1,991 6	-	(845 6)	1,146 0
Profit for the year	-	-	144 3	144 3
Loss on cash flow hedges	-	(154 4)	-	(154 4)
Deferred tax on cash flow hedge	-	30 8	-	30 8
Dividends payable	-	-	(63 1)	(63 1)
Actuarial loss on pension schemes	-	-	(127 1)	(127 1)
Deferred tax on actuarial loss	-	-	25 4	25 4
<b>At 31 March 2015</b>	1,991 6	(123 6)	(866 1)	1,001 9
Profit for the year	-	-	470 5	470 5
Loss on cash flow hedges	-	(65 0)	-	(65 0)
Deferred tax on cash flow hedge	-	8 7	-	8 7
Actuarial gain on pension schemes	-	-	113 2	113 2
Deferred tax on actuarial gain	-	-	(30 8)	(30 8)
<b>At 31 March 2016</b>	1,991 6	(179 9)	(313 2)	1,498 5

## Company statement of changes in equity

For the year ended 31 March

	Share capital £m	Retained earnings £m	Total equity £m
<b>At 1 April 2014</b>	1,991 6	1,105 4	3,097 0
Profit for the year	-	244 7	244 7
Dividends payable	-	(63 1)	(63 1)
<b>At 31 March 2015</b>	1,991 6	1,287 0	3,278 6
Profit for the year	-	268 2	268 2
<b>At 31 March 2016</b>	1,991 6	1,555 2	3,546 8

The accounting policies and notes on pages 30 to 76 are an integral part of these financial statements

## Consolidated statement of cash flows

For the year ended 31 March

	Note	2016 £m	2015 £m
Cash generated from operations	29	1,169 6	1,205 5
Tax (paid)/received		(2 3)	0 9
<b>Net cash generated by operating activities</b>		<b>1,167 3</b>	<b>1,206 4</b>
<b>Investing activities</b>			
Interest received		109 5	123 8
Purchase of property, plant and equipment		(1,262 4)	(1,307 4)
Purchase of intangible assets		(27 3)	(14 8)
Proceeds from sale of property, plant and equipment		14 7	17 2
<b>Net cash used in investing activities</b>		<b>(1,165 5)</b>	<b>(1,181 2)</b>
<b>Financing activities</b>			
(Increase)/decrease in current asset investments		(12 4)	211 9
New loans raised		1,082 9	593 5
Repayment of borrowings		(550 6)	(192 6)
Interest paid		(367 9)	(429 9)
Derivative settlements		(149 3)	(18 1)
Derivative collateral liability		(7 4)	-
Dividends paid		(1 5)	(61 6)
<b>Net cash (used in)/generated by financing activities</b>		<b>(6 2)</b>	<b>103 2</b>
Net (decrease)/increase in cash and cash equivalents		(4 4)	128 4
Net cash and cash equivalents at beginning of the year		571 7	443 3
<b>Net cash and cash equivalents at end of the year</b>		<b>567 3</b>	<b>571 7</b>

The accounting policies and notes on pages 30 to 76 are an integral part of these financial statements

## Company statement of cash flows

For the year ended 31 March

	Note	2016 £m	2015 £m
Cash generated from operations	36	-	-
Tax paid		-	-
<b>Net cash (used in)/generated by operating activities</b>		-	-
<i>Investing activities:</i>			
Interest received		-	63.1
<b>Net cash generated by investing activities</b>		-	63.1
<i>Financing activities</i>			
Dividends paid		(1.5)	(61.6)
<b>Net cash used in financing activities</b>		(1.5)	(61.6)
Net (decrease)/increase in cash and cash equivalents		(1.5)	1.5
Net cash and cash equivalents at beginning of the year		1.5	-
<b>Net cash and cash equivalents at end of the year</b>		-	1.5

The accounting policies and notes on pages 30 to 76 are an integral part of these financial statements

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## Accounting policies

The following accounting policies have been adopted in the preparation of these financial statements. They have been applied consistently in dealing with items which are considered material, except as noted below.

### General information

Kemble Water Holdings Limited ("the Company") is a company incorporated and domiciled in the United Kingdom under the Companies Act 2006 whose principal activity is to act as the holding company for the Kemble Water Holdings Limited group of companies ("the Group"). The Group's principal activity is the appointed supply of water and wastewater services to customers in London, the Thames Valley and surrounding area, delivered through its wholly owned subsidiary Thames Water Utilities Limited ("TWUL" or "Thames Water") in accordance with TWUL's licence of appointment.

The address of the registered office of both the Company and the Group is Clearwater Court, Vastern Road, Reading, RG1 8DB.

### Statement of compliance with International Financial Reporting Standards ("IFRS")

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU"). These are the Group and Company's first full IFRS financial statements and IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied. The Group and Company's previously reported results for the year ended 31 March 2015 have been restated, the effective date of transition to IFRS being 1 April 2014.

An explanation of how the transition to IFRS has affected the reported financial position, financial performance and the cash flows of the Group and Company is provided in notes 31 and 37 respectively. This note includes reconciliations of equity and total comprehensive income for comparative periods and of equity at the date of transition from previous reported numbers prepared under United Kingdom Generally Accepted Accounting Practice ("UK GAAP") to IFRS.

The group and parent company financial statements have been prepared in accordance with IFRS, International Accounting Standards ("IAS") and IFRIC interpretations issued and effective and ratified by the European Union as at 31 March 2016.

### Basis of preparation

The financial statements for the Group and parent company for the year ended 31 March 2016, set out on pages 24 to 76, have been prepared on the going concern basis and under the historical cost convention, as modified by the revaluation of certain financial assets and liabilities at fair value.

### Basis of consolidation

The Group financial statements consolidate the financial statements of the Company and entities controlled by the Company (its subsidiaries) and incorporate the results of its share of joint ventures using equity accounting. Associates are accounted for on an equity basis either where the Group's holding exceeds 20% or the Group has the power to exercise significant influence.

Where necessary, adjustments have been made to the financial statements of subsidiaries to align the accounting policies used under the relevant local GAAP into line with those used by the Group. Control is achieved where the Company has the power to govern the financial and operating policies, generally accompanied by a shareholding of more than one half of the voting rights, of an investee entity so as to obtain benefits from its activities. All intra-group transactions, balances, income and expenses are eliminated on consolidation. The results of subsidiary undertakings acquired or disposed of during the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

### Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position, the financial position of the Group, its cash flows, liquidity position and borrowing facilities are set out in the Strategic Report.

The Directors believe, after due and careful enquiry, and noting that the Group is in a net current liabilities position as at the year end, that both the Group and Company have sufficient resources for their present requirements and is able to meet their liabilities as they fall due for the foreseeable future. For these purposes the foreseeable future is taken to mean a period of at least twelve months from the date of approval of these financial statements. This is based upon a review of the Group's financial forecasts for the forthcoming financial year, consideration of the Group's compliance with its covenants and the cash, current asset investments and available facilities.

On this basis the Directors consider it appropriate to prepare the financial statements on a going concern basis.

## Goodwill

Goodwill arises on the acquisition of subsidiaries and represents the excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree over the fair value of the identifiable net assets acquired. If the total of consideration transferred, non-controlling interest recognised and previously held interest measured at fair value is less than the fair value of the net assets of the subsidiary acquired, in the case of a bargain purchase, the difference is recognised directly in the income statement.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash generating units ("CGU"), or groups of CGUs, which is expected to benefit from the synergies of the combination. Each unit or group of units to which the goodwill is allocated represents the lowest level within the entity at which the goodwill is monitored for internal management purposes.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of the CGU containing the goodwill is compared to the recoverable amount, which is the higher of the value in use and the fair value less costs of disposal. Any impairment is recognised immediately as an expense within the income statement and is not subsequently reversed. Where goodwill forms part of a cash generating unit and all or part of that unit is disposed of, the associated goodwill is included in the carrying amount of that operation when determining the gain or loss on disposal of the operation.

## Foreign currency

Transactions in foreign currencies are translated to sterling (the Group and Company's functional and presentational currency) at the foreign exchange rate ruling at the date of the transaction. On consolidation the results of overseas subsidiaries and associated undertakings (none of which are domiciled in a country with a hyper-inflationary economy) are translated into sterling using average rates of exchange ruling during the financial year. The net investment is translated into sterling at the rates of exchange ruling at the year end and any exchange differences so arising are treated as movements in equity.

Monetary assets and liabilities denominated in foreign currencies at the financial reporting date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement except for differences arising on the retranslation of qualifying cash flow hedges, which are recognised directly in equity.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are retranslated to the functional currency at foreign exchange rates ruling at the dates the fair value was determined.

## Revenue recognition

Revenue represents the fair value of the consideration received or receivable in the ordinary course of business, excluding value added tax and trade discounts, for goods and services provided which are recognised in accordance with IAS18 *Revenue*. Revenue is recognised at the time of delivery of the service. Should the Group consider that the criteria for full revenue recognition are not met at the time of a transaction, recognition of the associated revenue would be deferred until such time as the criteria have subsequently been met. Bad debt on bills raised in the year, which are considered uncollectable based on historic experience, is recognised as a deduction to revenue.

Revenue includes an estimate of the amount of mains water and wastewater charges unbilled at the period end, which are recorded within accrued income. The usage is estimated using a defined methodology based upon historical data and managerial judgement. When a new property is connected to the infrastructure network an estimate is made of the sales value of water supplied and wastewater charges incurred between the date of connection and the period end. Where actual results differ from estimates used, revenue is adjusted in the period for which the revision to the estimate is determined.

For unmetered customers, the amount to be billed is dependent upon the rateable value of the property, as assessed by an independent rating officer. The amount billed is recorded within deferred income and is apportioned to revenue over the period to which the bill relates. The Group only raises bills in the name of the "occupier" when it has evidence that an unmeasured property is occupied but cannot confirm the name of the occupier. When the Group identifies the occupants the bill is cancelled and re-billed in the customer's name. If the Company has not identified an occupant within six months the bill is cancelled and the property is classified as empty.

Interest income is accrued on a time basis by reference to the principal outstanding and the Effective Interest Rate ("EIR") applicable. The EIR is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability. Interest income is presented within finance income in the income statement.



## Property, plant and equipment

Property, Plant and Equipment ("PP&E") is comprised of network assets (including water mains, sewers, pumped raw water storage reservoirs and sludge pipelines) and non-network assets. PP&E is stated at cost (or at deemed cost in the case of network assets, being the fair value at the date of transition to IFRS) less accumulated depreciation and provision for impairment.

The Group capitalises the directly attributable costs of procuring and constructing PP&E in accordance with IAS16 *Property, Plant and Equipment*. These costs include labour and other internal costs incremental to the business due to the scale and nature of the capital implementation programme of the Group. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and its cost can be measured reliably.

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the associated asset. All other borrowing costs are included as finance expenses within the income statement.

Where items of PP&E are transferred to the Group from customers or developers, generally in the form of adopted water mains, self-lay sewers or adopted pumping stations, the fair value of the asset transferred is recognised in the statement of financial position. Fair value is determined based on estimated replacement cost. Where the transfer is in exchange for connection to the network and there is no further obligation for ongoing services, the corresponding credit is recognised immediately within revenue. Where the transfer is considered to be linked to the provision of ongoing services, the corresponding credit is recorded in deferred income and is released to other operating income over the expected useful economic lives of the associated assets as shown below.

The gain or loss arising on the disposal or retirement of an item of PP&E is determined as the difference between the sale proceeds and the carrying amount of the asset at the date the transaction arises, and is recognised separately in the income statement.

PP&E is depreciated to its estimated residual value over its estimated useful life, with the exception of freehold land which is not depreciated. Assets in the course of construction are not depreciated as these assets are not considered to commence their economic lives until they are commissioned, whereupon they are transferred into an appropriate category of PP&E.

The estimated useful economic lives are as follows:

	Years
<b>Network assets</b>	
Reservoirs	250
Strategic sewer components	200
Wastewater network assets	150
Water network assets	80-100
Raw water tunnels and aqueducts	80
<b>Non-network assets</b>	
<i>Land and buildings</i>	
Buildings	15-60
Operational structures	30-100
<i>Plant and equipment</i>	
Other operational assets	7-40
Fixtures & fittings	5-7
Vehicles	4-5
Computers	3-5
Fixed and mobile plant	4-60

## Grants and contributions

Contributions received in respect of certain infrastructure charges (where on connection of a new property to the network the Group receives cash from the developer towards the investment required to enhance network capacity, to meet new demand and maintain service levels) are treated as deferred income and released to other operating income over a 30 year period.

Contributions which are given in compensation for expenses incurred with no future related costs, including the cost of excavating, connecting and reinstating a new water supply to an existing mains connection, are recognised within other operating income in the period that they become receivable as no continuing obligation remains once the connection has been made.

## Intangible assets (excluding goodwill)

Separately acquired intangible assets are stated at cost, less accumulated amortisation and any provision for impairment. Research expenditure is expensed to the income statement as incurred. Development expenditure is capitalised when appropriate criteria are met under IAS 38 *Intangible Assets*. Amortisation of the asset begins when development is complete and the asset is available for use. It is amortised over the period of expected future benefit on a project by project basis. Amortisation is charged to the income statement on a straight-line basis over the estimated useful economic life of the intangible asset. These intangible assets are amortised from the date they become available for use. The estimated useful economic life is as follows:

	<b>Years</b>
Development expenditure	3-25
Software	5-10

## Non-current asset investment in subsidiaries

Investments in subsidiary undertakings are stated at cost, less any provision for impairment.

## Non-current assets held for sale

Non-current assets are reclassified as held for sale if all of the following criteria are satisfied:

- the carrying amount will be recovered principally through sale rather than through continuing use,
- the asset is available for immediate sale in its present condition, and
- a sale is considered to be highly probable.

On initial reclassification as held for sale, non-current assets are measured at the lower of the previous carrying amount and fair value less costs to sell, with any adjustments being recognised within the income statement. Once classified as held for sale no further depreciation or amortisation is recognised.

## Inventories

Inventories are stated at the lower of cost and net realisable value ("NRV"). Costs comprise direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average basis. Inventory is assessed for obsolescence on an item-by-item basis and when determined to be obsolete is written off immediately to the income statement.

Purchased carbon emission allowances (relating to the emission of carbon dioxide in the UK) are recorded within current inventories as intangible assets, initially at cost and subsequently at the lower of cost and net realisable value. A provision is simultaneously recorded in respect of the obligation to deliver emission allowances in the period in which the emissions are made and the associated charge is recognised as an operating expense within the income statement.

## Leased assets

Leases where the Group obtains assets which transfer substantially all the risks and rewards of ownership to the Group are treated as finance leases. The lower of the fair value of the leased asset and the present value of the minimum lease payments is capitalised as an asset, with a corresponding liability representing the obligation to the lessor. Lease payments are treated as consisting of a capital element and a finance charge, the capital element reducing the obligation to the lessor and the finance charge being written off to the income statement at a constant rate over the period of the lease, in proportion to the capital amount outstanding. Depreciation is charged at the shorter of the estimated useful economic life and the lease period.

All other leases are classified as operating leases. Payments made under operating leases are recognised in the income statement on a straight line basis over the term of the lease. Lease incentives and premiums received are recognised in the income statement as an integral part of the total lease expense and are released to the income statement on a straight line basis over the term of the lease. Leases of land are ordinarily treated as operating leases, unless ownership is transferred to the Group at the end of the lease.

On completion of construction of the Thames Tideway Tunnel, the Group will be granted use of the tunnel under a 125 year lease. As substantially all the risks and rewards of ownership are transferred to the Group and the lease is for a substantial part of the tunnel's life, the Company will account for the transaction as a finance lease. The tunnel will be therefore be recognised as an asset within Property, Plant and Equipment and depreciated over the life of the lease. On inception of the lease, the tunnel will be recognised at fair value, being the prepayment plus the present value of the minimum lease payments, with a corresponding liability being recognised as a finance lease payable. Interest will be recognised in the income statement over the period of the lease.

## Provisions for liabilities and charges

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated

The Group is subject to a number of claims which relate to and include commercial and contractual disputes, which are handled and defended in the ordinary course of business. The Company routinely assesses the likelihood of any adverse judgements or outcomes to these matters as well as ranges of probable and reasonably estimated losses. Reasonable estimates involve judgements made by management after considering available information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible entities and their ability to contribute, and prior experience.

Provisions for insured liabilities are recognised or released by assessing their adequacy using current estimates of future cash flows under insurance contracts.

Provisions are discounted to present value using a pre-tax discount rate that reflects the risks specific to the liability, where the effect is material.

The Group is subject to Outcome Delivery Incentives ("ODIs") where failure to achieve targets can lead to financial penalties and outperformance can result in financial rewards. These penalties and rewards are in the form of revenue adjustments or Regulated Capital Value ("RCV") adjustments. The Group does not recognise a provision for penalties or rewards in the period in which they are incurred or achieved as the financial impact of these is taken in the following AMP period.

## Risks, opportunities and innovation ("ROI") funds

The Group has entered into certain alliance arrangements with a number of third parties. The alliance agreements include incentive mechanisms which result in the alliance partners sharing in any over or underspend on contracted works, as well as sharing in outcomes against TWUL's performance commitments. During the year ended 31 March 2016 there were two alliances responsible for delivering various works over AMP 6.

A notional ROI fund for each alliance is created and built up over the AMP once certain conditions, as specified in the contract between TWUL and the alliance partners, are satisfied.

A provision for ROI amounts is recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Conversely, a receivable for ROI will be recognised when the Group has a right to receive cash at a future date, the amount can be reliably estimated and receipt is virtually certain.

ROI amounts arising from an over or underspend against the contracted cost for a capital project, where the spend is directly attributable to the asset created, is deemed to be an integral cost in bringing an asset into the condition and location for use as intended by management and therefore is capitalised as part of the cost of the asset and depreciated over the asset's useful life.

ROI amounts arising from operating expenditure over or underspend against the contracted cost, where the spend cannot be directly attributed to a capital asset, is recognised directly in profit or loss as the spend is incurred. ROI amounts resulting from an ODI penalty or reward is recognised in the income statement at the point the penalty has been incurred or reward has been achieved.

## Dividends

Dividends unpaid at the financial reporting date are only recognised as a liability at that date to the extent that they are appropriately authorised and are no longer at the discretion of the Company. This occurs when the shareholders' right to receive payment has been established. Unpaid dividends that do not meet these criteria are disclosed in the notes to the financial statements.

## Financial guarantees

Five companies in the Group are part of a whole business securitisation group. Companies in the whole business securitisation group raise debt in external debt markets through the issuance of secured bonds and the issue of loans. Thames Water Utilities Holdings Limited, Thames Water Utilities Limited, Thames Water Utilities Finance Limited, Thames Water Utilities Cayman Finance Holdings Limited and Thames Water Utilities Cayman Finance Limited have guaranteed the principal and interest payments due under the terms of the bonds. Where a company enters into financial guarantee contracts to guarantee the indebtedness of other companies within this group, the company considers these to be insurance arrangements and accounts for them as such. In this respect, the company treats the guarantee contract as a contingent liability until such a time as it becomes probable that the company will be required to make a payment under the guarantee.

## Retirement and other employment benefits

### Defined benefit schemes

The Group operates three, independently administered, defined benefit pension schemes, all of which are closed to new employees. Actuarial valuations are carried out as determined by the Trustees, using the projected unit credit method for both schemes at intervals of not more than three years. The rates of contributions payable and the pension cost are determined on the advice of the actuaries, having regard to the results of these valuations.

The difference between the value of defined benefit pension scheme assets and liabilities is recorded within the statement of financial position as a retirement benefit or obligation. Defined benefit pension scheme assets are measured at fair value using the bid price for assets with quoted prices. Defined benefit pension scheme liabilities are measured at the reporting date by an independent actuary using the projected unit credit method and discounted at the current rate of return on high quality bonds of equivalent term and currency to the liability.

Service cost, representing the cost of employee service in the period, and scheme administration expenses are included within operating expenses in the income statement. The net finance cost is calculated by applying the discount rate used for the scheme liabilities to the net deficit.

Changes in the retirement benefit obligation may arise from

- differences between the return on scheme assets and interest included in the income statement,
- actuarial gains and losses from experience adjustments, or
- changes in demographic or financial assumptions.

Such changes are classified as re-measurements and are charged or credited to equity and recorded within the statement of comprehensive income in the period in which they arise.

### Defined contribution schemes

The Group operates a Defined Contribution Stakeholder Pension Scheme ("DCSPS") managed through Standard Life Assurance Limited. From 1 April 2011 the DCSPS is the only scheme to which new employees of the Company are eligible. The assets of the DCSPS are held separately from those of the Group and obligations for contributions to the scheme are recognised as an expense in the income statement in the periods during which they fall due.

The Group also operates two closed defined contribution pension schemes. The Group has no further payment obligations, however defined funds for individuals are held within these schemes.

### Long-term incentive plans ("LTIP") and bonus

Cash based LTIP awards are accrued in the financial statements for the duration of the award. The accrual is based on the values assessed for the applicable schemes, taking into account the duration of the individual scheme, and by comparing the Group's performance against the assumptions used to award payments. These are recognised as the present value of the benefit obligation.

Bonus payments are accrued in the period based on assessments of performance against targets set at the beginning of the financial year. Bonuses are paid in the following financial year, once performance has been measured against targets set.

During the year, the Group launched a new 'Share in Your Success' scheme. The scheme is open to all employees. Employees are able to contribute between £20 and £250 per month from their salary into a savings account over a three year period. At the end of the three years, the employee is then entitled to all of the cash they have sacrificed during that period, plus interest that has accrued on that balance, and a 'bonus' element paid by the Group of up to 35% of the amount invested. If an employee is to leave the Group within the three year period, then they are entitled to the amount they have invested up to the point of departure, including the interest earned in that period.

## **Non-derivative financial instruments**

A financial instrument is any contract that gives rise to a financial asset in one entity and a financial liability or equity instrument in another entity. Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings and trade and other payables.

### **Trade and other receivables**

Trade and other receivables are measured at fair value on initial recognition. Subsequent to initial recognition they are measured at amortised cost using the effective interest method. If there is objective evidence that the asset is impaired it is written down to its recoverable amount and the irrecoverable amount is recognised as an expense within operating costs. Debt is only written off after all available economic options for collecting the debt have been exhausted and the debt has been deemed to be uncollectable. This may be because the debt is considered to be impossible, impractical, inefficient or uneconomic to collect, and is assessed by management on a case-by-case basis.

Included within trade receivables is an assessment of the recoverability of debts which will ultimately be cancelled, and may or may not be rebilled, and of debts which have not yet been billed but are part of the metered sales accrual. This assessment is made by reference to the Company's historical collection experience, including comparisons of the relative age of the individual balance and consideration of the actual write-off history. The provisioning rates applied in the calculation are reviewed on an annual basis to reflect the latest historical collection performance data and management's expectation of future performance and industry trends. A provision is also made against debts due from Water Only Companies ("WOCs") who bill their customers for sewerage services provided by the Group. As detailed information about the debt, including the ageing, is unavailable the level of provision is calculated with reference to the level of historical, current and forecast write-offs.

### **Trade and other payables**

Trade and other payables are recognised initially at fair value. Subsequent to initial recognition they are measured at amortised cost using the effective interest method.

Trade and other payables include amounts owed to Bazalgette Tunnel Limited. Amounts owed to Bazalgette Tunnel Limited represent revenue collected on behalf of Bazalgette Tunnel Limited for the construction of the Thames Tideway Tunnel.

### **Cash and cash equivalents**

Cash and cash equivalents comprise cash at bank and in hand and demand deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value. Such investments are normally those with less than three months maturity from the date of acquisition and include cash and bank balances and investments in liquid funds.

Bank overdrafts that are repayable on demand form an integral part of the Group's cash management and are also included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

### **Interest bearing loans issued to other group companies**

Interest bearing loans issued to other group companies are initially recognised at fair value plus transaction costs that are directly attributable to the acquisition of the financial asset. They are subsequently measured at amortised cost using the effective interest rate method, less any provision for impairment. The amortisation is included within finance income in the income statement and is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate.

### **Interest bearing borrowings**

Interest bearing borrowings are financial liabilities recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition these are stated at amortised cost using the effective interest method. The amortisation is included within finance costs in the income statement and is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate.

## Derivative financial instruments and hedging

### Derivative financial instruments not designated as hedging instruments

Derivative financial instruments are initially recognised at fair value with transaction costs being taken to the income statement. The gain or loss on re-measurement to fair value is recognised immediately in profit or loss.

### Derivative financial instruments designated as hedging instruments

The Group uses derivative financial instruments, such as forward currency contracts and interest rate swaps to hedge its foreign currency risks and interest rate risks, respectively. At the inception of each hedge relationship the Group documents

- the relationship between the hedging instrument and the hedged item,
- its risk management objectives and strategy for undertaking the hedge transaction, and
- the results of tests to determine whether the hedging instrument is expected to be highly effective in offsetting changes in cash flows or fair values (as applicable) of the hedged item.

The Group continues to test and document the effectiveness of the hedge on an ongoing basis. Hedge accounting discontinues when the hedging instrument expires, is sold, terminated or exercised, or no longer qualifies for hedge accounting.

### Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in the cash flow hedge reserve. Any ineffective portion of the hedge is recognised immediately in the income statement.

When the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated cumulative gain or loss is removed from the cash flow hedge reserve and reclassified to the income statement in the same period or periods during which the asset acquired or liability assumed affects profit or loss, i.e. when interest income or expense is recognised.

When a hedging instrument expires or is sold, terminated or exercised, or the Company revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised in the income statement immediately.

### Embedded derivatives

Where a contract includes terms that cause some of its cash flows to vary in a similar way to a derivative financial instrument, that part of the contract is considered to be an embedded derivative. Embedded derivatives are separated from the contract and measured at fair value with gains and losses taken to the income statement if

- the risks and characteristics of the embedded derivative are not closely related to those of the contract, and
- the contract is not carried at fair value with gains and losses reported in the income statement.

In all other cases embedded derivatives are accounted for in line with the accounting policy for the contract as a whole.

### Fair value measurement

The Group measures financial instruments such as derivatives at fair value at each financial reporting date. Fair value is the price that would be received in selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value reflects the non-performance risk.

### Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

## De-recognition of financial instruments

A financial asset is de-recognised when the rights to receive cash flows from the asset have expired

A financial liability is de-recognised when the obligation under the liability is discharged, cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the de-recognition of the original liability and the recognition of a new liability. The difference between the carrying amount of the financial liability extinguished or transferred and the consideration paid is recognised in the income statement.

## Impairment (excluding inventories, goodwill and deferred tax assets)

### Financial assets (including receivables)

A financial asset not carried at fair value through profit or loss is assessed at each financial reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset and can be measured reliably.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Interest on the impaired asset continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment is reversed through the income statement.

Trade receivables that are assessed not to be impaired individually are assessed collectively for impairment by reference to the Group's historical collection experience for receivables of a similar age.

### Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each financial reporting date to determine whether there is any indication of impairment. If any such indication exists then the assets recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

An impairment loss is recognised if the carrying amount of an asset or its cash generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the income statement. Impairment losses recognised in prior periods are assessed at each financial reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

## Taxation

Tax on the profit or loss for the period comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly within equity, in which case it is recognised within the statement of other comprehensive income.

### Current tax

Current tax is the expected tax payable or receivable on the taxable income or loss for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustments to tax payable in respect of previous periods.

Taxable profit differs from the profit on ordinary activities before tax as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other periods. This includes the effect of tax allowances and further excludes items that are never taxable or deductible.

## Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax is measured on a non-discounted basis using tax rates enacted or substantively enacted at the balance sheet date and that are expected to apply in the period when the deferred tax asset is realised or the deferred tax liability is settled.

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

Deferred tax assets and deferred tax liabilities are offset when there is a legally enforceable right to set off tax assets against 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.

## New accounting policies and future requirements

At the date of approval of these financial statements the following standards and interpretations were in issue but not yet effective:

- IFRS 9 *Financial Instruments* is likely to affect the measurement and disclosure of financial statements. This standard has not yet been endorsed by the EU.
- IFRS 15 *Revenue from Contracts with Customers* will affect the measurement and recognition of revenue with effect from 1 April 2018. The impact on the results or net assets of the Group due to the changes to the standard has not yet been quantified. This standard has not yet been endorsed by the EU.
- IFRS 16 *Leases* will affect the measurement and recognition of leases, in particular operating leases, with effect from 1 April 2019. The effect on the results or net assets of the Group due to the changes to the standard has not yet been quantified. This standard has not yet been endorsed by the EU.



## Significant accounting judgements and key sources of estimation uncertainty

In the process of applying the Group's accounting policies, the Group is required to make certain judgements, estimates and assumptions that it believes are reasonable based on available information. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may ultimately differ from these estimates.

The key assumptions concerning the future and other key sources of estimation uncertainty at the financial reporting date used in preparing these financial statements are as follows:

### Property, plant and equipment

The Group capitalises expenditure relating to water and wastewater infrastructure where such expenditure enhances or increases the capacity of the network. Maintenance expenditure is taken to the income statement in the period in which it is incurred. Differentiating enhancement from maintenance expenditure is subjective, particularly where a single project may include a mix of both types of activities. Additionally, management capitalises employee time and other expenses incurred by central functions on capital programmes and consequently judgement is applied concerning the capitalisation rate used.

Calculation of the depreciation charge requires estimates to be made regarding the useful economic lives of the assets. These estimates are based on engineering data and the Group's experience of similar assets. If management identifies that actual useful economic lives differ materially from the estimates used to calculate the depreciation charge, that charge will be adjusted prospectively.

The Group is required to evaluate the carrying values of PP&E for impairment whenever the circumstances indicate that the carrying value of those assets may not be recoverable. An impairment review requires management to make subjective judgements regarding the recoverable value and value in use of the assets under review.

### Unbilled revenue

Revenue reflects the fair value of the consideration received, or receivable, in the ordinary course of business, excluding value added tax and trade discounts, for goods and services provided. Revenue is recognised at the time of delivery of the service and consequently payments received in advance of revenue recognition are recorded as deferred income.

The Group raises bills in accordance with its entitlement to receive revenue in line with the limits established by the periodic regulatory price review processes. For water and wastewater customers with water meters, the amount recognised depends on the volume supplied including an estimate of the sales value of units supplied between the date of the last meter reading and the financial reporting date. Amounts recognised within revenue but unbilled at the financial reporting date are included within accrued income. Meters are read on a cyclical basis and the Group recognises revenue for unbilled amounts based on estimated usage from the last billing to the financial reporting date. The estimated usage is based on historical data, judgement and assumptions.

Where actual results differ from estimates used, revenue is adjusted in the period for which the revision to the estimate is determined.

### Provision for doubtful debt

Provisions are made against trade receivables based on an assessment of the recovery of debts including those which will ultimately be cancelled, and may or may not be rebilled, and of debts which have not yet been billed but are part of the metered sales accrual. This assessment is made by reference to the Group's historical collection experience, including comparisons of the relative age of the individual balance and consideration of the actual write-off history. The actual level of receivables collected may differ from the estimated level of recovery which could affect operating results positively or negatively.

### Retirement benefit obligations

The Group operates defined benefit pension schemes for which full actuarial valuations are carried out as determined by the trustees at intervals of not more than three years. Determining the amount of the Group's retirement benefit obligations and the net costs of providing such benefits requires assumptions to be made including, but not restricted to, long term interest rates, inflation and rate of increases to pensions in payment. These are assessed using the advice of an independent qualified actuary, market observations and assumptions from the latest actuarial valuation.

Changes in these assumptions could significantly affect the amount of obligations recognised and the cost of providing such benefits.

### **Provisions for other liabilities and charges**

Assessing the financial outcome of uncertain commercial and legal cases requires judgement to be made regarding the extent to which any claim against the Group is likely to be successful after considering available information including notifications, settlements, estimates performed by independent parties and legal counsel, available facts, identification of other potentially responsible entities and their ability to contribute, and prior experience

The required provision may change in the future due to new developments and as additional information becomes available and in such instances the provision will be adjusted prospectively

### **Fair value of derivatives**

The fair value of financial assets and liabilities represents the price that would be received to sell an asset, or paid to transfer a liability between informed and willing parties, other than in a forced or liquidation sale at the measurement date. The fair value of the derivatives is determined by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates at the measurement date. The valuations are tested for reasonableness by comparing these to bank quotes. The fair value calculations have been adjusted to incorporate the Group's own and counterparty's credit risk where appropriate.

### **Impairment of investment in subsidiaries and goodwill**

Determining whether the Group's investments in subsidiaries or the carrying value of goodwill have been impaired requires estimations of the investment or cash generating unit's net realisable value. An enterprise valuation is derived through the application of an observable market multiplier uplift to the underlying entities Regulatory Capital Value ("RCV"). The recoverable amount is thus most sensitive to the uplift multiplier used in the valuation model. See notes 12 and 32 for the net carrying value of the investments and associated impairment provision.

## Notes to the Group financial statements

### 1. Revenue

	2016 £m	2015 £m
Regulated water and wastewater services	2,033.3	1,975.9
Other services	51.2	62.9
Gross revenue	2,084.5	2,038.8
Charge for bad and doubtful debts	(37.7)	(36.6)
Net revenue	2,046.8	2,002.2

All revenue is derived from activities based in the United Kingdom. In future periods, revenue will include amounts billed to wastewater customers on behalf of Bazalgette Tunnel Limited in respect of construction costs for the Thames Tideway Tunnel.

### 2. Operating expenses

	2016 £m	2015 £m
Wages and salaries	199.4	181.3
Social security costs	18.2	17.5
Pension costs – defined benefit schemes (excluding curtailment gain)	23.6	24.6
Pension costs – curtailment gain on defined benefit schemes	-	(10.0)
Pension costs – defined contribution schemes	5.2	4.3
Severance costs	1.7	12.2
Release of restructuring provision	(5.4)	-
Total employee costs	242.7	229.9
Power	110.0	105.1
Carbon reduction commitment	6.2	8.0
Raw materials and consumables	45.0	41.9
Charge for bad and doubtful debts	27.4	37.9
Rates	93.6	90.6
Depreciation of property, plant and equipment	479.4	476.4
Amortisation of intangible assets	18.6	22.5
Operating lease rental – hire of plant and machinery	1.8	3.8
Operating lease rental – other	9.1	3.8
Property development costs	-	1.6
Research and development expenditure	3.1	4.0
Other operating costs	554.1	552.4
Gross operating costs	1,591.0	1,577.9
Own work capitalised	(134.9)	(144.7)
Net operating expenses	1,456.1	1,433.2

The one-off non-cash curtailment gain of £10.0 million in 2015 arose as a result of the calculation of members' benefits in Mirror Image Pension Scheme changing from final salary to Career Average Revalued Earnings ("CARE"). Amounts payable to the Group's auditor are shown below in respect of the following services to the Group.

	2016 £'000	2015 £'000
<i>Fees payable to the Group's auditor</i>		
Fees payable for the audit of the Company's financial statements	36	36
Fees payable for the audit of the financial statements of subsidiaries pursuant to legislation	448	416
<i>Fees payable to the Group's auditor for other services</i>		
Audit related assurance services	155	93
Other assurance services	761	718
Taxation compliance services	-	11
Other tax advisory services	16	60
Corporate finance services	570	2,376
Other services	224	161
Total	2,210	3,871

## 2. Operating expenses (continued)

Other services include certain agreed upon procedures performed by KPMG LLP in connection with the Group's regulatory reporting requirements to Ofwat

Fees for corporate finance services above include £0.6 million (2015: £2.4m) in respect of advice on the Thames Tideway Tunnel. These costs have been capitalised as part of the design phase of the project. The contract was awarded to KPMG LLP in a prior year following a competitive tendering process in line with the Group's procurement processes.

No fees, other than those disclosed, were payable to KPMG LLP in respect of the Company, or Group, in the current or preceding financial year.

## 3. Employees and Directors

### Employees

All Group employees are based in the United Kingdom. The average number of persons employed by the Group during the year (including Executive Directors), analysed by category, was as follows:

	2016 Number	2015 Number
<i>Employed by Thames Water Utilities Limited</i>		
Retail	937	880
Wholesale Water	1,887	1,652
Wholesale Wastewater	1,746	1,771
Group services	487	506
	<b>5,057</b>	<b>4,809</b>
<i>Employed by other group companies</i>		
Property services	7	8
<b>Total</b>	<b>5,064</b>	<b>4,817</b>

The Company has no employees (2015: none)

### Directors

The Directors' emoluments were as follows:

	2016 £'000	2015 £'000
Salary	827	834

At 31 March 2016 no benefits were accruing to any Directors (2015: £nil) under the Group's defined benefit scheme in respect of services provided to the Group.

### Highest paid Director

Total emoluments, including payments and accruals under long term incentive schemes of the highest paid Director in respect of work done for the Group during the year were £325,000 (2015: £325,000).

## 4. Other operating income

	2016 £m	2015 £m
Power income	8.0	6.8
Requisitions and diversions charges	22.6	22.8
Service connection charges	21.6	19.6
Release from deferred income – infrastructure charges	14.1	13.0
Rental income	7.9	4.8
<b>Total</b>	<b>74.2</b>	<b>67.0</b>

Power income comprises of income from the sale of internally generated electricity.

## 5. Finance income

	2016 £m	2015 £m
Interest income on bank deposits	2 8	7 8
Interest income on swaps	104 7	111 6
<b>Total</b>	<b>107 5</b>	<b>119 4</b>

## 6. Finance expense

	2016 £m	2015 £m
<i>Interest in relation to bank and other loans</i>		
Interest expense	461 8	445 2
RPI accretion on loans	37 7	48 5
Interest expense on swaps	74 8	81 9
Swap termination expense	0 5	-
Amortisation	(11 6)	(11 4)
Net interest expense on defined benefit obligation	10 2	8 1
Gross finance expense	573 4	572 3
Capitalised borrowing costs	(114 4)	(86 4)
<b>Total finance expense</b>	<b>459 0</b>	<b>485 9</b>

## 7. Net gains/(losses) on financial instruments

	2016 £m	2015 £m
Exchange (losses)/gains on other loans	(68.6)	5 8
Gain/(loss) arising on swaps where hedge accounting is not applied	91 3	(252 7)
<b>Total</b>	<b>22 7</b>	<b>(246 9)</b>

## 8. Taxation

### Tax credit in the income statement

	2016 £m	2015 £m
<i>Current tax</i>		
Current year amounts due in respect of corporation tax	-	-
Adjustment in respect of prior periods	(6 0)	(2 9)
	(6 0)	(2 9)
<i>Deferred tax</i>		
Origination and reversal of temporary differences	75 8	31 4
Adjustment in respect of prior periods	(37 0)	(132 2)
Adjustment in respect of corporation tax rate changes	(118.7)	(1 6)
	(79.9)	(102 4)
<b>Tax credit on profit on ordinary activities</b>	<b>(85 9)</b>	<b>(105 3)</b>

Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were substantively enacted on 26 October 2015. A further reduction to the UK corporation tax rate was announced in the 2016 Budget to further reduce the tax rate to 17% (to be effective from 1 April 2020). The deferred tax asset at the balance sheet date has been calculated based on the rate of 18% substantively enacted at the balance sheet date.

## 8. Taxation (continued)

The tax charge for the year ended 31 March 2016 is lower (2015 lower) than the standard rate of corporation tax in the UK. The differences are explained below

	2016 £m	2015 £m
Profit on ordinary activities before taxation	384.6	39.0
Current tax at 20% (2015 21%)	76.9	8.2
<i>Effects of</i>		
Disallowable expenditure	6.8	6.4
Non-taxable income	(8.0)	(5.6)
Tax losses carried forward	-	22.4
Effect of tax change on temporary timing differences	(118.6)	(1.6)
Adjustments to tax charge in respect of prior periods – group relief	(6.0)	(2.9)
Adjustments to tax charge in respect of prior periods – deferred tax	(37.0)	(132.2)
<b>Total tax credit</b>	<b>(85.9)</b>	<b>(105.3)</b>

The income tax (charged)/credited directly to equity during the year is as follows

	2016 £m	2015 £m
<i>Deferred tax</i>		
Tax on actuarial (gain)/loss	(30.8)	25.4
Tax on cash flow hedges	8.7	30.8
<b>Total</b>	<b>(22.1)</b>	<b>56.2</b>

## 9. Intangible assets

	Software £m	Other £m	Assets in development £m	Total £m
<i>Cost</i>				
At 1 April 2014	126.8	1.3	-	128.1
Additions	14.8	-	-	14.8
At 31 March 2015	141.6	1.3	-	142.9
Additions	10.4	-	16.9	27.3
At 31 March 2016	152.0	1.3	16.9	170.2
<i>Amortisation</i>				
At 1 April 2014	(62.1)	(0.6)	-	(62.7)
Amortisation charge	(22.4)	(0.1)	-	(22.5)
At 31 March 2015	(84.5)	(0.7)	-	(85.2)
Amortisation charge	(18.5)	(0.1)	-	(18.6)
At 31 March 2016	(103.0)	(0.8)	-	(103.8)
<i>Net book value</i>				
At 31 March 2016	49.0	0.5	16.9	66.4
At 31 March 2015	57.1	0.6	-	57.7
At 1 April 2014	64.7	0.7	-	65.4

Other intangible assets include concessions, licences and similar rights and assets

## 10. Property, plant and equipment

	Land & buildings £m	Plant & equipment £m	Network assets £m	Assets under construction £m	Total £m
<i>Cost</i>					
At 1 April 2014	3,343 0	5,912 9	5,154 7	1,802 1	16,212 7
Additions	106 6	-	6 4	1,256 2	1,369 2
Transfers between categories	103 2	436 2	206 9	(746 3)	-
Disposals	(0 9)	(18 0)	-	-	(18 9)
At 31 March 2015	3,551 9	6,331 1	5,368 0	2,312 0	17,563 0
Additions	0 2	-	5 1	1,193 5	1,198 8
Transfers between categories	47 8	364 1	1,102 2	(1,514 1)	-
Disposals	(27 2)	(2 2)	(0 1)	-	(29 5)
At 31 March 2016	3,572 7	6,693 0	6,475 2	1,991 4	18,732 3
<i>Depreciation</i>					
At 1 April 2014	(815 2)	(2,981 7)	-	-	(3,796 9)
Depreciation charge	(56 4)	(299 2)	(120 8)	-	(476 4)
Disposals	0 2	17 4	-	-	17 6
At 31 March 2015	(871 4)	(3,263 5)	(120 8)	-	(4,255 7)
Depreciation charge	(56 2)	(299 6)	(123 6)	-	(479 4)
Disposals	26 0	1 8	0 1	-	27 9
At 31 March 2016	(901 6)	(3,561 3)	(244 3)	-	(4,707 2)
<i>Net book value</i>					
At 31 March 2016	2,671 1	3,131 7	6,230 9	1,991 4	14,025 1
At 31 March 2015	2,680 5	3,067 6	5,247 2	2,312 0	13,307 3
At 1 April 2014	2,527 8	2,931 2	5,154 7	1,802 1	12,415 8

£114 4 million borrowing costs were capitalised during the period (2015 £86 4 million) The effective rate of borrowing costs for the year was 4 22% (2015 4 29%)

## 11. Interests in associates

Thames Water Limited, a wholly owned subsidiary of the Group, controls 50% of the share capital of Foudry Properties Limited ("Foudry"), a property company incorporated in the United Kingdom The company made a loss in 2016 of £0 7 million (2015 £0 4m) and has net liabilities of £9 6 million (2015 £8 9m) The Group's share of these losses relate solely to loan and associated interest balances owed to the Group, which have been fully provided for, and consequently no separate provision in respect of these losses has been recognised

As at 31 March 2016 the associates did not have any significant contingent liabilities to which the Group was exposed and the Group did not have any significant contingent liabilities in relation to its interests in associates (2015 £nil) The Group had no capital commitments in relation to its interests in associates as at 31 March 2016 (2015 £nil)

## 12. Goodwill

The Directors have reviewed the carrying value of goodwill in line with the accounting policy on page 31 and do not consider there to be any impairment to this carrying value for the year ended 31 March 2016 (2015 £nil)

All purchased goodwill, which arose on acquisition of the Thames Water group in 2006, has been allocated to the regulated water and wastewater business Impairment of this purchased goodwill occurs where the carrying value is in excess of the net realisable value, the expected sales value of the regulated business

Due to the lack of an active market, or recent transaction involving the equity of the regulated business, an equity valuation model has been used which takes an external, observable, market multiplier uplift to the Regulatory Capital Value ("RCV") of the regulated business Ofwat, an external regulator, have developed the RCV as a measure of the capital value of the business, and the use of a multiplier reflects any premium to which the equity of publically listed water utilities is being traded

The critical assumption is thus the multiple of RCV used As at 31 March 2016, for the carrying amount of goodwill to exceed the recoverable amount, a 21% reduction to the multiplier used would be required

### 13. Inventories and current intangible assets

	2016 £m	2015 £m	As at 1 April 2014 £m
Raw materials and consumables	12 6	7 8	6 1
Current intangible assets – emissions allowances	9 4	2 1	-
<b>Total</b>	<b>22 0</b>	<b>9 9</b>	<b>6 1</b>

Emission allowances represent purchased carbon emission allowances (relating to the emission of carbon dioxide in the UK). A provision (see note 20) is simultaneously recorded in respect of the obligation to deliver emission allowances in the period in which the emissions are made and the associated charge is recognised as an operating expense within the income statement.

### 14. Trade and other receivables

	2016 £m	2015 £m	As at 1 April 2014 £m
<i>Non-current</i>			
Prepayment in respect of the Thames Tideway Tunnel	1 3	-	-
Other receivables	2 5	-	-
	<b>3 8</b>	<b>-</b>	<b>-</b>
<i>Current</i>			
Gross trade receivables	409 3	403 5	402 7
Less doubtful debt provision	(189 9)	(179 0)	(178 5)
Net trade receivables	219 4	224 5	224 2
Amounts owed by associated companies	2 8	2 8	2 8
Insurance claims receivable	16 9	25 1	38 6
Prepayments and accrued income	278 9	220 5	210 6
Other receivables	52 2	53 9	50 8
	<b>570.2</b>	<b>526 8</b>	<b>527 0</b>
<b>Total</b>	<b>574 0</b>	<b>526 8</b>	<b>527 0</b>

The Directors consider that the carrying amount of trade and other receivables is approximately equal to their fair value. Prepayments and accrued income at 31 March 2016 includes water and wastewater income not yet billed of £245.0 million (2015: £188.2 million).

#### Doubtful debts provision

Movements in the doubtful debts provision were as follows:

	2016 £m	2015 £m
At 1 April	(179 0)	(178 5)
Charge for bad and doubtful debts – charged against revenue	(37 7)	(36 6)
Charge for bad and doubtful debts – included within operating expenses	(27 4)	(37 9)
Amounts written off	54 2	74 0
<b>Total at 31 March</b>	<b>(189.9)</b>	<b>(179 0)</b>

The ageing of debt past its due date but not yet impaired cannot be performed. Ageing of gross receivables is as follows:

	2016 £m	2015 £m	As at 1 April 2014 £m
Up to 90 days	41 8	34 8	44 9
91 – 365 days	188 4	202 6	193 6
1 – 2 years	79.5	69 7	69 4
2 – 3 years	37 3	37 1	40 8
More than 3 years	62 3	59 3	54 0
<b>Total</b>	<b>409 3</b>	<b>403 5</b>	<b>402 7</b>



## 14. Trade and other receivables (continued)

A collective provision is recorded against assets which are past due but for which no individual provision is made. This is calculated based on historical experience of levels of recovery. Ageing of impaired receivables is as follows:

	2016 £m	2015 £m	As at 1 April 2014 £m
Up to 90 days			
91 – 365 days	79.5	74.8	76.2
1 – 2 years	37.0	30.5	30.8
2 – 3 years	20.9	19.7	22.0
More than 3 years	52.5	54.0	49.5
<b>Total</b>	<b>189.9</b>	<b>179.0</b>	<b>178.5</b>

Trade and other receivables are part of the Group's financial exposure to credit risk as explained on page 15.

## 15. Cash and cash equivalents

	2016 £m	2015 £m	As at 1 April 2014 £m
Cash at bank and in hand	7.0	21.0	13.1
Short-term deposits	560.3	550.7	430.2
<b>Total</b>	<b>567.3</b>	<b>571.7</b>	<b>443.3</b>

Included within cash at bank and in hand are restricted amounts of £nil (2015: £7.4 million) relating to collateral posted by derivative counterparties that have failed to meet minimum credit rating criteria assigned by Moody's. The net effect of this transaction has a neutral effect on the Group's net debt.

## 16. Trade and other payables

	2016 £m	2015 £m	As at 1 April 2014 £m
<i>Non-current</i>			
Accruals and deferred income	362.2	335.2	311.9
<i>Current</i>			
Trade payables	509.3	599.6	462.1
Amounts owed to Bazalgette Tunnel Limited	1.5	-	-
Accruals and deferred income	287.1	275.4	269.8
Corporation tax payable	1.0	9.3	12.0
Other taxation and social security	5.7	5.5	6.6
Other payables	9.9	3.7	0.6
	<b>814.5</b>	<b>893.5</b>	<b>751.1</b>
<b>Total</b>	<b>1,176.7</b>	<b>1,228.7</b>	<b>1,063.0</b>

Accruals and deferred income include £85.7 million (2015: £82.1m) of receipts in advance relating to amounts received from customers for water and wastewater charges.

The Directors consider that the carrying amount of trade and other payables is approximately equal to their fair value.

## 17. Borrowings

	2016 £m	2015 £m	As at 1 April 2014 £m
Secured bank loans	2,489 2	2,288 2	2,281 7
Other financing	9,313 1	8,869 2	8,459 2
Derivative collateral liability	-	7 4	-
	<b>11,802 3</b>	<b>11,164 8</b>	<b>10,740 9</b>
Interest payable on secured bank loans and other financing	240 5	201 7	187 1
<b>Total</b>	<b>12,042 8</b>	<b>11,366 5</b>	<b>10,928 0</b>
Disclosed within current liabilities	1,037 4	951 9	573 0
Disclosed within non-current liabilities	11,005 4	10,414 6	10,355 0

### Breakdown of secured bank loans:

	2016 £m	2015 £m	As at 1 April 2014 £m
<b>Thames Water Utilities Limited</b>			
£100 0m Class B floating rate loan due 2015 (a)	-	-	99 7
£200 0m floating rate loan due 2016 (a), (j)	200 0	199 9	199 7
£150 0m floating rate loan due 2017	150 0	150 0	150 0
£200 0m 0% Index linked loan due 2017	200 5	201 2	202 1
£100 0m floating rate loan due 2018 (a)	99 8	99 8	99 7
£60 0m 1 23% Index linked loan due 2019	72.0	71 1	71 0
£60 0m 1 415% Index linked loan due 2020	71 8	70 9	70 7
£60 0m 1 513% Index linked loan due 2020	71 4	70 5	70 3
£60 0m 1 38% Index linked loan due 2020	71 2	70 3	70 0
£60 0m 1 356% Index linked loan due 2020	71 3	70 3	69 9
£100 0m floating rate loan due 2020 (a), (c)	99 7	99 7	99 6
£75 0m 1 35% Index linked loan due 2021 (e)	81.6	80 5	80 3
£100 0m floating rate loan due 2021 (a), (c)	99 6	99 5	99 9
£215 0m 0 46% Index linked loan due 2023 (a)	226 8	223 7	222 9
£125 0m 0 598% index linked loan due 2026 (a), (c)	125 0	-	-
£70 0m Class B 3 867% fixed rate loan due 2026 (a)	69 4	-	-
£50 0m Class B 3 875% fixed rate loan due 2026 (a)	50 0	-	-
£20 0m Class B floating rate loan due 2026 (a)	19 9	-	-
£215 0m 0 38% Index linked loan due 2032 (a), (b)	221 3	218 4	215 2
£100 0m 3 28% index linked loan due 2043 (a), (d)	118 4	116 8	116 3
£100 0m 0 790% Index linked loan due 2025 (a), (e)	100 5	100 0	-
<b>Thames Water Utilities Limited total</b>	<b>2,220 2</b>	<b>1,942 6</b>	<b>1,937 3</b>
<b>Kemble Water Finance Limited</b>			
£200m floating rate due 2016 (g), (h), (i)	-	200 0	200 0
£150m floating rate due 2015 (a), (g), (i)	-	145 6	144 4
£75m floating rate due 2022 (a)	72.9	-	-
£200m floating rate due 2025 (a)	196 1	-	-
<b>Kemble Water Finance Limited total</b>	<b>269.0</b>	<b>345 6</b>	<b>344 4</b>
<b>Total secured bank loans</b>	<b>2,489 2</b>	<b>2,288 2</b>	<b>2,281 7</b>

- (a) These loans are shown net of issue costs
- (b) This debt amortises in equal tranches from 2017 onwards
- (c) The interest margins of these two loans are based on a ratings grid and will increase should the Securitisation Group Senior Debt credit rating be downgraded by both Standard & Poor's and Moody's
- (d) This debt amortises from 2023 to 2033 in tranches of £3 0 million, followed by tranches of £750,000 until maturity where there will be a bullet payment of £25 0 million
- (e) These loans contain a collar mechanism that limits total accretion repayment within a predetermined range
- (f) All loans are Class A except where highlighted
- (g) Amounts repayable wholly in one year
- (h) The Group holds five floating to fixed interest rate swaps on this debt which contain mandatory break clauses in March 2016. At this date the outstanding mark-to-market balances would be settled to the counterpart in the money
- (i) Loan is repayable on a monthly basis and therefore has been classed as current
- (j) This loan facility was originally due in 2015 but has subsequently been extended to 2016

## 17. Borrowings (continued)

### Breakdown of other financing

	2016 £m	2015 £m	As at 1 April 2014 £m
<b>Thames Water Utilities Limited Group</b>			
£200m 4 9% Fixed rate bond due 2015 (c), (g)	-	200 1	200 5
£500m Euro 3 25% Fixed rate bond due 2016 (a)	395 4	361 4	413 3
£200m 5 05% Fixed rate bond due 2020 (c), (h)	203.1	203 8	204 5
£225m 6 59% Fixed rate bond due 2021 (p) (i)	247 4	250 6	254 1
£175m 3 38% Index linked bond due 2021 (b), (e)	259 0	256 3	250 8
£550m 5 37% Class B fixed rate bond due 2025 (b), (q), (m)	547.9	547 1	547 5
£330m 6 75% Fixed rate bond due 2028 (b), (i)	396 0	399 2	403 9
£300m 5 75% Class B Fixed rate bond due 2030 (b), (a)	297 2	296 9	297 2
£200m 6 5% Fixed rate bond due 2032 (b), (c), (j)	250 4	252 3	255 1
£300m 4 37% Fixed rate bond due 2034 (b)	295 1	294 9	295 0
£600m 5 13% Fixed rate bond due 2037 (b), (k), (c)	659 9	661 4	663 5
€113m 2 30% CPI IL bond due 2022 (a), (c)	91 6	85 1	100 8
20bn Yen 3 28% Fixed rate bond due 2038 (b), (c)	123 5	112 3	116 9
£50m 3 85% Index linked bond due 2040 (e)	59 3	58 6	58 3
£500m 5 5% Fixed rate bond due 2041 (b)	489 1	488 9	489 5
£50m 1 98% Index linked bond due 2042 (e)	62 9	62 2	61 0
£55m 2 09% Index linked bond due 2042 (b), (e)	66 5	65 6	65 0
£40m 1 97% Index linked bond due 2045 (b), (e)	45 5	45 5	45 1
£300m 4 625% Fixed rate bond due 2046 (b)	292 9	292 8	293 0
£100m 1 85% Index linked bond due 2047 (e)	125 8	124 3	122 1
£200m 1 819% Index linked bond due 2049 (b), (e)	251 0	248 0	243 6
£300m 1 68% Index linked bond due 2053 (b), (e)	399 4	395 4	387 2
£300m 1 68% Index linked bond due 2055 (b), (e)	399 4	395 4	387 2
£200m 1 77% Index linked bond due 2057 (b), (e)	251 0	248 0	243 6
£400m 7 241% Fixed rate bond due 2058 (d)	399 3	398 9	399 0
£350m 1 76% Index linked bond due 2062 (b), (e)	439 2	434 0	426 5
\$156m FRN due 2015 (a), (c)	-	-	93 7
\$150m 4 69% Class B USPP due 2019 (a), (b)	103 3	99 8	88 6
\$150m 3 87% USPP due 2022 (a)	104 2	101 1	90 2
\$200m 4 020% USPP due 2024 (a)	138 9	134 7	120 2
\$250m 4 22% USPP due 2027 (a)	173 7	168 5	150 3
£500m 4 00% Fixed rate bond due 2025 (b)	494 3	493 9	-
£40m 0 75% index linked bond due 2034 (b)	39 8	-	-
£45m 0 721% index linked bond due 2027 (b)	44 6	-	-
£300m 3 5% fixed rate bond due 2028 (b)	295 9	-	-
Fees	(10.1)	(14 4)	(14 2)
	<b>8,432 4</b>	<b>8,162 6</b>	<b>7,753 0</b>
<b>Thames Water (Kemble) Finance plc</b>			
£400m 7 75% fixed rate bond due 2019 (b)	397 1	396 2	395 8
£175m 5 75% fixed rate bond due 2022 (b)	173.2	-	-
	<b>570 3</b>	<b>396 2</b>	<b>395 8</b>
<b>Kemble Water Eurobond plc</b>			
£310m Shareholder loan due 2021	310 4	310 4	310 4
	<b>9,313 1</b>	<b>8,869 2</b>	<b>8,459 2</b>

## 17. Borrowings (continued)

- (a) The Group has entered into swap agreements which eliminate the risk of currency fluctuations in relation to the US Dollar, Euro and Yen loans
- (b) These loans are shown net of issue costs
- (c) The Group has entered into swap agreements that convert this debt into index-linked debt
- (d) £400m Class A bond issued with a final maturity date of 9 April 2058 with a fixed coupon of 7.241% until 9 April 2018. If at this date interest rates have risen, the bond will be "put" at par by investors and repaid by the Group. Should interest rates have fallen, the bond will be called by the Group and either re-marketed for the remaining 40-year period at the underlying Puttable, Callable, Resettable ("PCR") rate (4.572%) plus the prevailing credit spread or the Group will settle related derivative contracts with bank counterparties and redeem the bond at par.
- (e) The value of the capital and interest elements of the index-linked loans is linked to movements in the Retail Price Index ("RPI")
- (f) Amounts repayable wholly within one year
- (g) This bond includes £nil (2015: £0.1m) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group
- (h) This bond includes £3.1m (2015: £3.8m) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group
- (i) This bond includes £68.8m (2015: £72.2m) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group
- (j) This bond includes £52.9m (2015: £54.9m) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group
- (k) This bond includes £63.7m (2015: £65.3m) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group
- (l) This bond includes £22.4m (2015: £25.6m) fair value adjustment to carrying value at acquisition by Kemble Water Holdings Group
- (m) In July 2017 this Class B bond has a 'Step Up and Call' meaning the interest rate changes to 3 months LIBOR plus 7.96% at which point the issuer can exercise a call option to redeem the nominal value of the debt at par value.
- (n) In September 2022 this Class B bond has a 'Step Up and Call' meaning the interest rate changes to 3 months LIBOR plus 7.97% at which point the issuer can exercise a call option to redeem the nominal value of the debt at par value.

The total carrying value of the fair value adjustment to the debt on acquisition of the Thames Water Group by Kemble is £212.9 million (2015: £224.0 million). Capitalised debt issuance costs in relation to the debt portfolio are £79.9 million (2015: £79.3 million). The range of interest rates charged on outstanding bank loans and other financing is 0.0% to 11.0% (2015: 0.0% to 11.0%).

## 18. Financial instruments

### Categories of financial instruments

The carrying values of the primary financial assets and liabilities are as follows

	2016 £m	2015 £m	1 April 2014 £m
<b>Financial assets</b>			
<i>Fair value through profit and loss</i>			
Options	336.4	255.1	76.1
Cross currency swaps	16.1	2.2	-
Index-linked swaps	14.1	14.3	12.7
<i>Loans and receivables (including cash and cash equivalents)</i>			
Trade and other receivables	574.0	526.8	527.0
Short term investments	289.5	277.1	489.0
Cash and cash equivalents	567.3	571.7	443.3
<b>Total</b>	<b>1,797.4</b>	<b>1,647.2</b>	<b>1,548.1</b>
<b>Financial liabilities</b>			
<i>Fair value through profit and loss</i>			
Options	(336.4)	(255.1)	(76.1)
Cross currency swaps	(139.0)	(213.8)	(149.6)
Interest rate swaps	(2.2)	(88.6)	(53.6)
Index-linked swaps	(647.5)	(711.2)	(565.7)
<i>Derivatives designated as hedging instruments</i>			
Forward starting interest rate swaps – cash flow hedges	(219.4)	(154.4)	-
<i>Other financial liabilities</i>			
Trade and other payables	(1,176.7)	(1,228.7)	(1,063.0)
Borrowings	(12,042.8)	(11,366.5)	(10,928.0)
<b>Total</b>	<b>(14,564.0)</b>	<b>(14,018.3)</b>	<b>(12,836.0)</b>

### Fair value measurements

The fair value of financial assets and liabilities represents the price that would be received to sell an asset or paid to transfer a liability between informed and willing parties, other than in a forced or liquidation sale at the measurement date. The techniques for determining the fair value of financial instruments are classified under the hierarchy defined in IFRS 13 *Fair Value Measurement* which categorises inputs to valuation techniques into Levels 1-3 based on the degree to which the fair value is observable. All of the Group's inputs to valuation techniques are Level 2 - the fair value is determined from inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. The table below sets out the valuation basis of financial instruments held at fair value as at 31 March.

	2016 £m	2015 £m	1 April 2014 £m
<i>Financial assets - derivative financial instruments</i>			
Options	336.4	255.1	76.1
Cross currency swaps	16.1	2.2	-
Index-linked swaps	14.1	14.3	12.7
<i>Financial liabilities - derivative financial instruments</i>			
Cross currency swaps	(139.0)	(213.8)	(149.6)
Interest rate swaps	(2.2)	(88.6)	(53.6)
Index-linked swaps	(647.5)	(711.2)	(565.7)
Forward starting interest rate swaps	(219.4)	(154.4)	-
Options	(336.4)	(255.1)	(76.1)
<b>Net total</b>	<b>(977.9)</b>	<b>(1,151.5)</b>	<b>(756.2)</b>

## 18. Financial instruments (continued)

The fair value of derivative financial instruments, including interest rate swaps, cross currency swaps, index-linked swaps and options, are measured using discounted cash flows. The future cash flows are estimated based on forward interest rates from observable yield curves at the period end and discounted at a rate that reflects the credit risk of the Company and the counterparties. Currency cash flows are translated at spot rate.

As at 31 March 2016, the Group holds two offsetting options with equal and opposite values of £336.4 million (2015: £255.1m) in relation to the £400.0 million Puttable Callable Resettable ("PCR") Bond held in Thames Water Cayman Utilities Finance Limited. This value of the liability would be the cost to Thames Water of settling the option in cash and the value of the asset is the reciprocal value to Thames Water of, instead, choosing to remarket the original bond for a 40 year period. See note 25 for further details.

### Comparison of fair value of financial instruments with their carrying amounts

The carrying amounts of the Group's trade receivables and trade payables are considered to be approximate to their fair values. The fair values and carrying values of the Group's other financial assets and financial liabilities are set out in the table below.

	2016		2015		1 April 2014	
	Book value £m	Fair value £m	Book value £m	Fair value £m	Book value £m	Fair value £m
<b>Financial assets</b>						
<i>Non-current</i>						
Derivative financial instruments						
Options	336.4	336.4	255.1	255.1	76.1	76.1
Cross currency swaps	16.1	16.1	2.2	2.2	-	-
Index-linked swaps	14.1	14.1	14.3	14.3	12.7	12.7
<i>Current</i>						
Short term investments	289.5	289.5	277.1	277.1	489.0	489.0
Cash and cash equivalents	567.3	567.3	571.7	571.7	443.3	443.3
<b>Total</b>	<b>1,223.4</b>	<b>1,223.4</b>	<b>1,120.4</b>	<b>1,120.4</b>	<b>1,021.1</b>	<b>1,021.1</b>
<b>Financial liabilities</b>						
<i>Non-current</i>						
Borrowings						
Floating rate	(738.1)	(738.1)	(451.6)	(451.6)	(800.6)	(800.6)
Index-linked	(3,766.3)	(4,337.8)	(3,711.9)	(4,284.1)	(3,579.7)	(3,562.8)
Fixed rate	(6,501.0)	(7,653.4)	(6,251.1)	(7,430.3)	(5,974.4)	(6,196.3)
Derivative financial instruments						
Cross currency swaps	(96.6)	(96.6)	(213.8)	(213.8)	(149.6)	(149.6)
Interest rate swaps	(2.2)	(2.2)	(2.9)	(2.9)	(53.6)	(53.6)
Index-linked swaps	(647.5)	(647.5)	(711.2)	(711.2)	(565.7)	(565.7)
Forward starting interest rate swaps	(219.4)	(219.4)	(154.4)	(154.4)	-	-
Options	(336.4)	(336.4)	(255.1)	(255.1)	(76.1)	(76.1)
<i>Current</i>						
Borrowings						
Floating rate	(200.0)	(200.0)	(542.8)	(542.8)	(386.2)	(386.2)
Index-linked	(200.5)	(200.5)	-	-	-	-
Fixed rate	(396.4)	(403.0)	(200.0)	(202.0)	-	-
Interest payable	(240.5)	(240.5)	(201.7)	(201.7)	(187.1)	(187.1)
Derivative financial instruments						
Cross currency swaps	(42.4)	(42.4)	-	-	-	-
Interest rate swaps	-	-	(85.7)	(85.7)	-	-
Derivative collateral liability	-	-	(7.4)	(7.4)	-	-
<b>Total</b>	<b>(13,387.3)</b>	<b>(15,117.8)</b>	<b>(12,789.6)</b>	<b>(14,543.0)</b>	<b>(11,773.0)</b>	<b>(11,978.0)</b>

## 18. Financial instruments (continued)

The fair value of floating rate debt instruments is assumed to be the nominal value of the primary loan and adjusted for credit risk if this is significant. The fair value of index-linked debt instruments is based on the nominal value of the debt plus accretion already accrued and accretion expected to accrue to maturity.

### Capital risk management

Details of the Group's capital risk management strategy can be found on page 15.

The capital structure of the Group consists of net debt and equity as follows:

	2016 £m	2015 £m	1 April 2014 £m
Cash and cash equivalents	567.3	571.7	443.3
Short-term investments	289.5	277.1	489.0
Secured bank loans	(2,489.2)	(2,288.2)	(2,281.7)
Other financing	(9,313.1)	(8,869.2)	(8,459.2)
Derivative financial liabilities	(226.0)	(330.9)	(319.0)
<b>Net debt</b>	<b>(11,171.5)</b>	<b>(10,639.5)</b>	<b>(10,127.6)</b>
<b>Equity attributable to the owners of the Group</b>	<b>1,498.5</b>	<b>1,001.9</b>	<b>1,146.0</b>

Net debt in the table above excludes accrued interest on debt but includes accretion on index-linked debt. Derivative financial liabilities in the above table of £226.0 million relates solely to accretion on index-linked swaps and the effect of movement in foreign exchange rate on cross currency swaps.

### Financial risk management

The Group's activities expose it to a number of financial risks: market risk (including interest rate risk and exchange rate risk), credit risk, liquidity risk and inflation risk. Details of the nature of each of these risks along with the steps the Group has taken to manage them is described on page 15.

#### (a) Market risk

Below is the effective interest rate and foreign currency risk profile of the debt held by the Group after taking into account the derivative financial instruments used to manage market risk.

As at 31 March 2016	Total at fixed rates £m	Total at floating rates £m	Total at index linked rates £m	Total £m
Interest bearing loans and borrowings				
Net of corresponding swap assets				
- £ Sterling	5,752.3	903.1	5,168.4	11,823.8
<b>Total</b>	<b>5,752.3</b>	<b>903.1</b>	<b>5,168.4</b>	<b>11,823.8</b>

As at 31 March 2015	Total at fixed rates £m	Total at floating rates £m	Total at index linked rates £m	Total £m
Interest bearing loans and borrowings				
Net of corresponding swap assets				
- £ Sterling	5,375.7	979.4	5,141.4	11,496.5
<b>Total</b>	<b>5,375.7</b>	<b>979.4</b>	<b>5,141.4</b>	<b>11,496.5</b>

## 18. Financial instruments (continued)

As at 1 April 2014	Total at fixed rates £m	Total at floating rates £m	Total at index linked rates £m	Total £m
Interest bearing loans and borrowings Net of corresponding swap assets				
- £ Sterling	4,872 0	878 1	5,307 1	11,057 2
<b>Total</b>	<b>4,872 0</b>	<b>878 1</b>	<b>5,307 1</b>	<b>11,057 2</b>

The weighted average interest rates of the debt held by the Company and the period until maturity for which the rate is fixed at fixed rate and index linked debt are given below

	Weighted average interest rate for fixed rate and index linked debt			Weighted average period until maturity for which rate is fixed for fixed rate and index linked debt		
	2016 %	2015 %	1 April 2014 %	2016 Years	2015 Years	1 April 2014 Years
Interest bearing loans and borrowings Net of corresponding swap assets						
- £ Sterling	3 4%	3 8%	3 9%	16 5	16 9	20 2
<b>Total</b>	<b>3 4%</b>	<b>3 8%</b>	<b>3 9%</b>	<b>16 5</b>	<b>16 9</b>	<b>20 2</b>

### (i) Interest rate risk sensitivity analysis

The table below summarises the impact, on pre-tax profits, of 1% increase or decrease in interest rate at 31 March 2016. This analysis considers effect of variable interest rate instruments and assumes that all other variables, in particular exchange rates, remain constant

	2016	
	+1% £m	-1% £m
Profit	251 7	(319 5)
Equity	385.5	(464 5)

### (ii) Exchange rate risk sensitivity analysis

The table below summarises the impact of changes in the year end valuations of financial assets and liabilities denominated in foreign currency on pre-tax profits of a 10% strengthening or weakening of GBP (£) against the respective currencies in which the financial assets and liabilities are denominated at 31 March 2016. This analysis assumes that all other variables in the valuation remain constant

	2016	
	+10% £m	-10% £m
Profit	(22 2)	19 6
Equity	(22 2)	19 6

### (iii) Inflation risk sensitivity analysis

The table below summarises the impact on pre-tax profits of a 1% increase or decrease in inflation rates at 31 March 2016. This analysis assumes that all other variables, in particular exchange rates, remain constant

	2016	
	+1% £m	-1% £m
Profit	(725.2)	605 4
Equity	(725 2)	605 4



## 18. Financial instruments (continued)

### (b) Credit risk

The Group's maximum exposure to credit risk is the carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, less collateral cash held under the terms of the whole business securitisation agreement explained on page 34

At 31 March 2016 the Group held £nil (2015 £7.4 million) of collateral cash, representing amounts due from counterparties to the Group's derivative contracts that have failed to meet minimum short term credit rating criteria assigned by Moody's

Following table summarises amounts held on short term investments by credit rating of counterparties

	2016 £m	2015 £m	1 April 2014 £m
AA-	17.0	76.0	60.0
A+	60.0	161.7	199.0
A	212.5	39.4	230.0
<b>Total</b>	<b>289.5</b>	<b>277.1</b>	<b>489.0</b>

Following table summarises fair value of derivatives assets by credit rating of counterparties

	2016 £m	2015 £m	1 April 2014 £m
A+	2.0	15.0	12.7
A	184.4	126.5	-
A-	-	128.6	76.1
AA-	10.7	1.5	-
BBB+	169.5	-	-
<b>Total</b>	<b>366.6</b>	<b>271.6</b>	<b>88.8</b>

### (c) Liquidity risk

Details of the nature and management of the Group's liquidity risk is provided on page 16

The maturity profile of interest bearing loans and borrowings disclosed in the statement of financial position are given below

	2016 £m
Within one year	796.9
Between one and two years	150.0
Between two and three years	203.1
Between three and four years	854.6
Between four and five years	613.1
After more than five years	9,184.6
<b>Total</b>	<b>11,802.3</b>

## 18. Financial instruments (continued)

### (i) Cash flows from non-derivative financial liabilities

The maturity profile of the anticipated future cash flows including interest in relation to the Group's non-derivative financial liabilities on an undiscounted basis, which, therefore, differs from both the carrying value disclosed in the statement of financial position and fair values, is as follows

Undiscounted amounts payable	2016 £m
Within one year	(2,096 6)
Between one and two years	(603 6)
Between two and three years	(677 5)
Between three and four years	(1,378 0)
Between four and five years	(1,038 8)
After more than five years	(21,268.3)
Total	(27,062 8)

### (ii) Cash flows from derivative financial instruments

The maturity profile of the Group's financial derivatives (which include interest rate swaps and cross currency swaps), based on undiscounted cash flows, is as follows

Undiscounted amounts payable	2016 £m
Within one year	(7 4)
Between one and two years	(31 4)
Between two and three years	15 2
Between three and four years	(16 4)
Between four and five years	14 2
After more than five years	(1,188 1)
Total	(1,213 9)

### Cash flow hedges

The Group has designated a number of contracts which qualify as hedges in accordance with IAS 39 *Financial Instruments recognition and Measurement*, as cash flow hedges. The accounting policy on cash flow hedges is explained on page 37.

In mid-2014 the Group executed £2.25bn of forward-starting pay fixed/ received floating interest rate swaps of a 5-7 year maturity with various financial institutions to fix the future interest costs of an element of the new debt issued in March 2016. This protects the Group against adverse movements in underlying interest rates by matching debt issuance against a derivative instrument with fixed cash flow. The expected cash flows of the Group's cash flow hedges are as follows:

Undiscounted amounts payable	2016 £m
<i>Interest rate swaps</i>	
Within one year	(2 2)
Between one and two years	(12 8)
Between two and three years	(20 2)
Between three and four years	(25 4)
Between four and five years	(27 1)
After more than five years	(66 9)
Total	(154 6)

In respect of the above cash flow hedges, a loss of £65.0 million was recognised in other comprehensive income in the year (2015 loss of £154.4m). The amount reclassified from equity to profit or loss for the year was £nil (2015: £nil).

## 19. Deferred tax

An analysis of movements in the major deferred tax liabilities and assets recognised by the Group is set out below

	Accelerated tax depreciation £m	Retirement benefit obligations £m	Cash flow hedge £m	Other £m	Total £m
At 1 April 2014	(1,387 4)	48 3	81 8	77 1	(1,180 2)
Credit/(charge) to income	75 4	(4 0)	38 6	(7 3)	102 7
Credit to equity	-	25 4	30 8	-	56 2
At 31 March 2015	(1,312 0)	69 7	151 2	69 8	(1,021 3)
Credit/(charge) to income	107 5	6 8	(21 0)	(13 5)	79 8
Credit to equity	-	(30 8)	8 7	-	(22 1)
At 31 March 2016	(1,204 5)	45 7	138 9	56 3	(963 6)

Deferred tax assets and liabilities have been offset. The offset amounts, which are to be recovered/settled after more than 12 months are as follows

	2016 £m	2015 £m
Deferred tax asset	240 9	290 7
Deferred tax liability	(1,204 5)	(1,312 0)
Total	(963 6)	(1,021 3)

There is an unrecognised deferred tax asset in respect of tax losses where the Group does not anticipate taxable profits in the immediate future. The amount of deferred tax asset not recognised at 18% (2015: 20%) is

	2016 £m	2015 £m
Deferred tax asset not recognised in respect of tax losses	6 4	72 3

## 20. Provisions for liabilities and charges

	Emissions provision £m	Insured liabilities £m	Restructuring provision £m	AMP4 provision £m	Other provisions £m	Total £m
At 1 April 2014	-	57 3	0 6	8 5	33 5	99 9
Utilised during the year	(8 0)	(19 3)	(0 6)	(0 8)	(9 6)	(38 3)
Charge to income statement	8 0	7 7	12 3	-	11 1	39 1
At 31 March 2015	-	45 7	12 3	7 7	35 0	100 7
Utilised during the period	-	-	(6 3)	(1 4)	(1 8)	(9 5)
Charge/(credit) to income statement	7 0	(0 3)	(5 4)	-	9 9	11 2
Transfer to current liabilities	-	-	-	(2 4)	-	(2 4)
At 31 March 2016	7 0	45 4	0 6	3 9	43 1	100 0

Emissions provisions relate to the obligation to purchase carbon emissions allowances, see note 13

The insured liability provision is in respect of insurance claims notified. A receivable in respect of these obligations has been included in note 14 representing the reimbursement value from captive and third party insurance companies net of retentions.

The restructuring provision principally relates to severance costs and onerous lease provisions recognised as a result of the Group's restructuring and reorganisation. The outflows associated with the restructuring provision are expected to arise within the next 12 months however the timings of those associated with an onerous lease provisions are uncertain and therefore amounts provided have been classified as non-current.

## 20. Provisions for liabilities and charges (continued)

The AMP4 provision represents agreed settlement in respect of an information request received from Ofwat issued under section 203 of the Water Industry Act 1991 concerning the properties claimed as safeguarded from internal sewer flooding by capital schemes completed in 2009/10. The provision is utilised against contributions made to various charity schemes. The associated outflows are expected to arise over AMP6.

Other provisions principally relate to a number of legal claims against the Group and represents management's best estimate of the value of settlement and costs. Timing of settlement for these claims is uncertain and therefore amounts provided have been classified as non-current.

## 21. Share capital and other reserves

### Share capital

	2016 £m	2015 £m	1 April 2014 £m
<i>Allotted, called up and fully paid</i> 1,991,600,000 ordinary shares of £1 each	1,991.6	1,991.6	1,991.6

The Company has one class of ordinary share which carries no right to fixed income. The holders of ordinary shares are entitled to receive dividends as declared and are entitled to one vote per share at meetings of the Company.

### Other reserves

	2016 £m	2015 £m	1 April 2014 £m
Cash flow hedge reserve	(179.9)	(123.6)	-
Retained earnings	(313.2)	(866.1)	(845.6)
<b>Total</b>	<b>(493.1)</b>	<b>(989.7)</b>	<b>(845.6)</b>

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

## 22. Dividends

	2016 £m	2015 £m	1 April 2014 £m
Interim dividend paid (2016: 0p per share, 2015: 3.17p per share)	-	63.1	45.1

Of the total interim dividend payments declared in the year ended 31 March 2015 of £63.1 million, £1.5 million was paid in April 2015.

## 23. Retirement benefit obligations

### Background

The Group operates four material pension schemes, one of which is a defined contribution scheme and the other three are defined benefit

In addition to the cost of the UK Pension arrangements, the Group operates arrangements under which it augments benefits on retirement in certain cases of redundancy. These augmentations are funded by way of additional employer contributions to the schemes. In the year to 31 March 2016 these related payments amounted to £2.2 million (2015: £0.3m).

The defined contribution scheme was set up in April 2011, managed through Standard Life, and is open to all new employees of the Group. The pension charge for the period represents contributions payable by the Group to the scheme and amounted to £5.2 million (2015: £4.3 million). These were paid in the following financial year in line with the scheme rules. Defined benefit arrangements for the Group's eligible employees are provided through three defined benefit Group pension schemes:

- Thames Water Pension Scheme ("TWPS"),
- Thames Water Mirror Image Pension Scheme ("TWMIPS"), and
- The SUURBS Arrangement ("SUURBS")

The assets of all three schemes are held separately from the rest of the Group in independently administered funds in the United Kingdom. The Trustees of these schemes are required to act in the best interest of the scheme beneficiaries.

The SUURBS Arrangement provides retirement benefits to a previous director, and their spouse, of Thames Water Limited, a subsidiary entity in the Group. The scheme is an unfunded arrangement but is secured against assets held by Thames Water Limited. The latest full valuation was carried out at 31 March 2013 on behalf of the pension Trustees by Mercer Limited, the independent and professionally qualified consulting actuaries to the scheme.

Both the TWPS and TWMIPS schemes represent career average pension schemes. On 1 April 2011 the defined benefit arrangements were closed to new entrants and replaced with a defined contribution scheme. The most recent full actuarial valuation was at 31 December 2013 on behalf of the Trustees by AON Hewitt Limited, the independent and professionally qualified consulting actuary to the schemes.

For all three schemes the 2013 valuations were updated to 31 March 2016 by PricewaterhouseCoopers LLP, an independent and professionally qualified consulting actuary, using revised assumptions that are consistent with the requirements of IAS 19R *Employee Benefits* and shown in this note to the financial statements. The Group expects to contribute approximately £35.3 million in aggregate to the defined benefit pension schemes in the next financial year.

### Amounts included in statement of financial position in respect of defined benefit pension schemes

The net pension liability recognised within the statement of financial position is as follows:

	2016			2015		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Equities	430.1	146.4	-	435.0	160.1	-
Corporate bonds	74.5	68.7	-	73.5	70.8	-
LDI portfolio	571.8	488.0	-	-	-	-
Fixed interest government bonds	-	-	-	99.9	204.1	-
Index linked government bonds	-	-	11.2	452.5	287.7	11.3
Property	62.5	46.6	-	62.1	46.3	-
Cash	3.9	3.5	2.0	23.2	4.9	1.8
<b>Fair value of scheme assets</b>	<b>1,142.8</b>	<b>753.2</b>	<b>13.2</b>	<b>1,146.2</b>	<b>773.9</b>	<b>13.1</b>
<b>Present value of defined benefit obligations</b>	<b>(1,385.1)</b>	<b>(694.8)</b>	<b>(7.1)</b>	<b>(1,478.8)</b>	<b>(748.8)</b>	<b>(7.4)</b>
<b>(Deficit)/surplus</b>	<b>(242.3)</b>	<b>58.4</b>	<b>6.1</b>	<b>(332.6)</b>	<b>25.1</b>	<b>5.7</b>
Effect of asset limit	-	(76.1)	-	-	(46.4)	-
<b>Retirement benefit surplus/(obligations)</b>	<b>(242.3)</b>	<b>(17.7)</b>	<b>6.1</b>	<b>(332.6)</b>	<b>(21.3)</b>	<b>5.7</b>

The Directors have reviewed the scheme rules of the defined benefit pension schemes and have concluded that, for the TWMIPS scheme, as the Company does not have an unconditional right to a refund of any surplus, including as a deduction to future contributions payable, the provisions of IFRIC 14 *IAS 19 – The limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* apply. Consequently the surplus for this scheme has been restricted with an obligation recognised for the present value of deficit funding contributions payable to the scheme.

## 23. Retirement benefit obligations (continued)

The movements in the fair value of scheme assets were as follows

	2016			2015		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
At 1 April	1,146 2	773 9	13 1	976 8	709 4	12 4
Interest income on scheme assets	37 9	24 2	0 4	44 3	30 1	0 4
Contributions by sponsoring employers	12 1	2 3	0 3	35 2	7 7	0 3
Contributions from scheme members	0 1	-	-	0 1	-	-
Administration costs paid from scheme assets	(2 5)	(1 4)	-	(4 2)	(1 5)	-
Benefits paid	(40 4)	(37 7)	(0 3)	(37 2)	(38 7)	(0 3)
Contributions for termination benefits	1 4	0 9	-	0 3	-	-
Gains/(losses) on assets above interest	(12 0)	(9 0)	(0 3)	130 9	66 9	0 3
<b>At 31 March</b>	<b>1,142.8</b>	<b>753 2</b>	<b>13 2</b>	<b>1,146 2</b>	<b>773 9</b>	<b>13 1</b>

The movement in the present value of the defined benefit obligations were as follows

	2016			2015		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
At 1 April	1,478 8	748 8	7 4	1,202 0	657 7	6 9
Current service cost	14 9	3 2	-	12 6	3 1	-
Past service cost	-	-	-	-	-	-
Interest cost	49 1	23 4	0 2	54 7	27 8	0 3
Contributions from scheme members	0 1	-	-	0 1	-	-
Benefits paid	(40 4)	(37 7)	(0 3)	(37 2)	(38 7)	(0 3)
Termination benefits	1 4	0 9	-	0 3	-	-
Curtailment	-	-	-	-	(10 0)	-
Actuarial (gains)/losses	(118 8)	(43.8)	(0 2)	246 3	108 9	0 5
<b>At 31 March</b>	<b>1,385 1</b>	<b>694 8</b>	<b>7 1</b>	<b>1,478 8</b>	<b>748 8</b>	<b>7 4</b>

The one-off non-cash curtailment gain of £10 0m in 2015 arose as a result of the calculation of members' benefits in Mirror Image Pension Scheme changing from final salary to Career Average Revalued Earnings ("CARE")

### Amounts recognised in the income statement in respect of defined benefit pension schemes

	2016			2015		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Curtailment gain	-	-	-	-	(10 0)	-
Current service cost	14 9	3 2	-	12 6	3 1	-
Scheme administration expenses	2 5	1 4	-	4 2	1 5	-
Effect of restriction of surplus	-	1 5	-	-	3 1	-
Net interest cost	11 2	(0 8)	(0 2)	10 4	(2 2)	(0 1)
<b>Total</b>	<b>28 6</b>	<b>5 3</b>	<b>(0 2)</b>	<b>27 2</b>	<b>(4 5)</b>	<b>(0 1)</b>

The net expense is recognised in the following captions within the income statement

	2016			2015		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Operating expenses	17 4	6 1	-	16 8	(2 3)	-
Finance expenses	11 2	(0 8)	(0 2)	10 4	(2 2)	(0 1)
<b>Total</b>	<b>28 6</b>	<b>5 3</b>	<b>(0 2)</b>	<b>27 2</b>	<b>(4 5)</b>	<b>(0 1)</b>

## 23. Retirement benefit obligations (continued)

Actuarial gains and losses have been recognised within other comprehensive income. An analysis of the amount presented is set out below.

	2016 £m	2015 £m
Actual return less expected return on pension scheme assets	(21.4)	198.1
Experience gain/(loss) arising on scheme liabilities	39.7	(57.6)
Gain/(loss) arising due to change in assumptions	123.1	(298.0)
Change in asset ceiling	(28.2)	30.4
<b>Total</b>	<b>113.2</b>	<b>(127.1)</b>
Cumulative actuarial losses recognised	<b>(406.3)</b>	<b>(519.5)</b>

### Actuarial risk factors

The schemes are exposed to actuarial risks including investment risk, inflation risk and longevity risk.

Investment risk arises because the Group's contributions to the schemes are based on expected returns from scheme assets based on actuarial assumptions. If these assets underperform a deficit will be created against the scheme liabilities.

The benefits payable to the members of the schemes are linked to inflation and as such higher inflation will lead to higher liabilities. The Group's contributions to the schemes are based on assumptions about the future levels of inflation. Therefore an increase in inflation above that assumed in the actuarial calculations will create a deficit.

The schemes' obligations are dependent on the assumptions about the life expectancy of the members after retirement. If scheme members live longer than assumed in the actuarial calculations, a deficit will be created.

### Actuarial assumptions

The main financial assumptions used in the valuation of these schemes are as follows:

	2016			2015		
	TWPS	TWMIPS	SUURBS	TWPS	TWMIPS	SUURBS
Price inflation – RPI	3.05%	2.95%	2.95%	3.05%	2.95%	2.95%
Price inflation – CPI	2.05%	1.95%	1.95%	2.05%	1.95%	1.95%
Rate of increase to pensions in payment – RPI	3.05%	2.95%	2.95%	3.05%	2.95%	2.95%
Rate of increase to pensions in payment – CPI	2.05%	1.95%	N/A	2.05%	1.95%	N/A
Discount rate	3.65%	3.50%	3.50%	3.35%	3.20%	3.20%

Both the TWPS and TWMIPS schemes provide benefits on a Career Average ("CARE") benefit structure whereby past entitlements are linked to movements in CPI therefore an assumption for increase in salary is not required.

In valuing the liabilities of the pension schemes at 31 March 2016, mortality assumptions have been made as indicated below, however in respect of the SUURBS Arrangement as mortality assumptions have been made regarding the schemes only member and their spouse they have not been disclosed. These mortality assumptions are based on standard mortality tables and the recent actual mortality experience of members within the schemes. The assumptions also allow for future improvements to mortality rates.

	2016		2015	
	TWPS Years	TWMIPS Years	TWPS Years	TWMIPS Years
<i>Life expectancy from age 60</i>				
Male	28.3	27.3	28.3	27.3
Female	29.7	29.7	29.7	29.7
<i>Life expectancy from age 60 currently age 40</i>				
Male	30.4	30.4	30.4	29.3
Female	31.8	31.8	31.8	31.8

## 23. Retirement benefit obligations (continued)

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

	2016			2015		
	TWPS £m	TWMIPS £m	SUURBS £m	TWPS £m	TWMIPS £m	SUURBS £m
Change in discount rate (+ 1% p a )	(260 0)	(100 0)	(0 8)	(285 0)	(95 0)	(0 9)
Change in rate of inflation (-1% p a )	(220 0)	(60 0)	(0 8)	(250 0)	(95 0)	(0 9)
Change in life expectancy (-1 year)	(40 0)	(20 0)	(0 3)	(45 0)	(22 0)	(0 3)

## 24. Capital commitments

	2016 £m	2015 £m	1 April 2014 £m
Contracted for but not provided	489 9	325 7	547 6

In addition to these commitments, the Group has long-term capital investment plans, under its business plan submitted to Ofwat, to provide for future growth and maintenance of the infrastructure network

## 25. Contingent liabilities

There are claims arising in the normal course of business, which are in the process of negotiation. The Group has set aside amounts considered appropriate for all legal and similar claims.

In April 2018 if interest rates are below a certain level a bond with par value of £400 0 million (see note 18) will either be remarketed for the remaining 40 year period or the Group will settle the related derivative contract (low strike call option) and the bond will be redeemed at par. If the Group decided to settle the derivative at this date, it would result in a cash outflow which reflects the fair value of the derivative at that date. As at 31 March 2016 the fair value of the derivative is £336 4 million (2015: £255 1m). The Group expects that should it wish to take the opportunity it will be able to successfully remarket the bonds at fair value and a cash settlement will not be required.

A debt under section 75 of the Pensions Act 1995 has arisen in respect of the TWMIPS pension scheme as a result of a trigger event in 2007. Information continues to be gathered, however initial conclusions drawn by Aon Hewitt Limited, actuarial advisers to the TWMIPS trustees, estimate the debt to be between £1 0 million and £2 0 million.

## 26. Operating leases

Lease payments under operating leases of £10 9 million (2015: £7 6 million) were recognised as an expense in the year. At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2016 £m	2015 £m
Within one year	6 8	7 0
Between two and five years	27 2	26 8
After more than five years	66 7	73 2
<b>Total</b>	<b>100 7</b>	<b>107 0</b>

Operating lease payments represent rentals payable by the Group for certain office properties, plant and equipment, and the vehicle fleet.

## 27. Off-balance sheet arrangements

The Group is party to a number of contractual arrangements for the purposes of its principal activities that are not required to be included within the statement of financial position. These are operating leases, outsourcing contracts and guarantees.

In respect of outsourcing contracts, the Group has entered into various arrangements to outsource the provision of certain back-office and operational functions with third party providers. These outsourced arrangements include aspects of IT support, legal services, supply chain, metering and capital delivery. These arrangements are on commercial terms and no associated penalty or termination clauses will have a material effect on the financial position of the Group.



## 28. Guarantees

Thames Water Utilities Holdings Limited, Thames Water Utilities Limited and its direct subsidiaries are Obligors under the whole business securitisation entered into in 2007. The Obligors have all entered into a Security Trust and Inter-creditor Deed. Under this document each Obligor will guarantee the obligations of each other Obligor with their future cash flows. The guaranteed debt at 31 March 2016 was £10.7bn (2015: £10.2bn).

At 31 March 2016 the Group has secured the overdrafts and loans of certain subsidiaries up to a maximum of £20.0 million (2015: £20.0m). The Group has also guaranteed facilities for contract bonding on behalf of certain subsidiaries amounting to £0.8 million (2015: £0.8m) at 31 March 2016.

The Group has provided security by way of a debenture over its assets in relation to monies owed by the Group under its credit facility agreement with RBS as Facility Agent. This facility amounted to £525 million (2015: £425m), the amount outstanding at 31 March 2016 was £340 million (2015: £350m). The chargee is RBS as Facility Agent. The Company has also entered into an inter-creditor agreement guaranteeing the obligations of its subsidiary, Thames Water Kemble Finance Plc under its £1bn debt issuance programme. The guaranteed debt outstanding at 31 March 2016 is £575m (2015: £400m).

Thames Water Insurance Company Limited, a wholly owned subsidiary of the Group, has letters of credit in issue totalling £3.9 million (2015: £3.9m). The letters of credit will be further reduced to £0.75m in August 2016.

In addition there are a number of parent company guarantees in respect of subsidiary company contractual obligations that have been entered into in the normal course of business. No un-provided loss is expected to arise under these arrangements.

## 29. Statement of cash flows

### Reconciliation of operating profit to operating cash flows

	2016 £m	2015 £m
Profit for the financial year	470.5	144.3
Less finance income	(107.5)	(119.4)
Add finance expense	459.0	485.9
(Less profit)/add loss on fair value of financial instruments	(22.7)	246.9
Less taxation credit on profit on ordinary activities	(85.9)	(105.3)
<b>Operating profit</b>	<b>713.4</b>	<b>652.4</b>
Depreciation on property, plant and equipment	479.4	476.4
Amortisation of intangible assets	18.6	22.5
Profit on sale of property, plant and equipment	(48.5)	(16.4)
Difference between pension charge and cash contribution	8.8	(28.7)
Increase in inventory	(12.0)	(3.9)
Increase in trade and other receivables	(6.0)	(4.6)
Increase in trade and other payables	16.5	107.0
(Decrease)/increase in provisions	(0.6)	0.8
<b>Cash generated from operations</b>	<b>1,169.6</b>	<b>1,205.5</b>

### Non-cash transactions

No additions to property, plant and equipment during the year, or the immediately preceding year, were financed through new finance leases. Assets transferred from developers and customers for nil consideration were recognised at their fair value.

### 30. Related party transactions

Kemble Water Holdings Limited is owned by a consortium of investors led by Macquarie European Infrastructure Fund II LP ("MEIF 2"), wholesale investment funds which make long-term investments in infrastructure and related businesses located across Europe. The Directors do not consider there to be an ultimate parent or controlling party. The Company's other shareholders are international pension funds and institutional investors.

MEIF 2 invest in businesses which

- Provide an essential service to the community,
- Have a strong competitive position, and
- Generate stable cash flows over the long term

MEIF 2 aims to deliver sustainable cash yields and moderate capital growth from their diversified portfolios of quality infrastructure investments. MEIF 2 is managed by Macquarie Infrastructure and Real Assets (Europe) Limited ("MIRAEL"). MIRAEL is a wholly owned member of the Macquarie Group, and is authorised and regulated by the Financial Conduct Authority. MIRAEL is resourced by executives of Macquarie Infrastructure and Real Assets.

#### Trading transactions

Transactions between subsidiaries within the Group, which are related parties, have been eliminated on consolidation and are not included in this note. The following transactions took place during the year between the Group and its related parties:

	2016		2015	
	Services provided by £m	Services provided to £m	Services provided by £m	Services provided to £m
Transactions with external entities	16.6	-	5.4	-

#### Outstanding balances

The following amounts were outstanding at the balance sheet date:

	2016		2015	
	Amounts owed to £m	Amounts owed from £m	Amounts owed to £m	Amounts owed from £m
Balances with external entities	5.0	-	-	-

The related parties are the subsidiaries and associates of the Company along with key management personnel. The amounts outstanding are unsecured and will be settled in cash. Provisions have been made for doubtful debts in respect of the amounts owed by related parties.

#### Key management personnel

Key management personnel comprise the members of the Board of Directors and the Executive Committee of the Group's principal trading subsidiary Thames Water Utilities Limited during the year. Information regarding transactions with post-employment benefits plans is included in note 23.

	2016 £'000	2015 £'000
Short term employee benefits	3,363	3,341
Post-employment benefits	475	477
Other long-term benefits	2,519	3,085
Termination benefits	321	-
Other	135	138
<b>Total</b>	<b>6,813</b>	<b>7,041</b>

## 31. Adoption of International Financial Reporting Standards

This is the first time that the Group and Company has presented its annual financial statements under IFRS. The policies applied in these financial statements are based on the IFRS, IAS and IFRIC interpretations issued and effective and ratified by the European Union as of 9 June 2016, the date that the Board of Directors approved the statements. The Group and Company's previously reported results for the year ended 31 March 2015 have been restated, the effective date of transition to IFRS being 1 April 2014.

In accordance with IFRS 1 *First Time Adoption of International Financial Reporting Standards* the Company's accounting policies under IFRS have been applied retrospectively at the date of transition, with the exception of a number of permitted exemptions. The key areas affected by the implementation of IFRS, including permitted exemptions taken, have been summarised below.

### Infrastructure accounting

Under UK GAAP the Group's water and wastewater infrastructure assets were accounted for in accordance with the renewals accounting provisions of FRS15 *Tangible Fixed Assets*. Under this the water and wastewater infrastructure networks were assumed to be single assets and the depreciation charged was the estimated level of annual expenditure required to maintain the operating capacity of the networks. Actual expenditure was capitalised as incurred.

Additionally capital contributions received in respect of the infrastructure assets were deducted from the cost as under UK GAAP these assets did not have a determinable finite life.

Under IAS16 *Property, Plant and Equipment* this treatment may not be applied. Therefore, the significant parts within the infrastructure networks have been identified, useful lives and residual values have been determined so that each component may be depreciated individually.

As the UK GAAP net book value of the infrastructure networks was determined using an accounting policy not in compliance with IFRS, as permitted by IFRS 1, a deemed cost for these assets has been established for the opening statement of financial position by reference to the fair value as at 1 April 2014, being the date of transition.

The election to record the carrying value of the water and wastewater infrastructure networks at fair value, and to use that fair value as the deemed cost in the opening statement of financial position, has increased net assets by £109.8 million as at 31 March 2015 compared to UK GAAP. This fair value uplift has been componentised in the same proportions as the network assets on the transition date, and depreciation on this uplift has resulted in a charge to the income statement of £38.4 million in the year to 31 March 2015.

The segments recognised within the water and wastewater networks have been based on asset class since no single pipe or section of sewer is significant compared with the total value of the networks. This has led to the identification of ten segments which have been assigned no residual value at the end of their useful economic lives. The lives allocated to these segments range from 7 to 250 years. Depreciation on these assets has resulted in a charge to the income statement of £81.9 million in the year to 31 March 2015. Due to the disapplication of renewals accounting amounts previously charged through the income statement as the Infrastructure Renewals Charge have been reversed and the net effect as a result of these adjustments is a credit to the income statement in the year to 31 March 2015 of £165.2 million.

In accordance with IAS 16, on transition to IFRS the classification between operating expenditure and capital expenditure for amounts incurred in maintaining the networks has been reassessed. As a result in the year to 31 March 2015 assets with a book value of £95.6m, which were capitalised under UK GAAP in accordance with renewals accounting, were considered to represent repairs and maintenance expenditure under IFRS. Consequently these assets have been de-recognised, resulting in a charge to the income statement.

Under IFRIC 18 *Transfers of Assets from Customers*, all customer and developer contributions previously deducted from the cost of associated network assets under UK GAAP have been reclassified to deferred income. These will be released as other operating income in the income statement as the associated performance obligations are fulfilled. Service connection charges made in accordance with sections 45 and 107 of the Water Industry Act 1991 are immediately recognised in the income statement as no continuing obligation exists once a connection to the network has been made. The net effect of these adjustments is a credit to the income statement of £55.4 million in the year to 31 March 2015.

### Borrowing Costs

Under UK GAAP the Group did not capitalise borrowing costs directly attributable in the acquisition, construction or production of qualifying assets. Under IFRS, IAS 23 *Borrowing Costs* requires such costs to be capitalised. As permitted by IFRS 1 the Group has elected to apply this requirement prospectively from the transition date of 1 April 2014, which has resulted in an increase to the net assets at 31 March 2015 of £86.4 million.

## **31. Adoption of International Financial Reporting Standards (continued)**

### **Defined benefit pension schemes**

IFRIC 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* introduces additional considerations to the measurement of a defined benefit obligation whereby a surplus may be restricted to the present value of any economic benefits available to the Group in the form of either a refund or a reduction in future contributions payable. This has resulted in a restriction of the surplus recognised under UK GAAP to the Thames Water Mirror Image Pension Scheme and an additional liability of £46.4 million at 31 March 2015. This additional liability, alongside the associated deferred tax effect, has been recognised within equity as part of other comprehensive income.

Additionally the scheme administration expenses are recognised within operating expenses under IAS 19 *Employee Benefits*, rather than through net finance costs. This has resulted in a reduction to operating profit of £8.8 million for the year ended 31 March 2015.

### **Transfer of assets from customers**

The Group receives transfers of assets from customers and developers, mainly in the form of adopted and self-lay sewers and water assets. The Group assesses whether each transferred item meets the definition of an asset, and if so, recognises the transferred asset as property, plant and equipment.

Under UK GAAP these assets were recognised by the Group at nil value. Under IFRS, IFRIC 18 *Transfers of Assets from Customers*, requires the cost to be measured at fair value with the associated credit being recognised within deferred income in recognition that the adopted asset results in a continued obligation to maintain the adopted assets. This has resulted in the recognition of £7.9 million within deferred income as at 31 March 2015, which will be released over the useful economic life of the adopted asset.

### **Financial instruments**

Under UK GAAP debt is initially recorded at the net proceeds of issue. In subsequent periods this is adjusted for accrued finance costs and payments made. The fair values of derivatives are not recognised in the balance sheet and consequently the charges to the income statement are relatively stable.

Under IAS 39 *Financial Instruments: Recognition and Measurement*, the default treatment is for debt to be carried at amortised cost whilst derivatives are recognised separately in the statement of financial position at fair value, with the movements on that fair value being recognised through the income statement.

This has the potential to introduce volatility to both the income statement and statement of financial position. Therefore in the case of cash flow hedges movements in the fair value of derivatives are deferred within reserves until they can be recycled through the income statement to offset the future income statement effect of changes in hedged risk.

However in order to apply this treatment, it must be demonstrated that the derivative has been and will continue to be an effective hedge of the hedged risk within the debt item. Any hedge ineffectiveness, provided it is within the range deemed acceptable by IAS 39, is recognised immediately within the income statement. Changes in fair value for derivatives that are designated and effective in terms of cash flow hedging relationships are deferred in equity as part of other comprehensive income. As a result of applying IAS 39 the Group has recognised derivatives at fair value which has resulted in a decrease to the net assets of £1,151.5 million as at 31 March 2015.

### **Explanation of material adjustments to the statement of cash flows**

Cash flows under IFRS include those in respect of cash and cash equivalents. An adjustment was made to include cash flows in respect of short term deposits that meet the definition of cash equivalents. Cash flows arising from corporation taxes were reclassified as cash flows from operating activities as it is not possible to identify elements associated with financing and investing activities.

## 31. Adoption of International Financial Reporting Standards (continued)

### Reconciliation of equity as at 1 April 2014

	UK GAAP £m	Reclassification £m	Transition £m	IFRS £m
<b>Non-current assets.</b>				
Intangible assets	1,468 7	(1,403 3)	-	65 4
Goodwill	-	1,468 1	-	1,468.1
Property, plant and equipment	11,768 7	(63 8)	710 9	12,415 8
Derivative financial assets	-	10 0	78 8	88 8
Retirement benefit surplus	-	5 5	-	5 5
	13,237 4	16 5	789 7	14,043 6
<b>Current assets.</b>				
Inventories	9 1	(1 3)	(1 7)	6 1
Assets held for sale	-	0 3	-	0 3
Trade and other receivables	573 4	(8 9)	(37 5)	527 0
Short-term investments	919 2	(430 2)	-	489 0
Cash and cash equivalents	15 6	430 2	(2 5)	443 3
	1,517 3	(9 9)	(41 7)	1,465 7
<b>Current liabilities.</b>				
Trade and other payables	(1,710 5)	943 6	15 8	(751 1)
Borrowings	-	(582 6)	9 6	(573 0)
	(1,710 5)	361 0	25 4	(1,324 1)
<b>Net current (liabilities)/assets</b>	(193 2)	351 1	(16 3)	141 6
<b>Non-current liabilities:</b>				
Trade and other payables	(10,486 4)	10,322 1	(147 6)	(311 9)
Borrowings	-	(10,532 4)	177 4	(10,355 0)
Derivative financial liabilities	-	(151 8)	(693 2)	(845 0)
Deferred tax liability	-	(786 5)	(393 7)	(1,180 2)
Provisions for liabilities and charges	(938 1)	834 8	3 4	(99 9)
Retirement benefit obligations	(150 5)	(53 8)	(42 9)	(247 2)
	(11,575 0)	(367 6)	(1,096 6)	(13,039 2)
<b>Net assets</b>	1,469 2	-	(323 2)	1,146 0
<b>Equity</b>				
Share capital	1,991 6	-	-	1,991 6
Other reserves	-	-	-	-
Retained earnings	(522 4)	-	(323 2)	(845 6)
<b>Total equity</b>	1,469 2	-	(323 2)	1,146 0

## 31. Adoption of International Financial Reporting Standards (continued)

### Reconciliation of equity as at 31 March 2015

	UK GAAP £m	Reclassification £m	Transition £m	IFRS £m
<b>Non-current assets</b>				
Intangible assets	1,423.7	(1,410.8)	44.8	57.7
Goodwill	-	1,468.1	-	1,468.1
Property, plant and equipment	12,552.2	(56.8)	811.9	13,307.3
Retirement benefit surplus	-	5.7	-	5.7
Derivative financial assets	-	-	271.6	271.6
	13,975.9	6.2	1,128.3	15,110.4
<b>Current assets.</b>				
Inventories	8.3	2.9	(1.3)	9.9
Assets held for sale	-	0.2	-	0.2
Trade and other receivables	556.3	(2.1)	(27.4)	526.8
Short-term investments	824.5	(547.4)	-	277.1
Cash and cash equivalents	26.8	547.4	(2.5)	571.7
	1,415.9	1.0	(31.2)	1,385.7
<b>Current liabilities.</b>				
Trade and other payables	(1,904.9)	1,033.9	(22.5)	(893.5)
Derivative financial liabilities	-	-	(85.7)	(85.7)
Borrowings	-	(958.4)	6.5	(951.9)
	(1,904.9)	75.5	(101.7)	(1,931.1)
<b>Net current liabilities</b>	(489.0)	76.5	(132.9)	(545.4)
<b>Non-current liabilities</b>				
Trade and other payables	(10,850.4)	10,669.1	(153.9)	(335.2)
Borrowings	-	(10,746.1)	331.5	(10,414.6)
Derivative financial liabilities	-	-	(1,337.4)	(1,337.4)
Deferred tax liability	-	(708.5)	(312.8)	(1,021.3)
Provisions for liabilities and charges	(873.7)	769.7	3.3	(100.7)
Retirement benefit obligations	(244.9)	(66.9)	(42.1)	(353.9)
	(11,969.0)	(82.7)	(1,511.4)	(13,563.1)
<b>Net assets</b>	1,517.9	-	(516.0)	1,001.9
<b>Equity.</b>				
Share capital	1,991.6	-	-	1,991.6
Other reserves	-	-	(123.6)	(123.6)
Retained earnings	(473.7)	-	(392.4)	(866.1)
<b>Total equity</b>	1,517.9	-	(516.0)	1,001.9

### 31. Adoption of International Financial Reporting Standards (continued)

#### Reconciliation of total comprehensive income for the year ended 31 March 2015

	UK GAAP £m	Reclassification £m	Transition £m	IFRS £m
Revenue	2,032.7	(30.5)	-	2,002.2
Operating expenses	(1,422.7)	9.3	(19.8)	(1,433.2)
Profit on the sale of property, plant and equipment	16.9	-	(0.5)	16.4
Other operating income	6.8	12.4	47.8	67.0
<b>Operating profit</b>	<b>633.7</b>	<b>(8.8)</b>	<b>27.5</b>	<b>652.4</b>
Finance income	62.4	57.0	-	119.4
Finance expense	(526.0)	(44.2)	84.3	(485.9)
Net losses on financial instruments	-	(4.4)	(242.5)	(246.9)
<b>Profit on ordinary activities before taxation</b>	<b>170.1</b>	<b>(0.4)</b>	<b>(130.7)</b>	<b>39.0</b>
Taxation on profit on ordinary activities	61.5	0.2	43.6	105.3
<b>Profit for the financial period</b>	<b>231.6</b>	<b>(0.2)</b>	<b>(87.1)</b>	<b>144.3</b>
<b>Other comprehensive income/(expense)</b>				
<i>Items that will not be reclassified to the income statement</i>				
Net actuarial loss on defined benefit pension schemes	(149.5)	-	22.4	(127.1)
Deferred tax on net actuarial loss	29.9	-	(4.5)	25.4
Exchange adjustments	(0.2)	0.2	-	-
<i>Items that may be reclassified to the income statement</i>				
Loss on cash flow hedges	-	-	(154.4)	(154.4)
Deferred tax on loss on cash flow hedges	-	-	30.8	30.8
<b>Other comprehensive expense for the period/year</b>	<b>(119.8)</b>	<b>0.2</b>	<b>(105.7)</b>	<b>(225.3)</b>
<b>Total comprehensive income for the period/year</b>	<b>111.8</b>	<b>-</b>	<b>(192.8)</b>	<b>(81.0)</b>

## Notes to the Company financial statements

### 32. Investment in subsidiaries

	2016 £m	2015 £m	1 April 2014 £m
Cost of shares in subsidiary undertakings	1 0	1 0	1 0
Provision for impairment	-	-	-
<b>Net book value</b>	<b>1 0</b>	<b>1 0</b>	<b>1 0</b>

A full listing of direct and indirect subsidiary and associated undertakings has been included in note 38 to these financial statements

### 33. Intercompany loans receivable

	2016 £m	2015 £m	1 April 2014 £m
Intercompany loans receivable			
Due from Kemble Water Eurobond Plc	1,990 6	1,990 6	1,990 6
Interest on intercompany loans receivable			
Due from Kemble Water Eurobond Plc	1,687 9	1,352 7	1,106 1
<b>Total</b>	<b>3,678 5</b>	<b>3,343 3</b>	<b>3,096 7</b>

The loan due from Kemble Water Eurobond Plc, the Company's immediate subsidiary entity, is unsecured, repayable on demand and charges interest at 10%

### 34. Trade and other payables

	2016 £m	2015 £m	1 April 2014 £m
Accruals and deferred income	-	1 5	-
Amounts payable in respect of group relief	132 7	65 7	0 7
<b>Total</b>	<b>132 7</b>	<b>67 2</b>	<b>0 7</b>

All amounts owed to group undertakings are unsecured, interest free and repayable on demand



## 35. Financial instruments

Details of the significant accounting policies and methods adopted (including the criteria for recognition, the basis of measurement and the basis for recognition of income and expenses) for each class of financial asset, financial liability and equity instrument are disclosed in the accounting policies. The Company does not hold any derivative financial assets or liabilities (2015: none)

### Categories of financial instruments

The carrying values of the financial assets and liabilities are as follows

	2016 £m	2015 £m	1 April 2014 £m
<b>Financial assets</b>			
<i>Loans and receivables (including cash and cash equivalents)</i>			
Intercompany loans receivable	3,678.5	3,343.3	3,096.7
Cash and cash equivalents	-	1.5	-
<b>Total</b>	<b>3,678.5</b>	<b>3,344.8</b>	<b>3,096.7</b>
<b>Financial liabilities</b>			
<i>Other financial liabilities</i>			
Trade and other payables	(132.7)	(67.2)	(0.7)
<b>Total</b>	<b>(132.7)</b>	<b>(67.2)</b>	<b>(0.7)</b>

### Fair value measurements

The fair value of financial assets and liabilities represents the price that would be received to sell an asset or paid to transfer a liability between informed and willing parties, other than in a forced or liquidation sale at the measurement date. The techniques for determining the fair value of financial instruments are classified under the hierarchy defined in IFRS 13 *Fair Value Measurement* which categorises inputs to valuation techniques into Levels 1-3 based on the degree to which the fair value is observable.

### Comparison of fair value of financial instruments with their carrying amounts

The carrying amounts of the Company's intercompany loan receivables and trade payables are considered to be approximate to their fair values.

### Capital risk management

Details of the Group's capital risk management strategy can be found on page 15. The capital structure of the Company is as follows:

	2016 £m	2015 £m	1 April 2014 £m
Cash and cash equivalents	-	1.5	-
Net debt	-	1.5	-
Equity attributable to the owners of the Group	<b>3,546.8</b>	<b>3,278.6</b>	<b>3,097.0</b>

## 35. Financial instruments (continued)

### Financial risk management

The Group's activities expose it to a number of financial risks market risk (including interest rate risk and exchange rate risk), credit risk, liquidity risk and inflation risk Details of the nature of each of these risks along with the steps the Group has taken to manage them is described on page 15 The Company's activities expose it to credit and liquidity risk

#### (a) Credit risk

The Company's maximum exposure to credit risk is the carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, therefore the maximum exposure to credit risk at the year end date was £3,678.5 million (2015 £3,343.3m)

#### (b) Liquidity risk

Details of the nature and management of the Group's liquidity risk is provided on page 16

The maturity profile of the Company's financial liabilities disclosed in the statement of financial position are given below

	<b>2016</b>
	<b>£m</b>
Within one year	<b>132.7</b>
Between one and two years	-
Between two and three years	-
Between three and four years	-
Between four and five years	-
After more than five years	-
Total	<b>132.7</b>

## 36. Statement of cash flows

### Reconciliation of operating profit to operating cash flows

	<b>2016</b>	<b>2015</b>
	<b>£m</b>	<b>£m</b>
Profit for the financial year	<b>268.2</b>	244.7
Less finance income	<b>(335.2)</b>	(309.7)
Add taxation on profit on ordinary activities	<b>67.0</b>	65.0
Cash generated from operations	<b>-</b>	-

### 37. Adoption of International Financial Reporting Standards

This is the first time that the Company has presented its annual financial statements under IFRS. The policies applied in these financial statements are based on the IFRS, IAS and IFRIC interpretations issued and effective and ratified by the European Union as of 9 June 2016, the date that the Board of Directors approved the statements. The Company's previously reported results for the year ended 31 March 2015 have been restated, the date of transition to IFRS being 1 April 2014.

In accordance with IFRS 1 *First Time Adoption of International Financial Reporting Standards* the Company's accounting policies under IFRS have been applied retrospectively at the date of transition, with the exception of a number of permitted exemptions.

In preparing the financial statements for the parent company no transition or reclassification adjustments have been identified. Accordingly there has been no restatement of the comparative figures prepared in accordance with previous UK GAAP. It has therefore not been deemed necessary to present tables showing a reconciliation of balances prepared under previous UK GAAP to IFRS within these financial statements.

### 38. Subsidiaries, associated undertakings, and significant holdings other than subsidiary undertakings

	Principal undertaking	Country of incorporation	Class of shares held	Proportion of voting rights and shares
<b>Direct</b>				
Kemble Water Eurobond Plc	Holding Company	United Kingdom	Ordinary	100%
<b>Indirect</b>				
Kemble Water Liberty Limited	Dormant Company	United Kingdom	Ordinary	100%
Kemble Water Structure Limited	Dormant Company	United Kingdom	Ordinary	100%
Kemble Water Investments Limited	Dormant Company	United Kingdom	Ordinary	100%
Kemble Water Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Holdings Limited	Dormant Company	United Kingdom	Ordinary	100%
Kemble Water Finance Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Commercial Ventures Finance Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Commercial Ventures Holdings Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Commercial Services Limited	Commercial Water	United Kingdom	Ordinary	100%
Thames Water (Kemble) Finance Plc	Finance company	United Kingdom	Ordinary	100%
Thames Water Insurance Company Limited	Insurance company	Guernsey	Ordinary	100%
Thames Water Limited	Holding company	United Kingdom	Ordinary	100%
Thames Water Utilities Limited	Water & wastewater	United Kingdom	Ordinary	100%
Kennet Properties Limited	Property company	United Kingdom	Ordinary	100%
Thames Water Utilities Cayman Finance Limited	Finance company	Cayman Islands	Ordinary	100%
Thames Water Utilities Finance Limited	Finance company	United Kingdom	Ordinary	100%
Thames Water Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Utilities Holdings Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Utilities Cayman Finance Holdings Limited	Holding Company	Cayman Islands	Ordinary	100%
Country Wide Collections Limited	Dormant Company	United Kingdom	Ordinary	100%
Foudry properties Limited	Property Company	United Kingdom	Ordinary	50%
Shapeshare Limited	Property Company	United Kingdom	Ordinary	100%
PCI Membrane Systems Limited	Dormant Company	United Kingdom	Ordinary	100%
Portacel Limited	Holding Company	United Kingdom	Ordinary	100%
Chlorination Equipment Limited	Dormant Company	United Kingdom	Ordinary	100%
Simon N-Viro Limited	Dormant Company	United Kingdom	Ordinary	100%
Stella Meta-Filters Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Products FWT Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products Overseas Limited	Holding Company	United Kingdom	Ordinary	100%
PWT Projects Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water (UK) Pension Trustees Limited	Pension Trustees	United Kingdom	Ordinary	100%
Thames Water Developments Limited	Property Company	United Kingdom	Ordinary	100%
Innova Park Management Company Limited	Property Company	United Kingdom	Ordinary	100%
Thames Water Drainage Services Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Environmental Services Limited	Dormant Company	United Kingdom	Ordinary	100%
Sub-Scan Limited	Dormant Company	United Kingdom	Ordinary	100%
S Holdings Limited	Dormant Company	United Kingdom	Ordinary	100%
Subtronic Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Pipeline Solutions Limited	Dormant Company	United Kingdom	Ordinary	100%
Total Pipeline Solutions Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Dorm 1 Limited	Dormant Company	United Kingdom	Ordinary	100%

B O P Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Healthcare Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water International Service Holdings Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Overseas Limited	Holding Company	United Kingdom	Ordinary	100%
Thames Water Asia PTE Limited	Legacy Investment	Singapore	Ordinary	100%
Thames Water International (Thailand) Limited	Legacy Investment	Thailand	Ordinary	100%
Thames Water DO Brasil Limitada	Legacy Investment	Brazil	Ordinary	100%
Thames Water International Services Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Investments Limited	Property Company	United Kingdom	Ordinary	100%
Trans4M Limited	Legacy Investment	United Kingdom	Ordinary	25%
Thames Water Nominees Limited	Pension Trustees	United Kingdom	Ordinary	100%
Thames Water Overseas Consultancy Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Pension Trustees (MIS) Limited	Pension Trustees	United Kingdom	Ordinary	100%
Thames Water Pension Trustees Limited	Pension Trustees	United Kingdom	Ordinary	100%
Thames Water Procurement Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products Limited	Dormant Company	United Kingdom	Ordinary	100%
Memtech (UK) Limited	Dormant Company	United Kingdom	Ordinary	100%
T M Products Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products SH Limited	Dormant Company	United Kingdom	Ordinary	100%
Coplastix Limited	Dormant Company	United Kingdom	Ordinary	100%
Stockdale Filtration Systems Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products UPE Limited	Dormant Company	United Kingdom	Ordinary	100%
Haymills Engineering Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products Castings Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products Coatings Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products SGE Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Products UPEI Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water property Services Limited	Dormant Company	United Kingdom	Ordinary	100%
Surta Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Retail Limited	Dormant Company	United Kingdom	Ordinary	100%
The Water Quality Centre Limited	Dormant Company	United Kingdom	Ordinary	100%
Thames Water Puerto Rico Inc	Legacy Investment	Puerto Rico	Ordinary	100%
Thames-Dick Superaqueduct Partners Inc	Legacy Investment	Puerto Rico	Ordinary	99.9%
Thames Water Senior Executive Pension Trustees Limited	Pension Trustees	United Kingdom	Ordinary	100%
Thames Water Share Scheme Trustees Limited	Pension Trustees	United Kingdom	Ordinary	100%
Water Projects International Limited	Legacy Investment	United Kingdom	Ordinary	100%

## Glossary

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

**Appointed business** – The appointed business comprises the regulated activities of the Company which are activities necessary in order for the Company to fulfil the function and duties of a water and sewerage undertaker under the Water Industry Act 1991

**Arm's-length trading** – Trading in which the Company treats the other party, usually an associate company on the same basis as an external party

**Asset Management Plan ("AMP")** – An AMP is the five-year period covered by a water company's business plan. These are numbered, with AMP1 referring to the first such planning period after the water industry was privatised – i.e. the period from 1990 to 1995. The current period (2015 – 2020) is known as AMP6, and the period for which we are now starting to plan (2020 – 2025) will be AMP7.

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

**C17 - The Water Act 2014** will allow 1.2 million businesses and other non-household customers of providers based mainly or wholly in England to choose their supplier of water and wastewater retail services from April 2017. Retail services include things like billing and customer services. At the moment only a limited number of non-household customers across England and Wales can choose their retailer. The new market will be the largest retail water market in the world. Customers will be able to shop around and switch to the best deal. Investors and retailers will have new opportunities for growth. And the environment will benefit from customers using new water efficient services. The UK Government is committed to delivering the new market. It set up 'Open Water', a single programme of work that brings together all of the key organisations to design and deliver the new market. These include the Department for Environment Food and Rural Affairs, Ofwat and Market Operator Services Limited – a private company owned by market participants. Thames Water has a programme of business readiness for Competition 2017, to ensure we are ready for market opening from April 2017.

**Cost** - The actual cost to the supplier, of the goods, works or services, including a reasonable rate of return on capital employed. Unless the circumstances of the transaction provide a convincing case for the use of an alternative measure, the return on capital should be consistent with the cost of capital/ net retail margin as set out in Ofwat's final determination of 12 December 2014 (or any other determination applicable in the 2015-20 period).

**Cost allocation** - Cost allocation is the means by which all costs are allocated to appointed and non-appointed businesses, price control units, or specific supplies, works and services, ensuring a fair share of overheads, even where costs cannot be directly attributed to specific activities and associated services.

**Cost driver** - A cost driver is the factor or factors which cause cost to occur. This can be further divided between the driver that causes an activity to occur, and a driver that determines how often it occurs. Costs may vary in relation to the cost driver over the short or longer term, depending on the nature of cost concerned.

**CPI** - The Consumer Prices Index ("CPI") is a measure of economic inflation based on a set series of goods and services set by the Office for National Statistics. This is the headline measure of inflation used in the Government's target for inflation.

**Cross-subsidy** - Cross-subsidy in this context is monetary aid or contributions from the appointee to the associate, or between price control units, which does not reflect the value of the services received. It also relates to services provided by the appointee to associate companies where there has been an under-recovery of costs incurred by the appointee.

**CSAT** - Short for "customer satisfaction", this refers to the qualitative component of the SIM measure.

**Customer numbers** - To ensure consistency with the way in which price controls have been set for 2015/20, customer numbers when used as a cost allocation metric is equal to 1.0 for single-service (water or wastewater only) customers and 1.3 for dual-service (water and wastewater) customers.

**Customer side leakage ("CSL")** – leakage resulting from leaks from customer side pipes that form part of our treated water distribution network.

**Final determination** – The conclusion of discussions on the scale and content of the asset management plan for the forthcoming five-year AMP period. It is accompanied by a determination of the allowable K factor for the forthcoming AMP.

**Financing adjustment** – The impact of RPI on the real value of net finance for the business.

**FTEs** - For the purposes of cost allocation, full-time equivalents ("FTEs") should include all full-time staff, and contractors/ temporary staff directly employed. Where there is an existing contractual arrangement in place with an associate or third party (for example a third party billing arrangement), FTEs will include all full-time staff, and contractors/ temporary staff directly employed by the associate or third party involved in providing that service to the appointee.

**Households** - These are properties used as single domestic dwellings (normally occupied), receiving water for domestic purposes which are not factories, offices or commercial premises. These include cases where a single aggregate bill is issued to cover separate dwellings having individual standing charges. (In some instances, the standing charge may be zero.) The number of dwellings attracting an individual standing charge and not the number of bills should be counted. Mixed/ commercial properties and multiple household properties – for example, blocks of flats having only one standing charge – should be excluded.

**Infrastructure and non-infrastructure assets** - Infrastructure assets are mainly our below-ground assets, such as pipes, water mains, sewers, dams and reservoirs. Non-infrastructure assets are those mainly found above ground, such as water and sewage treatment works, pumping stations, laboratories and workshops.

**Instrument of Appointment** - Water companies operating the public water networks hold appointments as water undertakers, and those operating the public wastewater networks hold appointments as sewerage undertakers, for the purposes of the Water Industry Act 1991. They also supply water and wastewater services direct to household and non-household customers who are connected to their networks.

**Licence** – The Instrument of Appointment dated August 1989 under Section 11 and 14 of the Water Act 1989 (as in effect on 1 August 1989) under which the Secretary of State for the Environment appointed Thames Water Utilities Limited as a water and sewerage undertaker under the Act for the areas described in the Instrument of Appointment, as modified or amended from time to time.

**Measured** - These are properties where some or all of the charges for supplies are based on measured quantities of volumes.

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

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

**Non-households** - These are properties receiving water for domestic purposes but which are not occupied as domestic premises, or where domestic dwellings are combined with other properties, or where properties are in multiple occupation but only have one standing charge. In this case, it is the number of bills that should be counted.

**Outcome Delivery Incentive ("ODI")** – ODIs is a collective term for the financial incentives – positive and negative – that Ofwat has applied to the delivery of our five-year plan. 'Rewards' allow us to charge more over the next five years (in this case, 2020-2025), while 'penalties' allows us to charge less. Some of these ODIs measure performance in each of the five years of our current plan, while others apply only to the whole five years.

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

**Operating Company ("Opco")** – The Company has four distinct opcos (not separate legal entities) consisting of retail household, retail non-household, wholesale water and wholesale wastewater. Each opco is responsible for its own planning, operational and investment decisions. To facilitate decision making there are separate management structures and executive teams in place in each operating company.

**Opex** - Pay for the day-to-day operations of our business, such as operating and maintaining our network and treatment works, paying our staff and our energy bills. This is known as operational expenditure or opex.

**Performance Commitment ("PC")** - Outcome performance commitments that reflects customers' views and priorities of service.

**Periodic Review ("PR")** – The price determination process undertaken by Ofwat every five years. Each water and sewerage undertaker submits an Asset Management Plan covering the five-year period for which Ofwat will determine prices (the K factor – see above).

**Price control units** - At the 2014 price review Ofwat introduced separate binding price controls. These include wholesale water, wholesale wastewater, retail household and retail non household.

**Rant & Rave** - Ofwat measures customer satisfaction on a quarterly basis, but we have worked with customer experience company Rant & Rave to measure this around the clock so that we can better assess our performance. When we have resolved a customer's issue, we send them a text message asking them to score our response on a scale of one to five. The data from this is known as "Rant & Rave".

**Regulatory Accounting Guidelines ("RAG")** – The accounting guidelines for regulatory accounts issued, and amended from time to time, by Ofwat.

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

**Retail** - This term refers to any water company activities that take place once water has passed to the customer's side of a property boundary. These include billing, payment handling, debt management, meter reading and handling billing related calls.

**Retail Price Index ("RPI")** – The RPI is compiled and published monthly by the Office for National Statistics. RPI is an average measure of change in the prices of goods and services bought for the purpose of consumption by the vast majority of households in the United Kingdom.

**Service Incentive Mechanism ("SIM")** – The Service Incentive Mechanism was introduced by Ofwat to replace the OPA as a measure of the service customers experience from their water company. It is now in its second year. There are two elements to the SIM: • A quantitative measure awards penalty points for issues ranging from callers to our customer centre receiving an engaged tone, through to complaints. • A qualitative measure is calculated via telephone interviews to assess the satisfaction of customers who have contacted us to resolve queries.

**Third-party contributions since 1989/90** – Grants and third-party contributions received in respect of infrastructure assets and any deferred income relating to grants and third-party contributions for non-infrastructure assets.

**Totex** - Total expenditure ("totex") is the mechanism, introduced in PR14 (price review 2014) for planning and reporting capital (for example, buying a new car) and operational (repairing your old car) spend. The object is to achieve the optimum combination to deliver the required business plan outcomes. It applies to both water and waste (i.e. our wholesale business) but not to retail.

**Thames Tideway Tunnel ("TTT")** - The Thames Tideway Tunnel is a major new sewer, urgently needed to protect the tidal River Thames from pollution. London's sewerage system is no longer fit for purpose and spills millions of tonnes of sewage into the tidal section of the river every year. The tunnel will tackle the problem of overflows from the capital's Victorian sewers for at least the next 100 years, and enable the UK to meet European environmental standards.

**Transfer pricing** - A transfer price is the price paid by one group company to another for transactions between the two companies or for transactions within the appointee between price control units or between appointed and non-appointed business.

**Unmeasured** - These are properties where none of the charges for supplies are based on measured quantities of volumes. These include properties which receive an assessed charge because metering is not possible or economic.

**Water 2020** - An Ofwat work programme, which aims to establish what will be required of water and sewerage companies in the 2019 Price Review.

**Wholesale** - This term covers all water company activities that take place before water passes the customer's property boundary – resources management, abstraction, treatment, distribution (water and sewer networks), sewage collection, transportation, sewage treatment, sludge disposal and energy from waste.

**Working capital** – The aggregate of stocks, trade debtors and trade creditors, if material.

**Working capital adjustment** – The impact of RPI on the real value of working capital to the business.

**Water Resource Management Plan ("WRMP")** - Our 25-year Water Resources Management Plan is updated every five years and sets out how we aim to meet the predicted demand for water in our region over that period.