

# Annual Report and Accounts 2013–14

Delivering our promises

THURSDAY



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# Overview

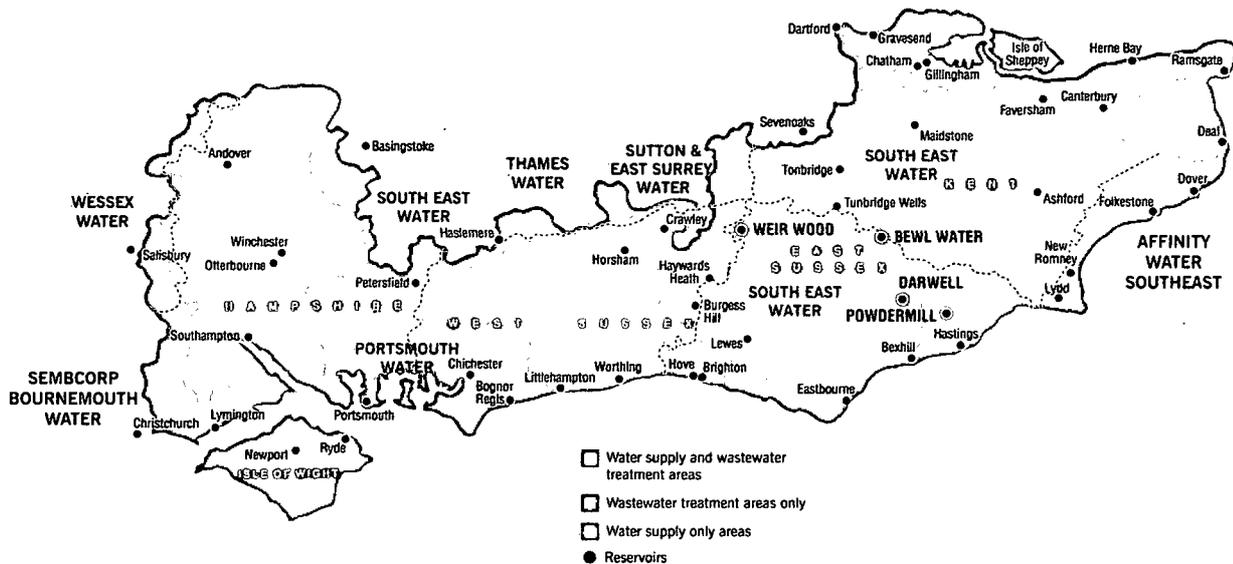
## At a glance

### Our business

We take care of life’s essentials by providing 4.5 million people with water and wastewater services across the South East of England.

Our vision is to be recognised as the UK’s leading water company and we will achieve this by:

- Providing excellent customer service – which meets and more often exceeds our customers’ expectations
- Embracing innovation and working collaboratively – so that we invest in, and operate, our mains sewers and treatment works efficiently and effectively
- Delivering value to our customers and shareholders – focusing on cost management and efficient investment to keep bills affordable and generate reasonable returns on investment.



<b>Water</b>	
People served, millions	2.4
Number of properties, millions	1.1
Number of metered properties	754,084
Average daily water supply, millions of litres per day	535
Number of service reservoirs	204
Number of water treatment works	90
Length of water mains, kilometres	13,753

<b>Wastewater</b>	
People served, millions	4.5
Number of properties, millions	1.9
Average daily wastewater recycled, millions of litres per day	700
Length of sewers, kilometres	39,600
Number of wastewater treatment works	368
Number of pumping stations	2,375

<b>Finance</b>	<b>2013–14</b>	<b>2012–13</b>
Turnover*	£806.2m	£778.7m
Operating profit (before exceptional item)	£325.0m	£331.0m
Exceptional item (severe weather)	£18.8m	-
Profit on ordinary activities after tax	£169.8m	£156.9m
Capital investment	£415.5m	£380.0m
Average water and wastewater customer bill	£424	£427

\* Non-appointed activities (not regulated by our licence, but related to our business, such as property search information) were 0.8 per cent of our turnover.

Key performance indicators	2013–14	2012–13
Overall drinking water quality, 2013 calendar year	99.94%	99.93%
Leakage, millions of litres per day	85	81
Beaches meeting European water quality standards	83	82
Service Incentive Mechanism (SIM)	75.2	62.2
Performance water non-infrastructure	Stable	Stable
Performance water infrastructure	Stable	Stable
Performance wastewater non-infrastructure	Stable	Marginal
Performance wastewater infrastructure	Stable	Stable
Pollution incidents, 2013 calendar year	320	409

### Where your money goes

The average combined bill for our water and wastewater customers in 2013–14 was £424 equivalent to £1.16 per day. This money contributed towards our five-year £1.8 billion investment programme, which is the equivalent of almost £1,000 for every property in our region.

The illustration shows how £1 of a typical combined bill was spent:



**32p on operating costs:** The day-to-day costs of running the treatment works, pumping stations, water mains and sewer network which supply drinking water and recycle wastewater.

**28p on interest payments and financing costs:** The costs involved in funding our multi-million-pound investment programme.

**40p on investment to maintain and improve our treatment works and network:** We spend millions of pounds to improve the quality of the water we supply and the wastewater we recycle.

# Welcome

## Chairman's introduction

It was a great privilege to become Chairman of the Southern Water Board in April 2014, having served as an Independent Non-executive Director for the last two years.

Southern Water's vision is to be recognised as the UK's leading water company and we again made good headway toward this goal during 2013–14, with notable achievements across our business. Examples include:

- Maintaining our exceptional health and safety performance and we are justifiably proud that we became the first water company to be awarded an Order of Distinction by the Royal Society for the Prevention of Accidents
- The successful investment of £415 million in key areas of our business. This helped us to improve water quality, reduce pollution incidents and significantly enhance our levels of service to customers
- The efforts of our employees and contractors to combat the extreme weather and flooding which brought devastation to parts of the South of England and affected many customers last winter. The success in keeping vital services running, often in very difficult conditions and particularly over Christmas and New Year, greatly reduced the impact of these circumstances. Such extreme weather events come at a price not only to our customers but also to ourselves and resulted in additional costs of £18.8 million, which will be borne by our shareholders as opposed to customers. This has been shown as an exceptional item in the accounts.

Even though the business showed improvement over the year, we know that we are not yet performing at the levels to which we aspire. We have made 26 promises through the extensive customer consultation exercise we undertook in preparing our 2015–20 Business Plan. The fulfilment of these will be a necessary requirement to achieve our vision.

This will require us to invest more and adapt our working methods in order, for example, to increase resilience to extreme drought and flood conditions, to further improve service to customers and to deliver on our environmental commitments.

We are also focused on keeping bills affordable, with price increases below the rate of inflation planned for each year to 2020. To achieve this, the Board will ensure the company employs innovation, efficiency and effective partnerships.

I am very grateful to all of the directors who served on the Board during the year, to our Executive Management Team and to Colin Hood, who stepped down as Chairman at the end of the financial year. Their respective contributions, advice and challenge have laid the strategies and foundations to deliver even better service to our customers in the years ahead.

The improvements we have made for our customers would not have been possible without the continuing support of our shareholders. In line with the last two years, they have not taken a dividend payment in order to support our investment programme, which is critical to strengthening the company's position and performance. Through their representation on our Board, and on various working groups, they have provided valuable counsel and support.

As I hope will be evident to you from our full report and accounts, it has been a positive year for Southern Water, with solid achievements and the development of customer-focused plans. These will underpin thousands of jobs and boost the region's economy in the years ahead.

In the coming year, the company will build on the improvements made during 2013–14 in preparation for our 2015–20 Business Plan, the introduction of competition to the sector and the focus on resilience in the newly-enacted Water Bill.



Robert Jennings  
Chairman

## **Our Board**

The Board is responsible for the overall strategic direction of the business. During 2013–14, it was made up of an independent non-executive Chairman, two executive directors (the Chief Executive Officer and Chief Financial Officer) and six non-executive directors, four of whom are independent.

The day-to-day operation of the company is overseen by the Executive Management Team, which comprises the Chief Executive Officer, Chief Financial Officer, Company Secretary and General Counsel, and seven functional directors. None of these seven directors are members of the Board.

The ultimate holding company of Southern Water Services (Southern Water) is Greensands Holdings (Greensands), owned by a consortium of pension and infrastructure funds which is committed to a long-term investment in our business.

Find out more about the Board on pages 59–62.

## Chief executive's summary

Following the extremes of drought and flooding in 2012–13, our region endured the wettest winter on record this year.

For the three months from December to February, the South East received more than 260 per cent of historical average rainfall and recorded unprecedented levels of groundwater. This impacted severely on many of our customers, who experienced extensive flooding in streets, homes and gardens.

I would like to thank those customers who were affected for their patience and understanding during such a difficult time when the sewer network was inundated with millions of litres of water it was not designed to deal with.

We worked hard to keep the sewers flowing for the vast majority of customers and protect their homes and businesses. I am grateful to the many staff who volunteered to work long hours, particularly over Christmas, to mobilise tankers and pumps, keep customers informed and restore sites which had lost power.

It was a challenging time and, at its height, we were deploying 117 tanker lorries and 44 temporary pumps to remove 125 million litres of water from our network every day – enough to fill 50 Olympic-sized swimming pools – at an additional daily cost of more than £160,000.

Our work formed part of a multi-agency response with local authorities and the Environment Agency, who are responsible for managing river, surface water and groundwater flooding.

Partnerships such as these will be critical in the future as we plan how to manage more extreme weather and a growing population and housing development while also protecting the sensitive local environment.

Working in collaboration was key to our two major achievements this year: Improving our service for customers and developing a £3.2 billion Business Plan for 2015–20 to deliver our customers' priorities in the future.

### Always improving

Despite the challenges presented by the weather, we continued to improve our performance and deliver better services to customers in 2013–14.

This was evidenced by a 21 per cent improvement in our Service Incentive Mechanism (SIM) score, the measure used by Ofwat to track customer service in the water industry.

We achieved our SIM target score of 75 following a commitment in last year's annual report to make improvements and provide customers with the service they expect, even when faced with the challenges of droughts and floods. This improvement is due to a turnaround plan, which included better training, recruiting the right staff for the job, reviewing processes and listening more effectively to customers. However, we recognise that we have further improvements to make.

From our contact centre agents and meter readers to sewer operatives and leak detectors, we are focussing on delivering a better service and we are committed to driving further improvements in the coming years as this work continues.

## Achieving targets

The improved SIM score reflects overall customer service and we also recorded good results against other targets, supported by an investment of £415 million.

This spend formed part of our current £1.8 billion capital investment programme for 2010–15 and included £88 million to enhance wastewater treatment, £30 million to improve water supply works, £35 million on increasing the capacity of our network, £185 million on maintenance work on our above-ground assets and £77 million on maintenance work on our sewer and water main networks.

This investment, coupled with a focus on putting customers first, delivered good progress against our targets for the year, including:

- Drinking water quality – we recorded a higher standard of 99.94 per cent in the Drinking Water Inspectorate measures
- Leakage – we maintained an industry-leading position on leakage, with one of the lowest levels per property of all the UK water and wastewater companies
- Metering – 75 per cent of customers are now paying metered charges in our five-year programme to install meters and we are recording a 10 per cent reduction in water use in homes where meters have been fitted
- Pollution – we achieved a further 22 per cent reduction in pollution incidents and the Environment Agency recognised us as one of only two companies to reduce the number of serious pollution incidents
- Coastal waters – 88 per cent of bathing waters along our coastline reached the stricter 'guideline' standards, a significant improvement on 70 per cent in the previous year
- Investment – we officially opened a £300 million state-of-the-art wastewater scheme at Peacehaven to bring cleaner seas to East Sussex. It is one of our largest investment projects to date
- Health and safety – in what we believe to be an industry first, we recorded 417 consecutive days without a serious injury (RIDDOR) reportable to the Health and Safety Executive.

## Putting customers first

I am proud of our performance during the year and we will continue to build on this through our £3.2 billion Business Plan for 2015–20.

The plan was developed in 2013 following widespread engagement with our customers and interest groups over the past two years.

During the largest consultation programme we have undertaken, we gathered the views of more than 27,000 customers to shape both the Business Plan and our 25-year Water Resources Management Plan.

The Business Plan, which sets out our investment and the level of customer bills for 2015–20, is based on the six priorities which customers say are most important to them.

Within these priorities, we have committed to 26 promises on what we will deliver in the future. See page 16 and, through these, we are confident we can deliver an industry-leading service for customers.

When developing the plan, we were conscious of the current economic pressures and recognised that, as a provider of essential services, it is vital to keep bills as low as possible.

Accordingly, we have set ourselves the challenge of incorporating nearly £200 million of efficiency savings into the plan in order to guarantee that bills rise by less than inflation until 2020. This compares with an average annual increase of 1.4 per cent above inflation from 2010 to 2015.

We published a draft of the plan for consultation and were pleased that more than 90 per cent of customers supported our proposals. A significant minority asked us to do more to keep bills affordable and we addressed this feedback in the final plan submitted to Ofwat in November 2013.

In order to prepare for the introduction of competition to the non-household sector in 2017, the plan was developed in four elements which separate the retail and wholesale sides of the business – household retail services, non-household retail services, wholesale water services and wholesale wastewater services.

As we engaged with our customers and developed the plans, we were challenged and scrutinised by the Southern Water Customer Challenge Group (CCG). This independent group gave us feedback and advice throughout the year and submitted a report to Ofwat on our engagement with customers and how their views were incorporated into our plans.

I am extremely grateful to the members of the CCG for their challenge and advice, which unquestionably led us to develop a better overall Business Plan. The CCG report was published on its website [www.swccg.org.uk](http://www.swccg.org.uk).

### **Innovative approach**

Innovation is a cornerstone of our plans to deliver improved services in the future while keeping customer bills affordable, and we are already leading the industry in several areas.

Our Water Resources Management Plan (WRMP) for 2015–40 is based on new modelling to secure a more resilient water supply which is able to withstand more severe droughts.

Historically, water resources plans have been based on droughts experienced in the last 100 years. We have taken a new approach, planning for more prolonged droughts that have not yet happened but may well in the future.

As a result, our proposals plan for a reduction in the risk of restrictions, such as hosepipe bans, to one year in 10 on average and a reduction in the risk of standpipes in the street from one in 100 years to a likelihood of one in 200 years. This means extreme restrictions are unlikely to happen in our lifetime, something customers expressed strong views on.

We also aim to harness innovation through the appointment of a Strategic Solutions Partner to work alongside us between 2014 and 2020. The focus will be on accessing the latest technologies to define cost-effective and sustainable ways to meet higher customer service and environmental standards.

We have also strengthened our in-house capabilities to bring more skills back into the business.

As a major employer in the South East, we support thousands of jobs – more than 2,000 directly and many more through our contractors. Delivery of the £3.2 billion plan will continue this legacy of stable employment in our region. We also remain committed to training and development, with 73 apprentices graduating during the year.

## Finances

During 2013–14, our operating profit before exceptional items was £325 million, a 1.8 per cent reduction from the previous year when our profit was £331 million.

The 2012–13 operating profit included a £9 million pension curtailment gain following the implementation of changes to the final salary pension scheme and other income of £5 million for services provided in the disposal of an investment held in the group.

Excluding these items, the underlying operating profit improved by £8 million (2.5 per cent), largely due to an increase in turnover of 3.5 per cent. This largely reflected a price increase of 5.1 per cent, offset by reduced income from customers switching to a metered supply as part of our metering programme. In addition, operating cost efficiencies of almost £16 million were delivered through continued focus on controlling operating costs.

These movements are offset by an increase of £21.5 million in the level of depreciation charged against profits, reflecting the continued significant investment being made in our assets.

As already mentioned, this winter we witnessed the highest levels of rainfall on record. Dealing with this and the associated storm damage through tankering, emergency pumping and also making the subsequent repairs required has come at a significant cost, reducing profits for the year by £18.8 million. Due to the scale of the costs, and the unprecedented nature of the event, we have recorded them as an exceptional item in the accounts for 2013–14.

## Local pride

We continued to play an active role in local communities through partnerships, education programmes and volunteering during 2013–14.

This was recognised by the Business in the Community charity, which measures companies against criteria for their community, workplace, marketplace and environment contributions.

## Thanks

This year I would particularly like to thank the customers who took the time to take part in consultations as we planned our services for 2015–20.

Without these views, we would not have been able to identify the priorities which are most important to our customers and develop the 26 promises we are confident will deliver continuous improvement in the years to come.

The Board of Southern Water has approved this Strategic Report, from page 12 to page 52 and I hope it is of interest. Please get in touch if you would like to share your views on our activities and future plans.



Matthew Wright  
Chief Executive Officer

## Strategic Report: Into the future

### Planning our services

During the year we developed our Business Plan for 2015–20. It has one overarching aim – to provide the services that our customers and stakeholders have told us they want at a price they can afford.

The plan is different to those we have produced in the past because the commitments we make in it are based on the most extensive programme of customer engagement and research we have ever undertaken.

Through the research, we identified six priorities our customers want us to deliver. We then further developed these into 26 performance commitments – or **promises**.

Our £3.2 billion plan was produced following publication of our 25-year Strategic Statement in 2013. This presents our long-term strategy to deal with future challenges and our ambition to work towards recognition as the UK's leading water company.

During 2013–14, we also published our 25-year Water Resources Management Plan, which sets out how we plan to secure healthy, reliable drinking water for homes and businesses across the South East between 2015 and 2040.

### Plans shaped by customers

Over the course of 18 months, we gathered, listened to and acted upon the views of more than 27,000 domestic and commercial customers, nearly 450 community representatives and Southern Water employees.

This engagement and research led our approach to the development of the Business Plan and shaped its contents. This practice is now embedded in our day-to-day work.

During the engagement, we undertook customer workshops and surveys, briefings for interest groups and launched a dedicated Have Your Say website, which was visited by more than 31,000 customers.

We publicised the plan through press, radio adverts and television news, reaching more than one million people, and partnered with the Citizens Advice Bureau to engage harder-to-reach customer groups.

To ensure we had accurately interpreted customers' views in the plan, we published a draft for public consultation.

We were delighted that our work on acceptability indicated that nine out of 10 domestic and commercial customers supported our proposals. A significant minority asked us to do more to keep bills affordable and we addressed this feedback in the final plan, which we submitted to Ofwat in November 2013 for final determination in December 2014.

### Our promises

The Business Plan is based around an ambitious set of promises which our employees are focused on delivering. We are confident that by delivering the promises in the plan we will provide a great service for customers between 2015 and 2020.

The plan outlines areas where we intend to lead the water industry and is based on the six key outcomes, below, which customers have told us are their priorities:

- Responsive customer service
- A constant supply of high-quality drinking water
- Removing wastewater effectively
- Looking after the environment
- Better information and advice
- Affordable bills.

We further developed these priorities into 26 promises, or performance commitments, which will be our measure for excellence in customer service in the next five years.

We have ensured the promises are clear and easily understood so that our customers can hold us to account.

They include commitments such as:

- Resolving 90 per cent of customer queries the first time they contact us
- Reducing sewer flooding inside people's homes and businesses by a quarter
- Making sure no serious pollution incidents are caused by our operations
- Further reducing leakage by nearly two million litres of water a day
- Reducing the average daily water use per person by 15 litres.

These promises change the way we measure our performance and will better reflect our customers' experience of the service we provide.

We are committed to openly reporting on our performance and providing financial information such as how much profit we make and how much tax we pay. This will give our customers a better understanding of what we do, how we are performing and the value we provide.

### **Keeping bills affordable**

As we developed the plan, we were fully aware of the tough economic conditions which have made life difficult for some of our customers over the past five years.

As a provider of essential services, we recognise we must maintain bills at an affordable level. We have therefore set ourselves the challenge of delivering nearly £200 million of efficiency savings, equal to more than £20 per year for every household we serve.

It is our own risk to meet this challenge and, even if we fail to make those savings, average customer bills will increase by less than inflation between 2015 and 2020. This compares with a typical increase of 1.4 per cent above inflation in 2010–15.

To help us deliver sustainable improvements at an affordable price, we have strengthened the skills in our asset management team and are appointing a Strategic Solutions Partner to help us access innovative technologies and approaches from across the worldwide water sector.

We have also identified customer promises that link to financial rewards and penalties if we beat or miss a target by specified amounts. These are targeted where customers told us they wanted to see most improvement in our service.

## **Securing resilient water resources**

This year also saw the publication of our Water Resources Management Plan (WRMP). This sets out how we intend to secure resilient and reliable drinking water supplies for 2015–40.

The plan is updated every five years. This time our WRMP is based on an innovative new approach to assessing the potential range of impacts from future changes in weather patterns to help ensure we can cope with more extreme droughts in the future than those we have experienced in the past.

Our industry-leading approach to drought planning was supported by 83 per cent of customers and will reduce the frequency of water restrictions, such as hosepipe bans, to one in every 10 years on average. It will also halve the risk of extreme restrictions, such as standpipes or rota cuts – where water supplies are limited to taps in the street or for a few hours a day – to one in 200 years on average. Customers were very clear in their feedback that they did not find rota cuts or standpipes acceptable.

Strong support was shown for water efficiency, water re-use and working with landowners and farmers to protect the quality of water in rivers. We listened to our customers' views and, as a result, these options feature more prominently than in previous plans.

The first five years of the water resources plan are incorporated into the 2015-20 Business Plan.

## **Challenges ahead**

Our region faces particular long-term challenges – continued high growth and development, water stress, a sensitive environment with increasing tightening of targets, a long coastline and the effects of climate change.

We make allowances to meet these demands in our plans and outline how we will tackle the challenges in a sustainable way in order to reduce the potential impact on customer bills.

Our focus is on embracing innovation and collaborative working in areas such as integrated water management, catchment management and water trading.

We will develop a more holistic approach to managing the water environment, looking across the whole water cycle rather than at individual solutions that address specific environmental aspects in restricted geographical areas.

## **Innovation through partnership**

Co-operating with others in strong and innovative partnerships is also a key part of our approach to meeting the challenges ahead and delivering the service our customers have asked for.

Partnerships give customers an alternative perspective on problems, a trusted voice to go to for advice and knowledgeable expertise on complex issues.

We will extend our collaboration with local authorities, environmental groups and customer support groups on issues such as flooding, catchment management and affordability.

For example, we are already working in partnership with the Arun and Rother Rivers Trust on a water trading pilot on the Rother and with the South Downs National Park Authority on the protection of groundwater sources from nitrate infiltration.

Collaboration with our neighbouring water companies is also important and we developed a joint water resources management plan for the South East through the Water Resources in the South East group. This has resulted in bulk transfers to share water resources and joint schemes to promote water re-use in Sussex and Kent.

The Citizens Advice Bureau is already an important partner and we will build on that relationship to introduce a Social Tariff from 2015. The tariff will offer bill discounts from 20 per cent to 90 per cent for households in

genuine financial difficulty. This will be supported by water-saving measures, including offering free help and advice to customers.

### **Customer Challenge Group**

During the development of our plans, we were helped and guided by the Southern Water Customer Challenge Group (CCG), a panel of independent representatives from local business, community and environmental organisations and water industry regulators.

The CCG was set up as part of the Price Review process and challenged us on how we gathered the views of customers and used their feedback to shape the plans.

During 2013–14, the group issued a number of formal advice notes to our Board and a report for Ofwat. These can be found on the CCG's website [www.swccg.org.uk](http://www.swccg.org.uk).

### **Reform in the water industry**

During the year, we actively engaged in debate on reform in the water industry.

The draft Water Bill, which was published in 2012, received royal assent in May 2014 and paves the way for competition for commercial customers from 2017.

As a consequence, our Business Plan was broken down into four elements for the first time – household retail services, non-household retail services, wholesale water services and wholesale wastewater services.

Retail services include customer service, billing and meter reading, while wholesale includes the operation, maintenance and improvement of treatment works, pumping stations and pipe networks.

We continue to play an active role in Open Water, a programme set up to deliver what is needed to implement the wholesale and retail arrangements outlined in the Water Bill. Working alongside representatives from Defra, Ofwat, other water companies and customers, we are exploring how the new market will operate and how businesses and public sector bodies can switch suppliers.

Abstraction licence reform will have a significant effect on the development of our next business and water resource plans and we submitted a response to a public consultation on its future to Defra in March. We are working closely with the regulators to link abstraction reform with wastewater recycling and water trading.

## Our promises

We have built our future plans around our customers, their needs and expectations. The six outcomes and 26 promises set out in our draft Business Plan for 2015–20 are shown below. They will form the basis for reporting our performance going forward. To find out more, visit our website at [www.southernwater.co.uk/businessplan](http://www.southernwater.co.uk/businessplan).



### Responsive customer service

- Quick and effective resolution of your queries – 90 per cent resolved first time by 2020. In 2013, this was an average of about 80 per cent
- Improved service to you and your community – increase the number of customers who feel our service meets their individual needs and those of their community
- Improved ranking in our regulator's league table for customer satisfaction – be among the best by 2020. In 2013, we were ranked 19<sup>th</sup> out of 21 companies
- Direct compensation paid if we let you down – this will be linked to the service standards set out in our updated Customer Charter



### A constant supply of high-quality drinking water

- No restrictions on water use, such as hosepipe bans, unless there are at least two dry winters in a row – current record is once every six years
- Reduce leakage by 2020 – target of 86 million litres a day by 2020, equating to a reduction of almost two million litres a day
- No increase in the average time you are without water because of a burst water main, for example – maintain performance of an average of nine minutes per customer per year
- Aim for 100 per cent compliance with drinking water quality standards – at least maintain performance of 99.93 per cent
- No increase in the number of households suffering from persistent low water pressure – currently less than 0.1 per cent of properties we supply (257 households)
- Help reduce the effect of hard water in homes and businesses – increased customer understanding through better information and advice



### Removing wastewater effectively

- No increase in the number of blockages in our sewer network – currently 23,000 blockages a year across 39,600 kilometres of sewers
- Significant reduction of 25 per cent in sewer flooding inside your homes and businesses by 2020 – number of incidents brought down from 2,755 to 2,070
- No increase in the number of incidents of sewer flooding affecting outside areas – maintain performance at 9,700 incidents a year
- Reduction of five per cent in complaints about smells from our wastewater treatment works and pumping stations by 2020 – number of complaints brought down from 423 to 403



### Looking after the environment

- No 'serious pollution incidents' affecting local rivers, streams and beaches caused by our operations by 2020 – there were 10 such incidents in 2012
- Aim for 100 per cent compliance by our wastewater treatment works with required standards – at least maintain performance at 98.6 per cent
- Increase the number of beaches with 'excellent' bathing water quality by 2020 – 15 per cent increase, up from 41 to 48
- Maintain the proportion of renewable energy we use – renewable energy currently makes up 15 per cent of energy we use
- Reduce the amount of water we take from the environment, despite predicted

population growth of four per cent – reduction of 1.4 per cent



#### **Better information and advice**

- 10 per cent reduction (15 litres per person, per day) in average water use by 2020 with better advice on saving water, energy and money – we will reduce average water use from 148 litres to 133 litres per person, per day
- Improved advice on how to prevent blocked drains to help reduce blockages – increase the number of customers who know how to help prevent blockages in drains and sewers
- A 50 per cent reduction in bill queries by 2020 – number of bill queries in 2012–13 was 49,000
- Customers provided with better information about what we do, why we do it and what it costs – increase the number of customers who understand how we use the money they pay us



#### **Affordable bills**

- Efficiency savings made during 2015 to 2020 to help keep bills as low as possible – £189 million in savings
- 10 per cent reduction (15 litres per person, per day) in average water use by 2020 with better advice on saving water, energy and money – this will reduce average water use from 148 litres to 133 litres per person, per day
- Customers in genuine financial hardship provided with improved support – increase the proportion of customers who take up the support we offer around bills
- Customers provided with better information on how we are providing value for money – increase the number of customers who feel our services provide value for money

## Customers

### Responsive customer service

#### Our performance

	2013–14		2012–13
	Target	Achieved	Achieved
SIM score	75	<b>75.2</b>	62.2
Quantitative score	33	<b>32.6</b>	21.9
Qualitative score	42	<b>42.6</b>	40.3

Our customers received a much better service from us in 2013–14. As a result, we achieved our target improvement for the Service Incentive Mechanism (SIM), the metric used by Ofwat to measure how well we serve our customers.

We achieved a score of 75.2 out of 100, a 21 per cent improvement on the previous year. The improvement is the result of investment, training and hard work by our employees, who have put our customers' needs at the heart of everything they do.

The SIM measure is made up of two parts – quantitative and qualitative scores. The quantitative score takes into account written complaints and telephone calls, including the number of times our customers are not able to talk to us if all our lines are busy.

During the year, we received 1.9 million telephone calls and letters or emails from our customers.

#### Customer surveys

The qualitative score is based on the results of surveys conducted four times a year by Ofwat. The surveys are carried out with 200 of our customers who have contacted us with a query or complaint.

If we are unable to provide the service our customers expect from us, we may compensate them with payments. This is done under the Guaranteed Standards Scheme (GSS), which guarantees the minimum standard of service customers should receive from their water company. The number of events and payments recorded under the GSS and our own voluntary Customer Charter in 2013–14 are shown here.

	2013–14	2012–13
Statutory GSS – number of events	4,380	3,105
Statutory GSS – number of payments made	4,315	2,774
Statutory GSS – payments made £k	433	313
Company Customer Charter – number of payments made	77	59
Company Customer Charter – payments made £k	4	4

The number of GSS payments increased during the year, mainly because of interruptions to customers' water supplies when storms over Christmas 2013 affected power supplies to some of our pumping stations on the Isle of Wight.

## Customer improvements

Keeping our promises to customers was the focus of our improvements in 2013–14. The turnaround in our SIM performance was helped by a review of almost every aspect of our work, as well as new training and development programmes for our staff.

Contact centre employees now take part in regular sessions to listen to recordings of their telephone conversations and share feedback with each other. They also record the promises they make to customers when committing to take action or provide updates by an agreed time. 'Resolvers' then work to make sure the promises are delivered and customers are kept up-to-date with developments.

Staffing levels have also increased to support extended hours in the contact centre, making it easier for customers to call us in the evenings and at weekends. Behind the scenes, work progressed on a £13 million upgrade to our billing system, which is scheduled to go live later this year. The new system will also enable customers to access their accounts online for the first time.

During the year, we set up a forum called Your Voice for customers to give their views on our services and let us know how we can improve. The forum enables customers to have their say through focus groups, online questionnaires and email surveys.

## Better information and advice

### Information initiatives

During 2013–14, we talked to thousands of our customers about the services they would like to receive from us. Many asked for better information and advice about the range of services we provide and a number of initiatives were introduced to make improvements in this area.

We launched our new-look bill after more than a year of research with customers and contact centre agents. The new bill is designed to be clear and easy to understand and we also simplified the information leaflet sent out with it.

New services were introduced on our [website](#), which was visited by more than 1.1 million people, a seven per cent increase on the previous year. Initiatives included Live Chat, which enables customers to discuss their queries online with an agent. The feature was a popular addition, with 1,754 chats in the first two months after its launch in January and 93 per cent of customers saying they would use the service again.

### Digital developments

Changes were made to improve online forms as a result of customer feedback and new forms were added. A section was created for customers who receive only wastewater services from us and we refreshed our interactive postcode search feature to include exact water hardness ratings in addition to information about water supply and quality.

Our website was moved to new servers to improve its performance and resilience, especially at times when the site is in high demand – such as during flooding or water supply incidents.

In 2013, we launched a new online annual report in the form of an [interactive website](#), supported by a downloadable pdf. The report is designed to be open, engaging and accessible, combining all of our previous public reports in one place to provide facts and figures about Southern Water as well as details about our operational and financial performance.

We also joined Twitter during the year, opening up a new communication channel for us to share information with our customers and for them to contact us.

### Water efficiency

Thousands of our customers were given information and advice about how to save water, energy and money during the year.

As part of our metering programme, 15,444 customers received water and energy audits in their homes from trained advisors – Green Doctors from the charity [Groundwork](#). The Green Doctors also fitted water-saving products, such as water-efficient showerheads and tap aerators. We continued to offer free [Save-a-Flush bags](#), which can save up to one litre of water with every flush, providing 37,878 to customers who requested them.

Ten more members of staff joined our team of [Waterwise speakers](#), who give talks about water to a range of school and community groups. A total of 84 talks were given during the year.

### **Five-year campaign**

During the year, we appointed a water efficiency manager to develop a multi-million pound campaign for 2015–20. This will ensure we continue to help our customers to save water, energy and money when our programme to install meters in the majority of homes across our region comes to an end in 2015.

We also became the first water company to join the Water Using Products Working Group, which is backed by the Government. The group struck an agreement with retailers, manufacturers and builders' merchants to introduce the new Water Label to give customers accurate information about the water efficiency of products such as taps, showers and toilets.

### **Fat, oil and grease campaign**

Our award-winning awareness campaign to help prevent sewer blockages, flooding and pollution reached thousands more customers.

Nearly 75 per cent of blockages in sewers result from items that should not be put down the sink or toilet, such as wet wipes, nappies and fat, oil and grease. Blockages can lead to flooding in homes and gardens. During the year, we cleared 10,858 blockages, many of which were caused by congealed cooking oil and wet wipes.

We gave away thousands of eco-funnels to help households and schools collect their cooking oil to be recycled as bio-fuel. We included information and advice about fat, oil and grease in our community talks and we even adapted a Christmas carol, Jingle Smells, to raise awareness about the dangers of flushing wet wipes down the loo.

### **Connectright**

We joined a partnership with other water companies and the Environment Agency to launch a new website about sewer misconnections.

The Connectright campaign highlights how pollution can happen when sewers are wrongly connected to the surface water network, which is only designed to carry clean rainwater directly to rivers and the sea. The website provides information about how to spot misconnections with advice on how to put them right and also links to plumbers.

## Affordable bills

### We can help you pay

During the year, we helped 21,502 customers who struggled to pay their water bills. Rising prices in the current economic climate have put pressure on household incomes and 85 per cent more customers received help in 2013–14.

Our Debt Advice Team answered 79,380 calls (a 38 per cent increase from 2012–13) from customers in financial difficulties and 59,092 people visited the [advice pages](#) on our website (a 53 per cent increase from the previous year). Overdue bills and bad debt are a key issue for the water industry, adding about £16 to our customers' bills. It's therefore important that we work with our customers to keep debt, and bad debt, to a minimum.

The [New Start Scheme](#) allows customers in severe financial hardship to reduce their debt when they make regular payments on their current water bill. The amount they pay is also cleared from their arrears and 4,885 customers joined the scheme in the year. A further 9,546 customers joined a Department for Work and Pensions [scheme](#) to repay their debts directly through their benefit payments.

### Charity grants

The Southern Water [Charitable Trust Fund](#), a registered charity set up to help customers in financial hardship, awarded grants totalling £168,000 to 413 people during the year.

Now in its sixth year, the fund has paid out in excess of £2.5 million to more than 4,600 customers in need. It has also awarded grants to agencies that offer money advice, such as Citizens Advice or housing associations.

We also helped 6,810 customers through the [WaterSure](#) tariff, which gives financial help to households that use large amounts of water for essential purposes. This includes customers on income-related benefits with three children under 19 in full-time education or customers with certain medical conditions.

### Metering support

We continued to support our customers who had a water meter installed as part of our five-year metering programme to secure water resources.

To date, 62 per cent of households moving to metered charges have experienced a reduction in their bills averaging £14 a month – a saving of £168 a year. Customers whose bills rise after a meter is fitted are offered our [Changeover Tariff](#), which introduces the increases gradually over three years. A total of 18,998 households have taken this up since it was introduced.

Those customers who are unable to pay the increased charges are also offered our [Support Tariff](#) and are put in touch with [IncomeMAX](#), an independent social enterprise, which helps people claim their full benefit entitlements and tax credits. A total of 2,849 customers are on this tariff.

The total we have now secured in benefits and tax credits for our customers has risen to £2 million, with 682 customers offered the Support Tariff during the year.

### **Social Tariff**

Work continued in 2013–14 to develop a Social Tariff for customers who have genuine financial difficulty in paying their water bills. A pilot with 2,000 customers will take place in 2014, with the tariff introduced for all eligible customers in 2015-16.

The pilot will include five levels of support, ranging from 20 per cent to 90 per cent reductions in bills. We are working with Citizens Advice to identify and assess customers who could benefit.

### **Working more efficiently**

We constantly look at ways to run our business more efficiently to deliver a better service and make savings for our customers. During 2013–14, we made almost £16 million of operating efficiency savings, which will help us to keep customer bills lower in the future.

Where possible, we reduce our energy use. We monitor the amount, and cost, of energy used at each of our 458 water and wastewater sites and in our main offices. This helps us to develop effective ways to reduce consumption, such as avoiding peak times when energy costs more.

During the year, we invested in a new system that will improve the management of planned work at our treatment works and on our network. The system will provide a single source of information about our capital projects so that we can produce more efficient and cost-effective work schedules.

An initiative was also introduced to reduce the amount of waste we send to landfill. We worked with our waste contractor, MTS, to recycle solid matter screened from wastewater into compost. As a result, we recycled 30 per cent of this difficult waste, which previously we had to pay to dispose of.

### **Debt reduction**

Debt caused by those who don't pay their water bills has an impact on every customer's bill. We share information about non-paying customers with the credit reference agency Experian. This helps to reduce the amount of money owed to us because a customer's credit rating can be affected if a default is registered on his or her account.

As a result of this action, more than 5,000 customers have so far paid their outstanding debt in full, resulting in the collection of £1.3 million in unpaid bills. If customers have genuine financial difficulty in paying their water bills, we offer help through our Debt Advice Team and with support tariffs.

## Services

### A constant supply of high-quality drinking water

#### Water quality

	2013		2012
	Target	Achieved	Achieved
Overall drinking water quality index	99.93%	<b>99.94%</b>	99.93%
Disinfection control index	99.99%	<b>100%</b>	99.99%
Process control index	99.97%	<b>99.96%</b>	99.92%

We continued to supply drinking water of the highest quality to more than two million people. In 2013, we achieved an overall rating of 99.94 per cent, taking us a step closer to our long-term target of 100 per cent compliance.

We carried out more than 222,000 tests of drinking water quality to report to the Drinking Water Inspectorate. A further 216,000 tests were conducted to measure samples against our own standards, which are more stringent than those set by our regulator. Our tests looked for more than 100 substances in samples taken from 90 water treatment works, 204 service reservoirs and customer taps.

For the first time, we achieved a rating of 100 per cent in our disinfection control index. This success follows a £70 million investment in water treatment processes in recent years, including more checks on the quality of water we put into supply.

#### Taste and smell

There was a significant reduction in the number of taste and smell failures in water samples tested, falling from 52 to 30.

The taste and smell of the water we supply has been an issue in some areas in recent years, particularly around Hastings in East Sussex, where the majority of supplies come from reservoirs. During the year, we installed carbon filters at our water treatment works at Brede and Beauport in East Sussex to help reduce these problems. In our 2015–20 Business Plan, we have also included schemes to add more advanced filters to these works. This will further improve the taste and smell of water supplied in the Hastings area.

#### Improving our service

We invested more than £30 million in improvements to water supply works during 2013–14. This included upgrades to wells and boreholes, service reservoirs and water supply works. We also flushed 155 kilometres of mains and cleaned 28 service reservoirs, which store water underground before it is pumped to customers' taps.

Heavy rain, such as we experienced during the year, can affect water quality because it washes more nitrates and pollutants into rivers. To avoid problems associated with this, we instigated new processes to stop abstracting water when possible during and after heavy storms.

New Drinking Water Safety Plans were completed and made available online for staff. These plans identify where and how problems can arise with drinking water quality and cover the entire supply system, from catchment to customers' taps.

## Water supply

	2013–14		2012–13
	Target	Achieved	Achieved
Performance water non-infrastructure	Stable	<b>Stable</b>	Stable
Performance water infrastructure	Stable	<b>Stable</b>	Stable
Distribution maintenance index (2013 calendar year)	99.96%	<b>99.94%</b>	99.94%
Security of supply index (critical period)	100	<b>100</b>	100
Security of supply index (annual average)	100	<b>100</b>	100

During the summer, we supplied 100 million litres less water than in the summer of 2003, when the weather was similar. We believe this difference is thanks to the efforts of our customers to save water, energy and money after their water meters were installed.

Water resources were in a healthy position during the year. No restrictions were put in place and none are expected in 2014-15.

### Fewer burst mains

We recorded 1,517 burst mains during the year, one of the lowest levels in the past 10 years. The average amount of time customers were without water because of bursts was about 11 minutes. This was despite difficulties working in the floods during the winter.

During the year, we replaced 28 kilometres of water mains to help reduce the number of bursts. We also continued investigations into potential new water sources for the future, including re-using water and aquifer storage and recovery, in which water is taken from rivers when flows are high and stored in underground aquifers for use when water is less plentiful.

### Metering

We continued our programme to install meters for the majority of our customers by 2015. The total number of meters fitted and brought on charge reached 326,768 with the programme visiting Hove, Horsham, Worthing, Lewes and Hastings in Sussex; Medway and Thanet in Kent; and Eastleigh, Fareham, Winchester and the Test Valley in Hampshire.

By 2015, when the five-year programme comes to an end, we expect nearly 30 million litres of water to be saved each day thanks to our customers being more water-efficient. That's enough water to supply the daily needs of Worthing, Eastbourne and Bognor Regis.

**Leakage**

	2013–14		2012–13
	Target	Achieved	Achieved
Leakage (million litres of water per day)	89	<b>85</b>	81

We continue to deliver one of the lowest levels of leakage per property of water and wastewater companies, working around the clock to find and repair leaks on our 13,753 kilometre network of water mains.

We beat the target set by Ofwat by four million litres of water each day, helped by the milder conditions over the winter. The level was slightly higher than the record low we achieved in 2012–13 when we put extra focus on tackling leaks during the drought.

Our sophisticated water meters automatically detect leaks on customers' supply pipes. During the year, leaks were found in 147 properties where meters were installed. In many cases, free repairs were carried out.

**Low water pressure**

During our conversations with customers about future service levels for 2015–20, they said they wanted us to keep down the number of homes with low water pressure.

We manage water pressure in our network because, if it is too high, it can cause burst mains and increase leakage, but we also have a duty to maintain a certain level of pressure so our customers can easily use their appliances.

We currently have one of the best performances on water pressure in the water industry, with just 258 households experiencing low pressure in 2013–14.

## Removing wastewater effectively

### Safely recycling wastewater

	2013–14		2012–13
	Target	Achieved	Achieved
Performance wastewater infrastructure	Stable	<b>Stable</b>	Stable

Amid heavy rain and flooding, it was a challenging year to safely recycle wastewater from 4.5 million people across our region.

During the wettest winter on record, communities suffered from flooding caused by high groundwater levels as well as overflowing rivers and excess surface water. Our sewers – which are designed to handle wastewater and not millions of litres of groundwater and floodwater – were also inundated in some areas.

### Fewer homes flooded

We invested more than £126 million to improve and maintain our service in 2013–14 and worked around the clock during the bad weather to keep our sewers flowing and prevent flooding incidents. As a result, our performance improved on the previous year, with a reduction in flooding inside homes, businesses and in gardens.

To help achieve this, we have invested £5.5 million to refurbish wastewater pumping stations. This led to a reduction in the number of homes affected by failures in our pumping stations. We also carried out more monitoring, collecting vast amounts of data about our operations to help us predict where problems are likely to occur so we can respond to them more quickly.

During the year, we renovated nine kilometres of sewers and replaced 10 kilometres of sewers and rising mains – the large sewers which connect to our pumping stations and treatment works. We also used cameras to survey 225 kilometres of sewers for blockages, build-ups of fat, oil and grease and damage that could lead to pollution and flooding. As a result, the number of blockages in our sewer network fell by 10 per cent.

### Flood protection

We worked around the clock during the winter months, spending nearly £19 million to help protect our customers from flooding following the worst storms to hit the country for decades.

With many parts of southern England under water, our region was also affected by groundwater and river flooding. We worked tirelessly to fulfil our duty to keep the sewers flowing and enable our customers to continue to use their toilets and sinks, removing up to 125 million litres of excess water from our network every day. That's enough to fill 50 Olympic-sized swimming pools. In a UK first, we used mobile biological treatment tanks in order to treat the excess water being removed from our sewers to a higher standard than could previously be achieved before returning it to the environment.

More than 40 areas in our region were affected. The worst hit included St Mary Bourne and Hambledon in Hampshire, Yalding and Nailbourne in Kent and the Rother Valley in Sussex. At its peak, the operation to keep our sewers working cost more than £160,000 a day, with 117 tankers and 44 mobile pumps in use day and night.

## Long-term solutions

Our teams worked in partnership with the Environment Agency and local councils to protect homes and businesses. The emergency showed how important it is that we continue to work as part of a multi-agency response team to develop long-term solutions to flooding.

Local authorities are responsible for developing flood management strategies, which identify local organisations with responsibility for flood risk and put partnerships in place to assess and manage this. We are working with all the lead flood authorities in our region and are contributing to these strategies. This includes membership of the Southern Regional Flood and Coastal Committee, which is made up of the Environment Agency and local councils.

As an example, in St Mary Bourne we developed an Infiltration Reduction Plan. This sets out the steps we will take to help prevent flooding should groundwater levels rise in the future. The plan was agreed with the Environment Agency, Hampshire County Council and the local steering group and will be used as a template for other communities at risk of groundwater flooding.

## Flood prevention

Some flooding was mitigated by our £6.0 million investment during the year to survey and seal sewers in areas vulnerable to groundwater flooding.

As part of the groundwater infiltration reduction project, we surveyed 40 kilometres of sewers and 800 manholes. In addition, we surveyed 225 kilometres of critical sewers. A total of 19 kilometres of sewers were repaired or replaced during the year and 100 manholes were sealed to reduce infiltration. We also installed flow monitors in sewers to help identify problem sites and surveyed pumping stations and outfalls where water is returned to rivers or the sea. As a result of our ongoing work, 29 properties were removed from our At Risk Flood Register.

We also continued to invest in and maintain more than 17,000 additional kilometres of sewers and lateral drains. These became our responsibility in October 2011 under Government legislation to transfer certain private pipes to wastewater companies in order to establish clear ownership.

Long-term initiatives include our £20 million scheme to radically change the Victorian sewer system in Portsmouth to reduce the risk of sewer flooding. Work continued to lay new pipes and build pumping stations to divert up to 6,000 litres of rainwater per second from the sewers and out to sea. A further £10 million is being invested in storm storage tanks and an emergency outfall to sea at Fort Cumberland to protect the city from severe storms.

## Preventing smells

We worked hard to prevent smells from our 368 wastewater treatment works and 2,375 pumping stations.

We strive to be a good neighbour in the communities we serve and spent about £750,000 on planned and reactive maintenance to keep complaints about smells as low as possible during the year. We wrote to residents, warning about possible smells for a short period, when we needed to carry out essential maintenance at our sites and we reacted to complaints as quickly as possible.

At Peacehaven in East Sussex, work was completed on a state-of-the-art odour control system at our new works, which treats 95 million litres of wastewater a day from Brighton and Hove and surrounding areas.

### **Significant benefits**

A scheme to reduce smells at our Peel Common Wastewater Treatment Works in Hampshire also made good progress and will bring significant benefits to people living and working in the neighbourhood. A £1.5 million upgrade at our Tunbridge Wells South Wastewater Treatment Works in Kent also included a new odour control unit.

We received 472 complaints about smells in 2013, which was an increase on our lowest level recorded of 322 in 2012. The increase was mainly because of unforeseen challenges with sludge treatment and maintenance work while the hot, dry summer resulted in less water flowing through our sewers. This can lead to stronger smells.

Over the longer term, complaints about smells have dropped by more than half in the past 10 years and we made a commitment in our Business Plan for 2015–20 to reduce them even further.

## Environment

### Climate change

#### Carbon performance

	2013–14		2012–13	
	Target	Achieved	Target	Achieved
Greenhouse gas emissions – ktCO <sub>2</sub> e	377	<b>270</b>	334	286
KgCO <sub>2</sub> e per person supplied with treated water	-	<b>25</b>	-	27
KgCO <sub>2</sub> e per person supplied with wastewater services	-	<b>41</b>	-	40

We were awarded the Carbon Trust Standard in recognition of our efforts to measure, manage and improve our carbon efficiency. It is the third time we have earned the standard for our ongoing efforts to reduce our impact on the environment.

During the year, we were also rated second among similar companies in a Government league table which rates carbon emissions against reductions in energy use. We were in the top two of the 10 water and wastewater companies, and ranked in the upper quartile of 2,000 companies overall in the Carbon Reduction Commitment (CRC) scheme, which is managed by the Environment Agency.

The success is partly down to installing smart electricity meters on our sites. The meters provide more accurate measurements of the amount of electricity we use. This has helped us to adapt the way we operate our works to drive down energy use and minimise our carbon footprint.

#### Greenhouse gases

During the year, we produced 270 kilotonnes of carbon dioxide and other greenhouse gases. This was similar to 2012–13.

Our target is set on the basis that our emissions will increase by 42 kilotonnes each year as we use more energy to treat water and wastewater to higher standards and to allow for population growth.

We supplied less water during 2013–14, which required less energy. However, the record levels of rain and flooding meant we used large amounts of fuel and energy to tanker and pump stormwater to prevent it overwhelming our sewers and people's homes.

#### Renewable energy

We set ourselves a long-term target during the year to maintain the percentage of energy we use from renewable sources at 15 per cent. This is despite a predicted increase in energy use as we cater for housing and population growth and the effects of climate change in the region.

We have increased the installed capacity of Combined Heat and Power (CHP) generation at our treatment works from 51 million kilowatt hours to 70 million kilowatt hours of renewable electricity. We now have 16 CHP plants which use biogas from the wastewater treatment process to produce renewable energy – providing power and heat to the works, with surplus exported to the National Grid. Overall, the units supply 15 per cent of

our energy needs, with the most recent ones installed at Hastings and Ford in Sussex and Sandown on the Isle of Wight.

A new heat exchanger was also installed at the CHP at Budds Farm Wastewater Treatment Works in Hampshire. The exchanger uses water to recover heat from the engine and exhaust systems. The water then warms the treatment tanks and speeds up the bacterial digestion of the waste.

## Looking after the environment

### Bathing water quality

Every beach in our region met European standards for bathing water quality in 2013. All 83 bathing waters achieved the European 'mandatory' rating during weekly sampling carried out by the Environment Agency between May and September. Nearly 88 per cent also passed the tighter 'guideline' standard, compared with 70 per cent in the previous year.

The quality of bathing water can be affected by factors that are out of our control, such as pollution in water running off roads and land or sewers wrongly connected to drains carrying rainwater. However, our ongoing environmental improvement programmes are continuing to benefit the water along our coastline.

### Official opening

Our scheme to bring cleaner seas to Sussex was one of the largest investment projects we've ever undertaken and it was officially opened during the year. The £300 million project included a new treatment works with a green roof at Peacehaven, two pumping stations, an 11 kilometre sewer tunnel and 2.5 kilometre sea outfall. It is the UK's last major scheme to ensure that wastewater treatment meets Urban Wastewater Treatment Directive standards. The scheme was named Major Civil Engineering Project of the Year in the British Construction Industry Awards, beating projects such as the London 2012 Olympic Park.

During 2013–14, we continued to take part in a voluntary trial to alert local authority beach managers when we release stormwater from combined sewer overflows (CSOs) during heavy rain. CSOs are sometimes needed because the water could otherwise back up in our sewers and flood customers' homes and gardens. The alerts allow beach managers to publicise the information for beach-users.

We are providing alerts for 22 beaches as part of the Cleaner Seas Forum Bathing Water Trials, which are led by the Government. The trials are in preparation for 2015, when higher quality standards for bathing water will be introduced under the Bathing Water Directive. We will then be required to provide more public information on water quality for all bathing waters.

### Preventing pollution

	2013		2012
	Target	Achieved	Achieved
All pollution incidents (wastewater), Category 1-3	295	<b>320</b>	409
Serious pollution incidents (wastewater), Category 1-2	5	<b>9</b>	10
Environmental Discharge permit compliance	98.2	<b>96.0</b>	96.8%

Despite the wettest winter on record, the number of pollution incidents in our region fell by 22 per cent in 2013. We recorded a total of 320 incidents, with serious events falling to nine. We were recognised by the Environment Agency as one of only two water companies with fewer serious pollution incidents during the year. There was also a four per cent reduction in incidents related to sewers or combined sewer overflows, falling from 144 in 2012 to 138 in 2013. This followed a 14 per cent reduction in the previous year and is the result of an action plan put in place to improve our performance.

Our improvement work has included the continuation of total care plans for 85 wastewater treatment works and pumping stations and more targeted jetting programmes for sewers. We have also added new processes and checks at our works and pumping stations and, where necessary, increased the capacity and levels of treatment.

## Wastewater treatment

	2013–14		2012–13
	Target	Achieved	Achieved
Performance wastewater non-infrastructure	Stable	<b>Stable</b>	Marginal

The performance of our wastewater treatment works is critical to ensure the water we recycle to rivers, streams and the sea is of the highest quality. The majority of our works, 266 out of 278, met the stringent conditions set by the Environment Agency during 2013–14.

Where failures occurred, many were because of a challenge we continued to face in meeting iron standards in the cleaned wastewater we recycle back to the environment. We have been working with the Environment Agency to review the standards, which were revised towards the end of 2013, and we are now compliant with them.

During the year, we safely recycled 100 per cent of the solid waste left over after the treatment process. The waste was used to produce bio-solids and sold as farm fertiliser.

## Our investment

We invested £119 million during the year to improve wastewater treatment and we spent £50 million on maintenance work.

Our work included a £2 million scheme to use ultraviolet light to disinfect the stormwater which collects in storage tanks during heavy rain before it leaves Chichester Wastewater Treatment Works. This is significantly improving the quality of the flows we release into Chichester Harbour, which is classified as an Area of Outstanding Natural Beauty.

A new treatment tank the length of 10 double-decker buses was built as part of a £25 million investment at Millbrook Wastewater Treatment Works in Southampton to help protect the water quality of the Solent. A £9 million upgrade at Morestead Road Wastewater Treatment Works in Winchester, Hampshire, was completed while, in Kent, we started a £5 million project to increase the capacity at Whitewall Creek Wastewater Treatment Works to cater for housing growth.

## Major improvements

In West Sussex, an £8 million maintenance scheme got under way at East Worthing Wastewater Treatment Works to reduce the risk of flooding in the area and improve operations at the site. We also gained planning approval for our plans to re-develop Woolston Wastewater Treatment Works in Hampshire. The new works, which will be designed to blend in with the surrounding area, will significantly reduce smells from the site and ensure the treated wastewater meets new standards.

Reed beds are often used as an extra stage of cleaning and we refurbished those at Ulcombe Wastewater Treatment Works, near Maidstone in Kent, and at Godshill Wastewater Treatment Works on the Isle of Wight.

## Water abstraction

The amount of water we took from the environment to supply to our customers fell to its lowest level since the water industry was privatised in 1989. We abstracted 190,614 million litres of water, with the majority coming from underground aquifers and the remainder from rivers and reservoirs.

The record low amount of water abstracted is because of two factors:

- Customers using less water as a result of our metering and water efficiency programmes
- Our ongoing work to maintain leakage below our industry target.

## Conservation

We strive to protect the environment and our care is recognised in our commitment to maintain certification to ISO 14001.

Compliance with ISO 14001 helps us to identify, manage and mitigate our impact on the environment, prevent pollution and ensure we meet environmental legislation. During the year, we passed our annual five-day audit for certification after inspectors visited five of our water and wastewater sites.

## Sites of Special Scientific Interest

As a large landowner in the South East, we own or lease a number of Sites of Special Scientific Interest (SSSIs). More than 80 per cent of these are recognised as being in 'favourable' condition, the highest rating for an SSSI.

We started 'health checks' at 11 SSSI sites to establish if conservation work is needed to maintain or improve their status to protect them for future generations. Some of the sites, which include former landfill sites or steep slopes, offer protection to rare plants and animals, have a unique geology or are an important wildlife habitat.

## Conservation work

Conservation work continued at our Testwood Lakes site, near Southampton, which is managed by the Hampshire and Isle of Wight Wildlife Trust. The trust is in the fourth year of a 10-year Higher Level Stewardship scheme promoted by Natural England. Work during the year included the creation of a large dipping pond, control of invasive species and coppicing. The Lakes recorded a good year for birds, with 125 species noted and common terns seen nesting for the first time. Two new species of orchid were also found flowering.

We carried out our annual ecology survey at our new reservoir site in West Sussex, where we have established a wild flower meadow. The section of river from which we abstract water is close to colonies of the depressed river mussel and greater water parsnip. The results were shared with Natural England, the RSPB and Sussex Wildlife Trust.

Our staff joined a national effort to help combat 'ash dieback', a fungus that has devastated ash woodland and spread to the UK. Two hundred elms were also planted on our land as part of our project to grow trees that are resistant to Dutch elm disease. A further 30 were donated to East Sussex County Council to replace elms lost to disease on its land.

We also took action to protect eels discovered at our site at Aylesford in Kent. Eels are becoming endangered, with the number of adults dropping by 80 per cent in the last 60 years. We installed scrapers at our treatment tanks to help clear weed in which the eels become trapped, and encourage them back into the River Medway.

### **Volunteering help**

Our staff helped to clean up Worthing beach as part of the Marine Conservation Society's BIG Beach Clean and Annual Litter Survey. Volunteers also cleared overgrown vegetation at a farm in West Sussex to make way for new hedgerows and establish a wildlife corridor between two areas of woodland.

Contractors working at our wastewater treatment works in Ockley, Surrey, also gave a boost to wildlife by planting buddleias to encourage butterflies, and work to protect grass snakes on site. In addition, we supported several conservation projects in our communities, including the restoration of a village pond by Climping Conservation Volunteers in West Sussex.

More than 180 days of voluntary work were given by education, conservation and weekend helpers at Testwood Lakes in addition to 494 days by the Friends of Testwood, who work at the site every week to improve the habitats.

### **Archaeology**

The conservation of buildings and historic artefacts is another important aspect of our work to protect the environment. An early 18<sup>th</sup> century labourer's cottage, which was dismantled and removed from our Bewl Water reservoir site in 1975, was opened to the public after a restoration project at a museum in West Sussex. Tindalls Cottage was re-erected at the Weald and Downland Open Air Museum, where a collection of traditional buildings tells the stories of the people who lived and worked in them over a 600-year period. The cottage includes furnishings and a garden and sets the scene during the time of the first John Tindall, who lived in it from 1748.

A more recent historical find was a Second World War bunker of national significance, discovered by engineers laying a sewer at a former airfield in Hampshire. The red-brick building, which has a concrete roof and is made up of five rooms, was surveyed by Archaeology South-East and is thought to have been a battle headquarters used during the co-ordination of the airfield's defence.

The Kent Archaeological Field School unearthed a glimpse into Roman life during an excavation of a villa next to our wastewater treatment works at Wateringbury, near Maidstone. It was the second excavation on the site and led to more significant finds from the 1st century AD through to the 4th century.

Following completion of the Cleaner Seas for Sussex scheme, we are looking forward to artefacts found during construction of the Peacehaven site being made available for public display on conclusion of examination by Archaeology South-East.

## About us

## Our workplace

### Health and safety

In an industry-leading performance, we achieved the longest period in our history without a reportable injury to a member of our staff.

We recorded 417 consecutive days without a RIDDOR – a serious injury which must be reported to the Health and Safety Executive. This is believed to be a first for the water industry and is the result of great focus by our staff on safety at work.

While any injury is one too many, our focus helped us to once again beat our target of 0.39 reportable injuries – and preferably fewer – per 100 employees/contractors during the year. We recorded 0.18, our lowest figure ever.

For the 15<sup>th</sup> consecutive year, we achieved the Royal Society for the Prevention of Accidents (RoSPA) gold level award and were recognised with an Order of Distinction – the first water company to receive such an accolade.

### Aim for Zero Injuries

Our ongoing Aim for Zero Injuries campaign has contributed to this achievement. During 2013–14, initiatives included:

- A two-day health and safety conference for more than 500 staff and contractors
- The creation of a wellbeing group alongside directors from our key suppliers
- Health and wellbeing drop-in sessions with local councils
- An awareness campaign for all staff about the dangers of driving on public roads and on sites during bad weather.

We also continued our campaign to encourage staff to report 'near misses' or hazards at work to help prevent injuries. As in previous years, we donated £2 to charity for each report and, as a result, raised a further £10,224 for Air Ambulance organisations in our region. This equates to about four potentially life-saving missions by air ambulance crews.

### Our people

We directly employed 2,090 people in Kent, Sussex, Hampshire and the Isle of Wight as of March 31, 2014 and many more through our suppliers. This included 468 in our UK-based contact centres.

### People development

We continued our apprentice scheme, with 44 apprentices graduating from our one-year customer services training scheme and a further 19 from our award-winning water and wastewater operations, mechanical, electrical and ICA apprenticeship programme. Ten apprentices also graduated from our innovative water supply and distribution scheme.

We implemented a Leadership Skills Development Roadmap during the year as part of an initiative to develop talent within the business. This includes a Leaders for Tomorrow scheme for first-line managers, which was completed by 86 employees, and an Inspired Leader Programme for middle managers, completed by 30 staff.

Thirty-two people took part in our week-long Employee Development Programme, which ran for the 44th time in 2013.

We also delivered our Ambassador programme across our operations staff, with 244 employees attending during 2013. This has significantly contributed to our customer service improvements. An initiative to improve processes across the business resulted in 56 people enrolling in the Business Improvement Techniques NVQ, which is recognised as best practice in the UK.

We continued our commitment to training during the year, delivering more than 2,100 training sessions, covering a range of topics from employee development to project management and confined space training.

### **Employee engagement**

We also continued to focus on helping to make our company a better place to work, with the support of engagement champions. We moved a step closer to our aim of being listed in The Sunday Times' Best Companies to Work For listing, with 72 per cent of staff completing our annual employee engagement survey. The score showed a seven per cent increase in the level of staff engagement from the previous year.

More than 300 nominations were also received in the second year of our STAR (Staff Thanks And Recognition) Awards, doubling last year's figure.

### **Our suppliers**

During the year, we supported many hundreds of jobs in the South East through the suppliers we employ to deliver our services to customers and our investment programme.

We continued our Multi-Services Framework agreements with Clancy Docwra, Morrison Utility Services and Barhale Trant Utilities to deliver our core water and wastewater services between 2010 and 2015. 4Delivery also continued to deliver improvements to our treatment works as part of its Single Entity Contract until 2015.

### **New contracts**

In addition, we put contracts out to tender for services during our next Business Plan period, which runs from 2015–20. They include a Strategic Solutions Partner to work with our in-house teams to develop projects to deliver the 26 promises we have made to our customers.

We also issued tenders for partners to develop and deliver capital projects and to provide maintenance and reactive services. Other contracts for 2015–20 include key services for customer engagement, human resources and IT.

The appointed contractors will work alongside us to deliver excellent customer service and maintain our outstanding health and safety record. The majority of new contracts will be awarded in 2014–15 to ensure the right suppliers are in place from 1 April 2015 to deliver the services we have promised our customers in the Business Plan.

## Our community

### Community and education

We firmly believe in giving back to the communities in which our customers live and work. This was done through a range of initiatives and programmes during the year.

Our work was recognised by the Business in the Community charity, which measures companies against criteria for their community, workplace, marketplace and environment contributions. We scored three stars in 2013–14, increasing our overall score from 86 per cent to 90 per cent and achieving an above-average score in the index.

#### Learn to Swim

In a region bordered by an extensive coastline, our long-standing Learn to Swim programme helped to teach another 35,000 children this life-saving skill.

The scheme received a high-profile boost from Olympic champion Becky Adlington, who joined our annual seminar for Learn to Swim instructors at a pool in Sussex and took part in a training session with youngsters from Crawley schools. Former Olympic gold-medallist Duncan Goodhew also continued in his role as ambassador for the scheme and presented awards to 50 inspirational children at our annual Learn to Swim Achiever Awards.

The Learn to Swim programme operates at 85 pools and clubs across the South East. Since its launch in 1992, more than 650,000 children have learned to swim through the scheme.

#### South and South East in Bloom

We continued to sponsor the annual South and South East in Bloom competition, which was bigger and better than ever in 2013. A record number of 366 entries were received from towns, villages and cities across the region, with 115 in the Blooming Schools section.

The themes of the competition are horticulture and gardening, environmental responsibility and community participation. Celebrity gardener Chris Collins presented awards to the winners at a ceremony in Kent.

#### Education programmes

The young people in our region are our customers of tomorrow, so our education programmes about how to use water wisely are important. A total of 4,571 children in 29 primary schools watched our fun mime play about a family called the Drips. The show, designed for seven to 11-year-olds, conveys the message that we should only use as much water in and around the home as we need to.

We continued to run an education programme for 10 secondary schools during the year. Our Acqua Innovation scheme encourages pupils to develop water-saving ideas and campaigns, which are judged against other schools in a 'Dragon's Den' style final. The year's winning design was a scheme by Thornden School in Hampshire to channel wastewater from baths and showers to a water butt through a series of filters.

More than 1,000 primary school children received whistle-stop lessons in water and wastewater during a Junior Citizen event at Crawley in West Sussex. Staff also volunteered to join the STEM ambassadors' programme, going into schools to help engage young people in Science, Technology, Engineering and Mathematics.

## Community campaigns

Other community campaigns during the year included our Sporting Chance programme, which engaged more than 6,200 young people through football and cricket. We worked with Gillingham Football Club in Kent to help disadvantaged children in the Medway area and we ran water efficiency and sewerwise workshops for students in conjunction with Southampton and Portsmouth football clubs. We also joined forces with Sussex Cricket Club to run the Southern Water Ashes competition and promote the health benefits of drinking water.

Our Water Café took to the road to visit 19 community events where we talked to our customers about water and wastewater and gave away free water-saving devices as well as fat traps to recycle fat, oil and grease to prevent drains from getting blocked.

## Charity support

We have a long-standing ethos of giving back to the communities in which we live and work through charity fund-raising. During the year, we raised and distributed more than £235,000 to good causes.

The organisations we supported were chosen by our staff and included national charities such as the NSPCC, Macmillan Cancer Support, Cancer Research UK and WaterAid. We also supported regional charities such as the Kent, Sussex, Hampshire and Isle of Wight Air Ambulance trusts, Chestnut Tree House Children's Hospice, near Arundel in West Sussex, and St Barnabas House hospice in Worthing.

## Annual events

Our three main annual charity events were our ball, which had a Swinging Sixties theme and raised £85,000; our seventh horse-racing day at Fontwell Park in West Sussex, attended by more than 4,500 people (£35,000); and our WaterAid golf day (£11,000). Other activities included a London to Turin Bike Challenge, Wear a Santa Suit to Work day and a sponsored walk along the South Downs to support The Argus Appeal, which helps disadvantaged children, the elderly and people with disabilities in Sussex.

Each of our directorates was invited to choose a charity for its own staff to support, with every £1,000 raised matched by the company. This resulted in £33,000 being donated to good causes including Chailey Heritage School in East Sussex, the Heart of Kent Hospice, Hampshire Asbestos Support & Awareness Group and Chelsea's Wishes on the Isle of Wight. We also made 68 smaller donations, worth £9,320, to community organisations, schools and to support staff fund-raising initiatives.

## Volunteering our time

Our staff spent 502 days helping worthy projects as part of our Community Volunteering Programme. The scheme allows staff to take two days' paid leave each year to volunteer their services for charities, community organisations or environmental work.

Volunteering initiatives included refurbishing a hotel for the partially-sighted, creating a woodland walk for children with life-limiting illnesses and painting a community beach hut.

## Access and recreation

As a major landowner in the South East, we are in a privileged position to help our customers enjoy days out and learn more about the environment.

We own four reservoirs – Darwell and Powdermill in East Sussex, Weir Wood in West Sussex and Bewl Water on the Kent/Sussex border. All offer outdoor activities such as public walks, fishing and sailing. Bewl is our largest reservoir and each year more than 150,000 visitors enjoy activities including windsurfing, sailing, fishing, cycling, walking and boat trips.

### New wetland habitat

Our Testwood Lakes site, near Southampton, is managed on our behalf by the Hampshire and Isle of Wight Wildlife Trust and we celebrated the 10th anniversary of the partnership.

The site, previously used for extracting gravel, is now a nature reserve covering 130 acres and features bird hides, a sand martin bank, wildlife ponds and an education centre. A new purpose-built pond and dipping platform were created, largely by volunteers, to extend the scope of education visits to the site.

During the year, about 30,000 people visited Testwood Lakes, including schools, community groups, walkers, birdwatchers and nature-lovers. More than 3,850 children and young people took part in visits and holiday activities while 2,691 participated in formal education programmes. The centre expanded its work with baby and toddler sessions and staged a World War II living history programme for primary schools.

Other visitor opportunities in our region included displays of historic pumping machinery at our water treatment works at Brede in East Sussex. The machinery is cared for and displayed by Brede Steam Engine Society and we printed 10,000 promotional leaflets about its work to help spread the word. An Edwardian pumping station is also open to visitors at our waterworks at Twyford in Hampshire.

### Sewer tours

Our tours of the Victorian sewer network in Brighton attracted more than 1,500 visitors during the year. High-profile guests included Michael Portillo, as part of his BBC Great British Railway Journey series, actor Alan Cumming and Meridian TV presenter Fred Dinenage. During the guided tours, we added information about the dangers of pouring fat, oil and grease down drains. We also opened the doors of our treatment works to groups of schoolchildren who toured our sites as part of our Aqua Innovation education programme for secondary schools.

## Financial performance

### Financial performance

#### Accounting policies

The accounting policies of the company, which are consistent with the prior year, are set out on pages 84 to 88.

#### Profit and loss account

The profit and loss account of Southern Water Services Limited is summarised in Table 1 below.

Table 1	Years ended 31 March		Change
	2014 £m	2013 £m	%
Turnover	806.2	778.7	3.5
Operating costs before exceptional items	(246.5)	(239.4)	3.0
Depreciation, net of amortisation	(234.9)	(213.4)	10.1
Other income	0.2	5.1	(96.1)
Operating profit before exceptional items	325.0	331.0	(1.8)
Exceptional item	(18.8)	-	-
Operating profit	306.2	331.0	(6.0)
Profit on disposal of fixed assets	0.5	1.0	(50.0)
Net interest	(167.2)	(152.9)	9.4
Profit before tax	139.5	179.1	(19.3)
Tax	30.3	(22.2)	(236.5)
Profit after tax	169.8	156.9	8.2

Turnover increased by 3.5 per cent to £806.2 million (2012–13: £778.7 million) principally because of the average tariff increase on metered and unmetered income of 5.1 per cent. This increase was applied from 1 April 2013 and was based on the annual RPI of 3.0 per cent at November 2012 together with a K factor of 2.1 per cent. We were entitled by Ofwat to increase prices by a K factor of 3.3 per cent, but we voluntarily chose not to implement the maximum allowed price increase because take-up of our metering transitional tariff has been lower than expected. The increase was offset by reduced income from customers switching from an unmetered supply to a metered supply principally as a result of our metering programme.

Operating costs before exceptional items increased by 3.0 per cent to £246.5 million (2012–13: £239.4 million) and the major reasons for this movement of £7.1 million are explained in Table 2.

<b>Table 2</b>	
<b>Increase/(decrease) in operating costs</b>	<b>£m</b>
Inflation	8.1
Pension curtailment in 2012–13	9.0
Increased bad debt charge (including inflation £1.3m)	4.1
Peacehaven – operating costs of new site	1.6
Power efficiencies	(3.2)
Contract renegotiations	(7.1)
Process improvements	(2.8)
Pension reduced service cost	(1.0)
Targeted efficiencies	(1.6)
<b>Movement in operating costs</b>	<b>7.1</b>

During 2012–13, we undertook a comprehensive review and consultation process relating to the final salary pension scheme, which resulted in the implementation of significant changes to the scheme to ensure its long-term sustainability. This resulted in a one-off, non-cash, curtailment gain of £9.0 million in 2012–13 and a reduction in overall pension service costs of £1.0 million in 2013–14.

Following the completion of our £300 million scheme at Peacehaven, operating costs are now being incurred. These amounted to £1.6 million in 2013–14 in relation to the part of the year that the site was operational. There will be a further increase in operating costs associated with the site next year when there will be a full-year impact.

Other efficiencies have been achieved through business process reviews, contract renegotiations and a focus on maintaining tight budgetary controls. These include initiatives to reduce power and chemical usage and reducing the work issued to external contractors through more efficient use of our own internal resources.

Depreciation increased by 10.1 per cent to £234.9 million (2012–13: £213.4 million) as a result of the continuing significant capital investment programme. New schemes commissioned during the year added £12.3 million to the depreciation charge with the most notable items being the impact of the Peacehaven scheme and water compliance projects. In addition, there was an increase in the infrastructure renewal charge of £6.3 million, reflecting the greater level of capital expenditure on infrastructure assets and private sewers.

Other income reduced to £0.2 million from £5.1 million in 2012–13. This reduction principally results from income for services provided in the disposal of an investment in Veolia Water Southeast Limited held by another group company that was received in 2012–13.

Operating profit before exceptional items for 2013–14 decreased to £325.0 million (2012–13: £331.0 million), a 1.8 per cent reduction as a result of the factors set out above.

During the period from December through to February, the South of England experienced a series of storms and heavy rainfall. The areas most affected included Hampshire, Sussex and Kent which all fall within our operational area. The level of rainfall across the South East was in excess of 260 per cent of the historical average and resulted in significant operational disruption, with many sites without power and lengthy periods of flooding due to the high groundwater levels. As a result of this exceptional weather event, we have incurred significant additional costs for pumping and tankering to alleviate the flooding and to ensure that we continue to serve our customers. We have recorded the costs associated with this event as an exceptional item of £18.8 million within the accounts for 2013–14.

The resultant operating profit for 2013–14 decreased to £306.2 million (2012–13: £331.0 million).

The profit on disposal of fixed assets of £0.5 million (2012–13: £1.0 million) mainly relates to the sale of land and buildings surplus to operational requirements.

Net interest payable of £167.2 million increased by 9.4 per cent (2012–13: £152.9 million). In March 2013 a new £250 million bond was issued in preparation for the repayment of an existing £250 million bond at March 2014. The increase in net interest largely relates to the additional £7.7 million associated with this new loan. In addition, the issue fees associated with the existing loan were written off when this was repaid. These increases were offset by lower indexation on the inflation-linked bonds as a result of lower RPI in 2013–14.

We have recognised a tax credit to the profit and loss account of £30.3 million (2012–13: £22.2 million charge). This differs from the charge that may be expected of £32.1 million, based on the profit before tax of £139.5 million and the current period tax rate of 23 per cent. This is primarily a result of the announcement of the reduction in the rate of corporation tax from 23 per cent to 21 per cent with effect from 1 April 2014, and to 20 per cent from 1 April 2015. A credit of £47.1 million is recognised for the impact of these changes on the deferred tax liability of the company, as described in note 8. A further credit of £10.6 million arises as a result of agreement of prior period tax returns with the tax authority, leading to lower tax liabilities in future periods. The current tax charge for the period is also reduced by £16.0 million as a result of capital allowances arising from our capital investment programme.

The profit after taxation for the year amounted to £169.8 million (2012–13: £156.9 million).

### **Cash flow statement**

Net cash inflow from operating activities increased to £543.3 million for 2013–14 from £499.8 million in 2012–13. This increase mainly results from a change to the payment terms of some of our maintenance contracts, the settlement of an outstanding debtor in respect of the disposal by a group company of its investment in Veolia Water Southeast Limited, additional cash receipts resulting from the price increase on turnover and lower cash expenditure from the operating efficiencies delivered.

The net cash outflow from returns on investment and servicing of finance increased to £90.4 million for 2013–14 from £81.8 million in 2012–13. This increase results from net interest payable on the new £250.0 million bond issued in March 2013 together with additional interest payable, which arises from the impact of inflation on the underlying nominal values of a number of our loans.

In total, tax payments of £22.9 million were made during 2013–14 (2012–13: £13.7 million). These relate to payments for group relief for taxable losses across the Greensands group. Of this, a payment of £13.1 million (2012–13: £13.7 million) was made to Southern Water Services Group (SWSG). This, together with the interim dividend of £43.8 million (2012–13: £43.2 million), is offset by interest received from SWSG of £56.9 million (2012–13: £56.9 million).

The outflow of cash relating to the purchase of tangible fixed assets was £382.0 million (2012–13: £360.1 million). The increase in cash outflow results from the increase in the overall capital programme during the year.

The net cash outflow before financing in 2013–14 was £1.5 million (2012–13: £215.4 million) with the higher outflow in 2012–13 arising from the transfer of funds to Southern Water Services (Finance) (SWSF) in preparation for the repayment of a £250.0 million Class B bond in March 2014.

The net cash outflow from financing of £2.9 million relates to the repayment of accrued indexation on some of our bonds. In 2012–13 there was a £279.9 million inflow principally from the issuance of a new Class B bond.

### **Balance sheet**

At the end of the year to 31 March 2014, we had fixed assets of £4,461.2 million (2012–13: £4,293.5 million), an increase of £167.7 million from March 2013. This increase largely results from capital investment of £415.5 million offset by depreciation of £237.8 million.

Debtors falling due within one year decreased to £198.0 million (2012–13: £416.6 million). This reduction mainly resulted from a movement in inter-company debtors of £238.0 million following settlement of the Class B bond in March 2014. This was offset by the continued increase in the level of accrued income of £12.9 million resulting from our metering programme.

The repayment of the Class B bond is also the principal reason for the reduction in the level of creditors falling due within one year, which decreased to £300.6 million (2012–13: £505.9 million). This reduction was offset by a change in the payment terms on some of our maintenance contracts and accruals made for costs associated with the flooding events over the winter.

As at 31 March 2014 creditors falling due after one year increased by £68.9 million to £3,836.4 million. This increase principally resulted from inflation on inflation-linked bonds of £72.1 million.

The net pension deficit increased in value to £72.3 million (2012–13: £72.1 million) following the latest actuarial valuation, as described in note 22.

Overall net assets increased from £914.3 million to £1,041.2 million.

### **Dividend policy**

Southern Water aims to deliver a sustainable long-term financial strategy, taking into account the interests of all stakeholders. Our shareholders are long-term investors and fully support the strategy adopted.

Southern Water's dividend policy is to propose dividends having given due consideration to the following financial and performance criteria.

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

Distribution proposals submitted to the Board will also include an assessment of our performance against the Business Plan, including expected performance over the balance of the regulatory period.

Southern Water's dividend policy and the associated financial and performance criteria are intended to support the credit ratings of the business and ensure continued access to diversified sources of finance.

These tests are not applied to the interim dividends paid to SWSG as the dividend payment is instantly offset by a corresponding interest receipt from SWSG.

The shareholders continue to support the business and no other ordinary dividend was paid or declared in relation to 2013–14 (2012–13: nil), and no dividends were paid to the shareholders of our ultimate parent company, Greensands Holdings Limited.

## Taxation

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

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

Our rate of corporation tax against accounting profits (our effective tax rate) is less than the statutory rate of corporation tax published by HMRC because of differences in the way in which some items of expenditure are treated for accounting and tax legislation. This is especially the case with regard to capital investment expenditure, where the UK taxation system recognises the benefit to the economy of investment in UK infrastructure. Since privatisation in 1989, the water industry has been required to make significant capital investment to improve environmental performance and resilience to drought and flooding, maintain existing assets and, in particular for SWS, accommodate population growth in the South East of England. Our taxable profits are lower than our accounting profits as a result of our capital expenditure, with capital allowances being recognised at a faster pace than the depreciation charge of our assets. This has the effect of reducing the amount of tax we pay, the benefit of which is passed to our customers through their bills.

Another aspect of our significant capital investment programme is that we borrow money to finance our capital investment. The interest associated with this borrowing is recognised as both an accounting and tax expense, so reducing profit and further reducing the amount of tax we pay. Again, the benefit of this is passed to our customers through reduced bills.

Our contributions to the Exchequer amounted to £57.1 million. These are explained below:

- Business rates of £24.4 million paid to local authorities (2012–13: £24.2 million) and payments to the Environment Agency of £8.2 million (2012–13: £7.7million), which reduce profits chargeable to corporation tax
- Employment taxes of £21.5 million paid to the Exchequer in PAYE (Pay As You Earn) and National Insurance contributions (2012–13: £20.5 million)
- Carbon Reduction Commitment of £3.0 million levied on our power cost (2012–13: £2.8 million), which reduces profits chargeable to corporation tax

Payments have also been made to other group companies of £22.9 million for tax losses surrendered to the company. Of these, £13.1 million was paid to SWSG and then repaid to Southern Water as interest, with the remainder paid to the Greensands financing companies.

In addition, we will have paid a significant amount of indirect taxation, such as fuel excise duty relating to transport costs and landfill tax in connection with the disposal of waste product from our wastewater treatment processing.

## Financial KPIs

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

The net debt used in the ratio of net debt to RCV is calculated from our Regulatory Accounts as short and long-term senior borrowings, less cash and short-term deposits. The RCV for each year is set by Ofwat for five-year periods at periodic reviews and reflects forecast growth in the asset base. It is adjusted at each periodic review for any out-performance, shortfalls in outputs or permitted additional investment and for certain asset disposals. The ratio of senior debt to RCV is targeted to be maintained at below 85 per cent, in line with our debt covenants.

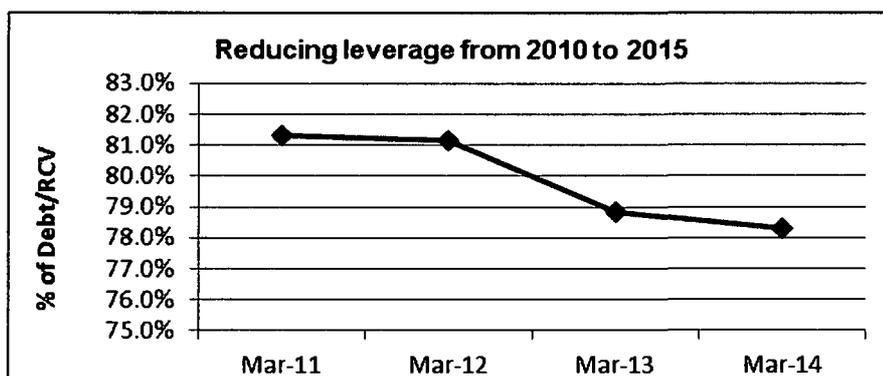
Senior adjusted cash interest cover (measured as net cash inflow from operating activities less current cost depreciation and the infrastructure renewals charge to senior debt interest) is targeted to be maintained above 1.1 times to meet covenanted levels.

Net debt: RCV	%
2010–11 performance	81
2011–12 performance	81
2012–13 performance	79
2013–14 performance	78
Covenanted lock-up level	<85

Senior adjusted cash interest cover	Times
2010–11 performance	1.4
2011–12 performance	1.6
2012–13 performance	1.5
2013–14 performance	1.6
Minimum target trigger level	1.1

Credit rating	
Standard & Poor's	Class A debt: A- Class B debt: BBB
Fitch	Class A debt: A- Class B debt: BBB
Moody's	Class A debt: Baa1 (negative outlook) Class B debt: Ba1 (negative outlook)

During the current five-year regulatory period from 2010 to 2015, we have faced financial risks such as a material shortfall in revenues compared to those assumed at the time of setting prices for this five-year period, as well as event risks such as the £18.8 million cost associated with the series of storms and heavy rainfall from December through to February. Shareholders have been extremely supportive during this period by voluntarily foregoing dividends in order to ensure we have sufficient cash to maintain our programme to improve performance and to reduce leverage and financial risk as well as to manage these financial KPIs.



## Capital structure

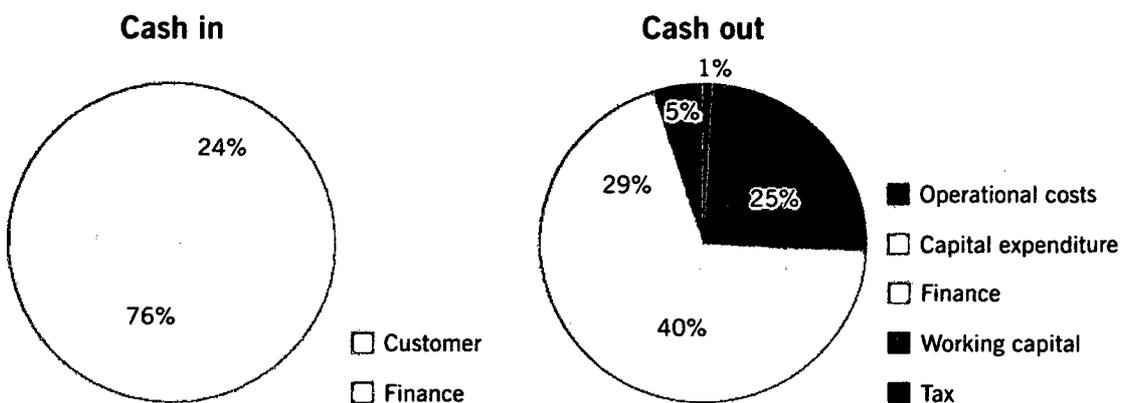
### Why Southern Water raises finance

Significant capital investment programmes have been a feature of Southern Water's business since privatisation in 1989. We have invested in both maintaining our existing asset base and constructing new assets to improve the environmental quality of wastewater, improve the quality of drinking water and accommodate population growth in our area of operation. As an example, prior to privatisation, wastewater discharged into our coastal waters was untreated, but the completion of our £300 million Cleaner Seas for Sussex scheme in 2013 marked the conclusion of a programme of capital investment to fully treat wastewater of the coastal towns and cities from Kent to Hampshire and the Isle of Wight.

We raise finance to pay for the construction of new assets. As a shareholder-owned company, we are incentivised to drive efficiency and need to maintain the proportion of assets financed by shareholder equity in order to absorb financial risk and to lay the basis for financing the construction of new assets. New finance is also required to repay loans taken out in previous years.

The level of customer charges is calculated to cover our operating expenditure, our annual financing costs (including any equity return to our shareholders) and the amount required to invest in and maintain our assets, such as water pipes, sewers, pumping stations and treatment works.

The charts below illustrate the sources and uses of expected cash flows for the current regulatory period April 2010 to March 2015, and demonstrate our requirement to raise finance to fund our capital investment programme. The data is based upon the regulatory price determination, which sets out our obligations and the limits for customer charges for this current five-year price period.



### Capital structure and borrowing covenants

We refinanced our regulated business in 2003 with the aim of reducing our cost of capital and gaining access to long-term, secure sources of finance. This was achieved by replacing a short-term parent company loan with a long-term framework for sustainable future financing.

Our financing subsidiary Southern Water Services (Finance) (SWSF) was established for the express purpose of raising debt finance on our behalf. The Southern Water Financing Group (see ownership chart below) was also established at that time to create a financial ring-fence to protect our ongoing operation.

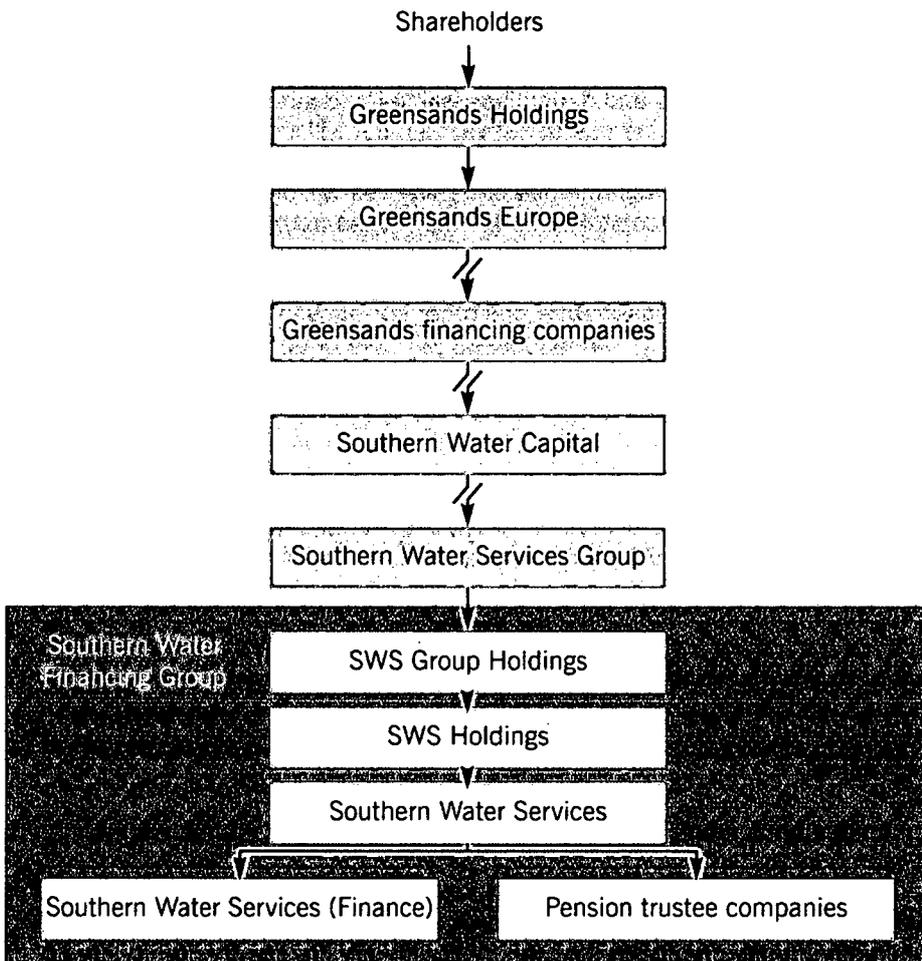
The financing group, whose immediate parent is Southern Water Services Group (SWSG), provides security to finance providers in the form of a charge over the share capital of SWS Group Holdings (SWSGH). No security is provided over our individual regulated operating assets. This structure ensures that, in the unlikely event that either Southern Water or SWSF were to default on their debt obligations, we will continue to operate our business as usual. Debt providers are not permitted to either break up or interrupt our business and can

therefore only look to a new owner of the financing group to recover their debt in the unlikely event of serious default.

In 2003, a Common Terms Agreement (the CTA) between the members of the financing group and its debt investors was established. The CTA sets out arrangements for the ongoing management of our debt issuance programme as well as a number of operating arrangements in order to minimise financial risk and adhere to good industry practice.

One of the CTA arrangements is a limit on the indebtedness of Southern Water and SWSF. This limit includes precautionary ‘early warning’ limits, which prevent us from paying dividends. We ensure that we operate with sufficient financial headroom against these limits and have not breached a limit at any time since the 2003 refinancing.

### Southern Water ownership structure summary



Greensands Holdings is the ultimate parent company of Southern Water and all other group companies, with no minority interests. A number of Greensands companies were set up to finance the acquisition of the share capital of Southern Water Capital (SWC) from the Royal Bank of Scotland in October 2007 (investing £1.9 billion of equity and debt to finance the acquisition). The shareholders of Greensands Holdings are a consortium of infrastructure funds and pension companies, with no single shareholder having majority control. The principal investors are pension funds, a fund managed by JP Morgan Asset Management, and a fund managed by UBS Global Asset Management.

Shareholders of Greensands Holdings are represented on our Board through two non-executive directors. During 2013–14 the Board also consisted of a further four non-executive directors, who are independent of the

shareholders, a non-executive Chairman, the Chief Executive Officer and the Chief Financial Officer. In April 2014, Colin Hood, who was Chairman during 2013–14, stood down and one of the existing independent non-executive directors, Robert Jennings, was appointed as our new Chairman. Find out more about them on page 59.

Our Chairman is also independent Chairman of the Greensands Holdings Board, which meets four times a year. No other independent members of our Board sit on the Board of Greensands Holdings.

All companies within the Greensands Holdings group of companies are UK resident for tax, with all profits and losses falling within the UK tax jurisdiction.

### **How we finance the business**

In note 16 to the financial statements, we provide an analysis of our outstanding debt at 31 March 2014 and 31 March 2013. The majority of our loans are sterling bonds and were issued by our financing subsidiary SWSF and are listed on the UK Stock Exchange.

The regulatory framework, under which revenues and the RCV are indexed, exposes us to inflation risk. This risk is managed through the use of inflation-linked loans and derivatives within the overall debt portfolio. We do not intend to access future inflation-linked debt through the use of derivatives, but will instead seek such debt from natural sources, such as public and private bond markets. As a consequence, we expect the proportion of the RCV and debt that is currently linked to inflation through the use of derivatives will decrease over time. Based on inflation of 2.9 per cent, this proportion of the capital structure will reduce from 36 per cent of the RCV today to 28 per cent of the RCV at 31 March 2020.

We are not restricted to issuing sterling bonds, but will ensure that any other currency loans are fully hedged back to sterling. We also hedge our exposure by ensuring that at least 85 per cent of our outstanding debt liabilities (in respect of Class A and Class B debt) is either inflation-linked or fixed rate for the current five-year regulatory period and at least 70 per cent in the next period (on a rolling basis).

We also consider refinancing risk by ensuring that loan maturities are not concentrated in any single year or regulatory period. When issuing new loans, we test that refinancing obligations are less than 20 per cent of RCV in any two consecutive years and 40 per cent of RCV within any five-year regulatory period. The maturity profile of loans ranges from within one year to March 2056, which ensures we comfortably meet this test. Although not formally required, we ensure that inflation-linked swap accretion payments are included within our maturity analysis.

Southern Water ensures that sufficient liquidity (cash and committed bank facilities) is in place to fund the business for at least the next 12 months (including loan and inflation-linked swap accretion maturities), an important consideration given that we have negative cash flow generation in the majority of years as a result of our ongoing capital investment programme.

We also maintain a £200 million committed bank credit facility, which is used as a liquidity buffer and was undrawn at 31 March 2014 and 31 March 2013.

As a result of our liquidity policy, we can have large cash balances. We reduce the risk of losing cash on deposit, from bank or fund failure, by setting maximum limits on cash deposits with any bank or fund. Banks must have, as a minimum, a credit rating of P1 (Moody's), A1 (Standard & Poor's) or F1 (Fitch). Funds must be AAA rated. These are the most secure ratings.

In addition to our loans as analysed in note 16, we issued a loan of £812.3 million to SWSG as part of the refinancing in 2003 (note 14). We receive £56.9 million annual interest on this loan, which is financed by dividend and tax payments we make to SWSG. For the year ended 31 March 2014, the dividend was £43.8 million and the tax payment, in respect of the taxable losses incurred by SWSG, amounted to £13.1 million. This loan provides no tax benefit to either us or the Greensands Group, with the tax payment from Southern Water to SWSG simply negating any tax effect of this loan. This is illustrated in figure 1 of the diagram below.

The Greensands companies also have their own loans: a UK-listed bond and bank loan issued by Southern Water Greensands (Financing) (SWGF), represented in the diagrams as Greensands financing companies, and Eurobonds issued by Greensands Europe. The UK-listed bond and bank debt issued by SWGF result in tax losses which can be used within the Greensands Holdings group of companies. All companies within the Greensands Holdings group are UK tax resident and form a single 'family' of companies for UK tax purposes.

Figure 2 below highlights cash flow movements between Southern Water and the Greensands Holdings group of companies for 2013–14.

## Interest and dividends payments 2013-14

Figure 1

£812m loan from SWS to SWSG

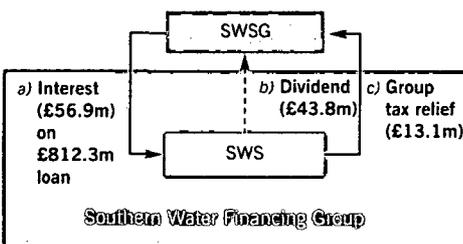
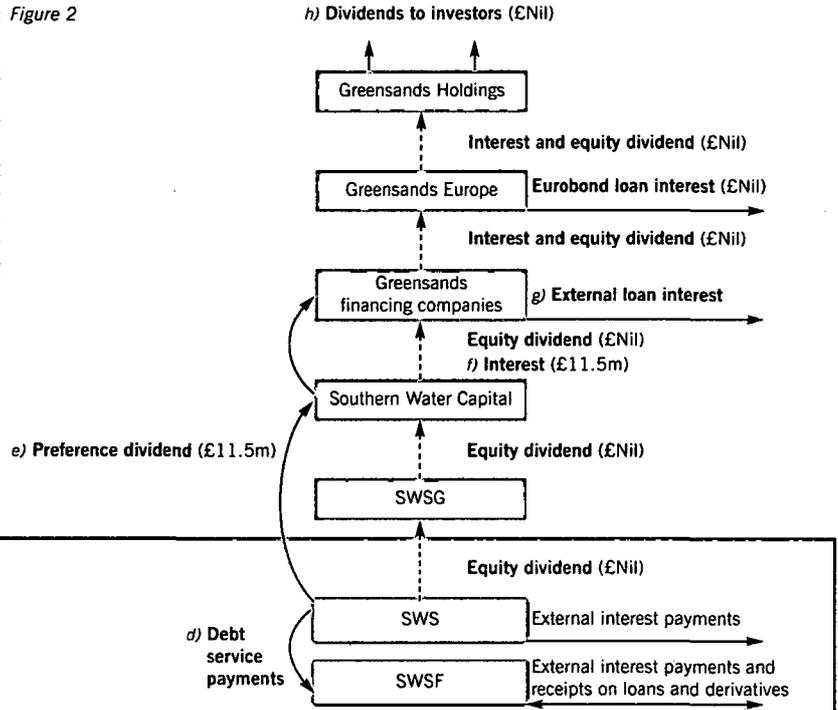


Figure 2



**Footnote:**

- a) Interest paid by SWSG to SWS on £812.3m loan.
- b) Dividend paid by SWS to SWSG.
- c) Payment of group tax relief by SWS for the taxable losses at SWSG.
- d) Interest payments from SWS to SWSF on the loans taken out by SWSF on behalf of SWS. This is then used by SWSF to pay the interest on these external loans.
- e) Interest payments on the preference shares.
- f) Interest payable on an inter-company loan.
- g) External interest payable, funded from interest receivable and cash held in the Greensands financing companies.
- h) No dividends were paid to investors.

## Risks

In order to provide a reliable and consistent service for our customers, it is important that we recognise and monitor risks to our business.

We ensure controls are in place so we can take action to minimise the impact of these risks. To do this, we manage risks through a central database where they are ranked and assigned to a senior manager who is responsible for implementing mitigation plans.

Risks are reviewed each month and the highest are escalated to our Executive Management Team, the Board and the Audit and Risk Review Committee. Any new risks added to the database with a score above a certain level are passed to a director and Chief Executive Officer for immediate review. Key risks during the year, which are listed by category, included:

**Future price limits:** The process for Ofwat's 2014 Periodic Review began in 2011–12. This will determine price limits for the period 2015 to 2020. The review is significantly changed with the introduction of separate price controls for retail and wholesale services. We submitted our final Business Plan to Ofwat in November 2013 and, in response to feedback and further guidance from Ofwat, will be submitting a revised Business Plan in June 2014. Failure by Ofwat to recognise significant investment needs or other major issues included within our plan may lead to a shortfall in funding for the regulatory period.

**Mitigation:** We completed extensive development work, including substantial consultation with customers, to produce a high-quality Business Plan. We consulted further with customers on our proposals to revise our plan in response to Ofwat's new guidance. Our plan and its revision were reviewed by our independent Customer Challenge Group, the Board and subjected to assurance testing. We have continued to respond to all Ofwat's consultations on price review methodology and will maintain close dialogue with Ofwat and other regulators on key issues.

**Market reform:** During the last two years, there has been a significant focus on reform within the water industry. This has included the Government's Water White Paper and Ofwat's Future Price Limits, which focus on changes to the way customer prices are set, the introduction of competition and a greater use of market mechanisms to promote innovation and efficiency. Our economic regulator, Ofwat, is continuing to review and revise the regulatory regime to ensure it is fit for the challenges of the future, including market reform and changes to water company licences.

**Mitigation:** We have continued to engage constructively with Ofwat and Defra on the proposals for market reform. We are also working with Water UK to ensure that any changes deliver better, more effective, regulation in the interests of our customers and the business. During the year we have taken an active participation in workshops and consultations held by the Open Water programme, which will deliver the market codes, systems and contracts needed to implement the wholesale and retail arrangements outlined in the draft Water Bill.

**Compliance with legislation:** Southern Water is a highly regulated business with three main regulators: Ofwat, the Environment Agency and the Drinking Water Inspectorate. If we do not meet the regulations set by these bodies, the company could face penalties during the five-year price review that sets our levels of investment and customer bills. We could also face fines, legal action and, in the worst case scenario, the loss of our appointment as a water and wastewater company.

**Mitigation:** We have procedures in place to comply with legislation and key procedures have been certified to meet high standards, including ISO 9001 and ISO 14001. Awareness training is provided throughout the company for critical issues, such as the Bribery Act and Competition Law, to ensure everyone understands our legal obligations. All sections of the business review their compliance with company procedures through self-assessment every six months and implement improvement plans if necessary.

**Operational failures and pollution incidents:** Reliable water and wastewater services are essential to maintain public health and protect the environment. Operational failures can lead to interruptions to drinking water supplies, risks to health or severe damage to the environment from pollution. As well as the risk of

damage to the environment or distress to customers, incidents like these can also affect our performance rating with Ofwat, lead to prosecution and fines by the Environment Agency or the Drinking Water Inspectorate and cause damage to our reputation.

**Mitigation:** The majority of our £1.8 billion capital investment programme for 2010–15 is targeted to maintain our water and wastewater sites and networks to reduce the risk of failure and incidents. We have response teams on standby to make sure if there are problems we can minimise the impact to our customers and the environment.

**Resilience to drought:** The South East is classified as an area of severe water stress and changing weather patterns are predicted to pose an increasing challenge for all water companies in the region in future years. Southern Water supplies drinking water to more than one million households across Kent, Sussex, Hampshire and the Isle of Wight and it is critical we are able to develop a resilient network to continue to do so now and in the future.

**Mitigation:** We have secured extra water resources through our new River Arun reservoir in West Sussex to achieve our target for the Security of Supply Index in the region. We have also continued to drive down leakage below our company target and are on track to install water meters for the majority of our customers by 2015, supported by a wide range of water efficiency initiatives. Should a drought occur, as in 2012, we have a Drought Plan which we follow to introduce measures to conserve water and secure additional resources through Drought Permits and Drought Orders and by changing the way in which we operate our sources. During the year, we also updated our Water Resources Management Plan, using an industry-leading approach that allows us to plan for a wider range of droughts than we have seen in the past.

**Preventing flooding of our sites and from our network:** Changing rainfall patterns, more frequent storms and rising sea levels could all lead to an increased risk of flooding. The serious floods in recent years have also highlighted the need to protect our water and wastewater treatment works and pumping stations from being put out of action in floods.

**Mitigation:** To help combat this increased risk, we are investing nearly £90 million in flood protection schemes between 2010 and 2015 to increase the capacity of our sewer network. This includes £20 million on sewer improvements in Portsmouth to help protect the city from flood damage during storm conditions after it was extensively damaged in a storm in 2000. Nearly £10 million is also being invested in updating sewer plans, computer models and drainage area plans to look at how our network can cope with changing weather in the future and how we can reduce the risk of flooding to homes and gardens, and £7.2 million to survey and seal sewers identified as vulnerable to groundwater flooding during the wet winter of 2012–13.

**Regional growth:** The population in the South East has grown considerably during the last 20 years and is expected to grow by a further 16 per cent between 2010 and 2030. The populations of Portsmouth and the Isle of Wight are forecast to be the fastest growing. This presents significant challenges because our region has increasingly scarce water resources, many environmentally important areas and a densely populated coastline, which will require higher standards of protection.

**Mitigation:** We need to ensure we can supply enough drinking water to cater for a growing population and that we have enough capacity at our wastewater treatment works and in our water mains and sewer network to cope with the extra flows. We continually review population forecasts as part of our forward planning in our five-year Business Plan and our 25-year Water Resources Management Plan. By 2020, we anticipate housing development will have started to grow again as the population increases in line with forecasts. Our future investment plans are developed in consultation with developers and local planners to make sure we have the necessary infrastructure in place to cater for new developments.

**Bad debt:** Levels of bad debt, which cannot be recovered and have to be written off as a loss, continue to be a significant issue for the water industry. In the current economic climate, there is a risk that the number of customers who do not pay their bills will increase. This puts an additional burden on customers who do pay their bills.

**Mitigation:** We understand that some customers may experience financial difficulties, particularly in these difficult economic times. We encourage customers who are struggling to make payments to contact our Debt

Advice Centre as early as possible. We offer a range of flexible instalment plans and tariffs and also refer those in severe financial hardship to our Charitable Trust, which can give grants. As part of our metering programme, we can offer water and energy audits in the customer's home to help them make savings and a free referral to the community organisation IncomeMAX, which can ensure households are receiving all the benefits and grants they are entitled to. We are proactive in collecting payment from our customers and in helping households to pay their bills and debt. When necessary, we also utilise a leading debt management system to recover overdue payments to keep bad debt to a minimum.

**Financing our business:** Significant change in interest rates or a reduction in the availability of credit to the water industry could put our ability to finance our capital investment programme at risk in the future. The industry requires ongoing access to capital markets because of negative cash flows, which have been a feature of the water industry since it was privatised in 1989. We only enter into treasury transactions to manage inherent risk and support prudent funding, not to speculate.

**Mitigation:** We ensure that we maintain sufficient cash reserves and liquidity facilities to finance our operations for at least 12 months. We also ensure the aggregate nominal value of debt maturities (and derivative inflation payments) does not exceed 40 per cent of RCV in any single regulatory period (and 20 per cent of RCV in any 24 months). Exposure to interest rate rises on our current borrowings is also hedged by a subsidiary company, Southern Water Services (Finance), and current borrowings are at either fixed rates or inflation-linked. We raise inflation-linked debt or derivatives to manage company risk relating to fluctuation in inflation and will limit our future source of inflation hedge to inflation-linked debt. Our next material debt maturity is on 31 March 2016. We ensure that sufficient funds are available for our operational and capital investment programme through ongoing monitoring and forecasting of our cash flow and we take steps to manage this when necessary.

**Credit ratings:** We need to maintain an investment grade credit rating to ensure we can continue to access the capital markets to efficiently finance our capital investment programme and refinance our existing debt maturities. This is required as a condition of our regulatory licence and it is also a primary duty of Ofwat to ensure we can finance our business. In addition, it is a condition of borrowing covenants, where a failure to maintain certain credit ratings could lead to a restriction in dividend payments.

Our current credit ratings are:

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

**Mitigation:** We have an internal business plan which is expected to stabilise our overall credit rating position. A primary duty of Ofwat when setting prices is to ensure companies can finance their business. If necessary, a company can apply to reset customer prices during the five-yearly regulatory periods through an Interim Determination of K (IDoK). In addition, regular meetings are held with the ratings agencies to provide them with updates on current performance and future projections.

**Delivery of our capital investment programme:** We have a capital investment programme of £1.8 billion between 2010 and 2015. We are on target to deliver this and some schemes are ahead of schedule; however, we have to continue our focus to complete all of our work on time. If we are unable to deliver significant parts of the programme on schedule, we face a risk to our ability to provide the best service we can for our customers and possible action by the Environment Agency, Drinking Water Inspectorate or Ofwat.

**Mitigation:** We closely monitor the progress of our programme to ensure we manage any risks to completing the work on time. We work closely with our regulators and other interested parties to resolve issues as they arise.

## Corporate Governance

### Chairman's overview

#### Introduction

Southern Water is committed to maintaining high standards of leadership, transparency and governance. We have adopted our own code and have committed to comply with its letter and spirit. As the Board, we fully accept our responsibility and accountability to stakeholders for ensuring effective governance processes are in place and followed.

The Board's role is to:

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

#### Southern Water Code of Board leadership, transparency and governance

During the year 2013–14, Jonson Cox, the Chairman of the Water Service Regulation Authority (Ofwat) encouraged water companies to improve their demonstrable governance further. Ofwat published draft principles in September 2013, which became essentially their final principles, published in January 2014 (the Ofwat Principles).

The Board readily adopted Ofwat's suggestion to develop our own code, which we adopted in November 2013. We have fully reflected the Ofwat Principles and drawn extensively on the appropriate principles of the UK Corporate Governance Code in the Southern Water Code of Board leadership, transparency and governance. We have committed to comply with the letter and the spirit of the principles and commitments of the Southern Water Code, and the board of our parent company, Greensands Holdings, has committed to assist us.

The Southern Water Code is published on our [website](#).

We are reviewing our code during 2014–15 and intend to remain at the forefront of maintaining high standards of leadership, transparency and governance.

#### Board membership

During the year we are reporting, Colin Hood was the independent non-executive Chairman. The Board also comprises two executive directors (the Chief Executive Officer and Chief Financial Officer) and six non-executive directors, of whom four are independent. I was one of the four independent non-executive directors and was appointed the independent non-executive Chairman on 1 April 2014, following Colin's decision to leave.

I have followed through with the Board evaluation that Colin initiated and believe that, during the year, we comprised a balanced and rounded board, giving independent support and advice as well as providing new ideas and healthy challenge. We have appointed a new Independent Non-executive Director, Paul Sheffield, consequent on my becoming Chairman, to continue the balance and leadership that is the Board's role. The presence of six non-executive directors in total, four of whom are independent, and the independent non-executive Chairman ensures that we achieve appropriate governance. The members of the Board, their biographies and descriptions of their complementary skills and extensive experience are on pages 59 to 62.

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

### **Chairman**

As Chairman, my role is to lead the Board in its shared responsibilities, to encourage and facilitate the contributions of its members and to ensure adherence to the governance principles and processes of the Board. The Board recognised the lead that Colin Hood took in particular on corporate governance during his chairmanship and I am already building on that.

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

### **Investor representation**

Our investors comprise the Greensands Consortium, the membership of which is explained on our [website](#).

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

### **Senior Independent Non-executive Director**

David Golden is the Senior Independent Non-executive Director. He chairs the Remuneration Committee and the Health and Safety Committee (chaired by Colin Hood in 2013–14), is a member of the Audit and Risk Review Committee and would chair Board meetings in the event that I am unable to do so for any reason. David has been a non-executive director for ten years. The Board recognises that his character and judgement show him to be independent and values his continuing contribution during the current quinquennial price review process. He is available to discuss matters or concerns with investors as required.

### **Independent Non-executive Directors**

The four independent non-executive directors are valued members of the Board. As well as meeting the company's obligation in its licence to have independent non-executive directors, they bring overall independent advice, review and challenge on behalf of all stakeholders, including customers. The independent non-executive directors have been appointed for their individual external expertise and experience in specific areas, such as customer service, the environment, operations, procurement and finance, and for the range of their experience of general corporate management. They meet without the Chairman at least once a year, and appraise the Chairman's performance annually.

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

The standard terms and conditions of the independent non-executive directors are published on our [website](#).

### **Shareholder Representative Non-executive Directors**

There are two non-executive directors each of whom is nominated to the Board by one of our two major investors. They bring the extensive knowledge, skills and resources of their nominating investors and employers, as well as their own personal skills, experience and knowledge of businesses and business sectors

similar to our own. On our Board, they have all the duties, obligations and rights of a director of Southern Water and act in the best interests of the company. They do not receive any remuneration from Southern Water.

### **Chief Executive Officer**

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

### **Chief Financial Officer**

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

### **Executive Management Team**

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

### **Role of the Company Secretary**

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

### **Director induction, training and development**

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

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

Directors received updates through the year on matters such as changes to the regulatory framework, the Water Bill (now the Water Act 2014) and Defra's Open Water programme, and deepened their knowledge through their leadership of and engagement in the regulatory Price Review 2014 (PR14). They also have access to professional development provided by external bodies and our specialist advisers.

### **Board evaluation**

Colin Hood, as the then Chairman, undertook the annual evaluation of the effectiveness of the Board during January 2014. Each member of our Board and of our holding company board received a questionnaire, and subsequently had direct discussions with Colin and CEO Matthew Wright. No areas of major concern or weakness were identified, but there was a desire to deepen some areas of experience. On my appointment as

Chairman, I have taken on the process and, with the members of the Nomination Committee, have identified where and how we want to add to the capabilities of the Board during 2014–15. Our first recruit from this process has been Paul Sheffield, who was appointed from 1 June 2014 as Independent Non-executive Director in my place.

Led by David Golden, Senior Independent Non-executive Director, in June 2013 the Board completed a review and appraisal of the performance of Colin Hood as Chairman, without his participation. No areas of major concern or weakness were identified.

The Board evaluation during 2014–15 will be externally facilitated.

### **Board operation**

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

The following matters are routinely determined by the Board:

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

The Shareholders' Agreement of our parent company, Greensands Holdings, reserves certain matters by exception to the board and shareholders of that company. A list of these matters is published on our [website](#). During the year 2013–14, no such matters have been decided by that board or those shareholders.

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

### **Board meetings**

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

Additionally, ad hoc Board meetings were held to consider, challenge and decide the Business Plan, for PR14, which has been such an important process for the Board during 2013–14 and which continues to engage the Board in 2014–15.

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

Attendance at scheduled Board meetings in 2013–14			
Colin Hood	9/10		
Robert Armstrong	10/10	Cheryl Black	10/10
Michael Carmedy	10/10	David Golden	10/10
Robert Jennings	10/10	Matthew Wright	10/10
Paul Moy	10/10	Surinder Toor (resigned 7 March 2014)	7/9
		Mark Walters (appointed 7 March 2014)	1/1
		Peter Antolik (as alternate)	2/2

Note – Attendance includes personal attendance and attendance by telephone.

### Board committees

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

The standing committees of the Board that met in 2013–14 are:

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

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

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

The company has previously appointed a Regulatory Committee. However, given the significance of the regulatory issues and changes taking place or proposed in the regulatory environment in 2013–14, and in particular the PR14 process, such regulatory matters have been discussed and decided by the full Board. Consequently, the Regulatory Committee did not meet during the year. This position will continue to be reviewed by the Board, which itself receives an economic regulation report at each scheduled monthly meeting and for the other two months, as described above, and which has been closely involved in PR14.

### Remuneration

The directors' remuneration report is set out on pages 72 to 75.

### **Interests**

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

### **Conflicts of interests**

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

### **Annual General Meeting**

Southern Water Services Limited is a private company with single corporate ownership and is not required to hold an Annual General Meeting (AGM). Greensands Holdings Limited, as the ultimate parent company, does hold an AGM, the last being held on 26 November 2013.

### **UK Corporate Governance Code**

As explained above, the Board adopted the Southern Water Code of Board leadership, transparency and governance on 27 November 2013. This underpins our corporate governance and is published on our [website](#).

For that part of the financial year from 1 April to 27 November 2013, the company complied with the spirit and letter of the UK Corporate Governance Code to the extent appropriate for a privately owned company. Schedules of our compliance with that code as at 31 March 2013, 26 June 2013 and 27 November 2013 are published on our [website](#).

### **Conclusions**

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



Robert Jennings  
Chairman

## **Board of Directors**

The day-to-day running of our company is led by Matthew Wright, our Chief Executive Officer, and our Executive Management Team, which reports to our Board of Directors.

### **Robert Jennings – Chairman**

Robert Jennings was appointed Chairman on 1 April 2014, having served as an Independent Non-executive Director since July 2012.

Robert is also Chairman of our parent company, Greensands Holdings, and the Department for Transport's representative on the board of Crossrail.

He joined SG Warburg & Co in 1986 and remained with the organisation until February 2009 where for many years he had been head/joint head of the bank's infrastructure group. During this period, he was also seconded to HM Treasury on two occasions.

Robert graduated from Bristol University in 1976 after reading Economics & Accounting. Articled to Coopers and Lybrand, he became a Chartered Accountant in 1979 and, in 2005, was made a CBE in recognition of his services to the transport sector and finance industry.

### **Matthew Wright – Chief Executive Officer**

Appointed in February 2011, Matthew Wright joined us from United Utilities where he was Managing Director, Asset Management and Delivery.

Prior to that, he was Managing Director, Operations, and his role included management of the operations, maintenance and customer service activities of United Utilities' regulated water and wastewater business as well as oversight of the company's external contracts with Dwr Cymru Welsh Water, Scottish PFI projects and other industrial customers.

Matthew has more than 25 years' experience of utility management in both UK and international markets.

He joined United Utilities in 2007 from ScottishPower's US operation, where he was Executive Vice-President of PacifiCorp's transmission, distribution and customer service division.

He has also held senior management positions in operations, regulation, corporate strategy and commercial utility functions.

**Michael Carmedy** – Chief Financial Officer

Appointed in November 2011, Michael Carmedy joined us from United Utilities where he was previously the Group Controller and Finance Director United Utilities Water Plc.

He joined United Utilities in January 2008 from Thames Water where he worked for 17 years in various financial, commercial and regulatory roles based in both the UK and the US.

Immediately prior to joining United Utilities, he was Thames Water Group Financial Controller, a role he took up following his return from the US where he spent four years with Thames Water Americas, including two years as VP Regulation, American Water.

**David Golden** – Senior Independent Non-executive Director

Appointed in November 2003, David Golden is Chairman of the MPSL Group of Construction/Design companies and EOS Ethical.

Previously, he was Contracts Director of Amec, Contracts Director of British Nuclear Fuels plc and Procurement Director of North West Water, each entity embracing significant civil engineering based capital programmes.

Subsequently he was Chief Executive of Banner Business Supplies and Executive Chairman of Altrix Healthcare plc. He is a former Chairman of the Water Industry Certification Scheme.

**Robert Armstrong** – Independent Non-executive Director

Appointed in May 2008, Robert Armstrong was previously Managing Director of United Utilities Customer Sales and a Director of United Utilities Water plc.

He is a former chairman of Water UK and was awarded the OBE for services to the water industry in 2006.

**Cheryl Black** – Independent Non-executive Director

Appointed in May 2008, Cheryl Black has spent her entire career in customer-focused roles, including Customer Service Director at Telefonica O2 (2006–2011) and Scottish Water (2002–2006).

She currently holds non-executive roles at Skipton Building Society and EDF Nuclear Generation Limited, and is a Director of Telefonica UK Pension Trustee Limited.

Cheryl is a Vice-President of the Institute of Customer Service (ICS) and is a special advisor to the Customer Contact Association (CCA).

She is also a Director of Cheryl Black & Partners Limited, a customer strategy consultancy.

**Paul Sheffield** – Independent Non-executive Director

Paul Sheffield joined the Board on 1 June 2014 following a 31-year career with Kier Group Plc, one of the UK's leading construction and services businesses. Having graduated with a Civil Engineering degree in 1983, Paul spent 15 years working on a series of significant infrastructure projects around the world and then headed up a number of the company's business units in the UK. In 2005, he joined the Kier Group Board, with responsibility for the £1.5 billion per annum construction division, and was appointed CEO at the start of 2010, stepping down in June 2014 having overseen a significant restructuring of the business and significant growth. Paul has a wealth of knowledge about the construction and maintenance of infrastructure assets and led his business to become much more customer-focused.

**Paul Moy** – Non-executive Director

Paul Moy is the global Head and Chief Investment Officer for UBS Infrastructure and Private Equity, a division of UBS Global Asset Management.

He has extensive principal investment, investment banking and advisory experience in the infrastructure sector across a broad range of asset types, including electricity generation, transmission and distribution, gas, water, toll roads, ports, rail, telecommunications and waste management.

Paul also has considerable experience as a non-executive director and is currently a Non-executive Director of Northern Star Generation, CWF Holdings and Njord Gas Infrastructure. Paul holds a BA and PhD in Economics.

**Mark Walters** – Non-executive Director

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

A seasoned investment professional, he is an Executive Director and asset manager with the J.P. Morgan Infrastructure Investments Group, based in London, and is responsible for principal investment activity across Europe.

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

Before joining J.P. Morgan, Mark held investment and advisory positions at Macquarie Bank, Deloitte and Arthur Andersen, where he started his career, and qualified as a Chartered Accountant with the ICAEW.

**Kevin Hall** – Company Secretary and General Counsel

Kevin is a qualified solicitor and has worked for Southern Water since 1975.

Having also undertaken legal environmental and regulatory work, he focused on customers and water supply on the creation of Southern Water Services in 1989 and became Company Secretary of the Southern Water Group in 1997 following its acquisition by ScottishPower.

Since then, he has been involved in many significant corporate and financing activities in addition to his overall legal responsibilities for Southern Water.

In February 2008, he also became Company Secretary of the Greensands companies and his role continues to be in supporting and advising the companies' boards and businesses.

Other Board members who served in 2013–14 were

**Colin Hood** – Chairman (Resigned 1 April 2014)

Colin Hood joined the Board as a Non-executive Director in February 2011 and served as Chairman from February 2012 until his resignation.

**Surinder Toor** – Non-executive Director (Resigned 7 March 2014)

Surinder Toor was a Shareholder Nominated Non-executive Director from 13 January 2010 until his resignation.

## **Executive Management Team**

Reporting to Matthew Wright, the Executive Management Team consists of:

**Michael Carmedy** – Chief Financial Officer

**Kevin Hall** – Company Secretary and General Counsel

**Philip Barker** – Director of Operations

**Darren Bentham** – Chief Customer Officer

**Mel Karam** – Director of Infrastructure

**Chris Maloney** – Director of Human Resources

**Simon Oates** – Director of Strategy and Communications

**Lesley Ottery** – Director of Transformation

**Jennie Reglar** – Director of Procurement

## Audit and Risk Review Committee

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

The members of the ARRC are Robert Jennings (Chairman from 26 June 2013; previously Paul Moy), David Golden, Cheryl Black, Paul Moy and Mark Walters (previously Surinder Toor), whose experience and background are set out on pages 59 to 62.

Robert Jennings was appointed an independent non-executive director member of the ARRC in July 2012 and appointed Chairman of the ARRC in June 2013. He was appointed Chairman of the Board on 1 April 2014 and will consequently resign as Chairman of the ARRC. However, for continuity, Robert has remained Chairman of the ARRC until conclusion of approval of the Annual Report and Accounts for 2013–14. He will be replaced by an independent non-executive director as Chairman of the ARRC as soon as practicable.

The members of the committee receive updates on financial reporting and the regulatory framework in various forms throughout the year. The ARRC Chairman, the Chief Executive Officer, the Chief Financial Officer, the Head of Internal Audit, the Group Financial Controller and the external auditor are invited to all meetings and are usually in attendance. Other members of senior management are also invited to attend when necessary or appropriate. The ARRC has access to the services of the Head of Internal Audit, the Company Secretary and external professional advisers to assist it in performing its duties.

The ARRC met three times in 2013–14 and its work focused on the following key areas:

- Financial statements
- Internal controls
- Corporate governance matters
- Areas of risk
- Oversight of internal and external audit
- The regulatory reporting obligations.

Audit and Risk Review Committee attendance in 2013–14			
Robert Jennings	3/3	Cheryl Black	3/3
David Golden	3/3	Paul Moy Bronte Somes (as alternate)	1/3 2/2
Surinder Toor (resigned 7 March 2014)	1/2		
Mark Walters (appointed 7 March 2014)			
Peter Antolik (as alternate)	1/1		
	1/1		

Note – Attendance includes personal attendance and attendance by telephone.  
The terms of reference of the ARRC are published on our [website](#).

### Financial statements

The ARRC received and reviewed the financial statements and the external audit report from Deloitte regarding the year-end financial statements, considering any items of significant judgement that have been made, before making a recommendation to the Board to approve the annual results. There were no significant issues to be addressed.

### Internal controls

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

The ARRC also receives a regular report of incidents of fraud or bribery, including the actions taken to investigate and respond to the incidents and information on potential incidents of wrong-doing under investigation. There were no material incidents during the year.

Further details of our internal control framework, including the main features of our internal control and risk management systems in relation to the financial reporting process, can be found in the Annual Report on page 50.

#### **Oversight of internal audit and external audit**

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

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

#### **Internal audit**

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

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

#### **External auditor**

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

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

Details of the amounts paid to Deloitte for audit and non-audit services are provided in note 4 to the accounts page 89.

## Health and Safety Committee

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

The members of the H&SC are David Golden (Chairman; previously Colin Hood), Matthew Wright, Robert Armstrong and Robert Jennings.

The H&SC met on two occasions in 2013–14.

Health and Safety Committee attendance in 2013–14			
David Golden	1/2	Matthew Wright	2/2
Colin Hood	2/2	Robert Armstrong	2/2

Note – Attendance includes personal attendance and attendance by telephone.

The terms of reference of the H&SC are published on our [website](#).

## Nomination Committee

The Nomination Committee is responsible for reviewing the structure, size and composition of the Board and evaluating the balance of independence, skills, experience, knowledge and diversity. It prepares descriptions of roles and capabilities required and leads the process for identifying and nominating candidates for the approval of the Board. Following the Board evaluation during January 2014, the Nomination Committee first met on 26 February 2014 to conduct its own review and to identify objectively the skills and experience required. On Colin Hood's decision to resign, the Nomination Committee then met specifically to refresh the description of the role and capabilities required of the Chairman of the Board and to consider candidates, with a view to a recommendation for appointment being made to the Board as soon as possible. The Nomination Committee recommended that Robert Jennings be appointed, and he was duly appointed Chairman on 1 April 2014.

The members of the Nomination Committee are Robert Jennings (Chairman, from 1 April 2014; previously Colin Hood), David Golden, Robert Armstrong, Mark Walters (previously Surinder Toor) and Paul Moy.

Nomination Committee attendance in 2013–14			
Colin Hood	1/1	David Golden	2/2
Robert Armstrong	2/2	Paul Moy	1/2
		Bronte Somes (as alternate)	1/1
Surinder Toor (resigned 7 March 2014)	0/1	Mark Walters (appointed 7 March 2014)	1/1
Peter Antolik (as alternate)	1/1		

Note – Attendance includes personal attendance and attendance by telephone.

The terms of reference of the Nomination Committee are published on our [website](#).

## Directors' Remuneration Report

This report is on the activities of the Remuneration Committee for the period to 31 March 2014. It sets out the remuneration policy and remuneration details for the executive and non-executive directors of the company. It has been prepared in accordance with our Code, the guidance issued by Ofwat in RAG 3.07 and where relevant for a non-listed company taken into account the new requirements of the Companies Act as amended in August 2013.

### Chairman's annual statement

On behalf of the Board, I am pleased to present the Remuneration Report for the year ended 31 March 2014, which sets out the remuneration policy for the directors of Southern Water Services Limited and provides details of their remuneration in respect of the year ended 31 March 2014. The Government has introduced new regulations which impact on the presentation and disclosure of directors' remuneration and, where applicable, the layout of this report reflects those new regulations.

At the start of this year, the Remuneration Committee set targets for the annual bonus. These focused the executive and senior management on improving business effectiveness through improvements in service to customers, operational efficiency and performance whilst ensuring sufficient financial returns to maintain investor confidence and enable the company to finance the business at competitive rates.

As a result of the improving company performance and the Remuneration Committee's assessment of performance against the personal objectives of each individual executive director, the annual bonus payments for 2013–14 were between 63 per cent and 67 per cent of annual bonus potential.

### Remuneration in 2014–15

The Committee believes the remuneration policy currently in place is working well to support the company's strategy in the current economic environment, and to retain and motivate our experienced management team ahead of the next price review period.

During 2014–15 the Committee plans to introduce a new Long Term Incentive Plan to incentivise our executive directors to deliver the ambitious AMP6 Business Plan and to ensure the focus remains on delivering improving customer service and shareholder value.



David Golden  
25 June 2014

## Remuneration Committee

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

### Committee membership

We recognise that the independent non-executive directors of the company have an important role to play in determining and challenging remuneration policy and practice. We have therefore revised the membership of the RemCom in preparation for 2014–15 to ensure that the independent non-executive directors represent a majority on the committee.

The RemCom is chaired by the Senior Independent Non-executive Director, David Golden, and the other members are Robert Armstrong, Robert Jennings (from 26 March 2014), Surinder Toor (to 7 March 2014), Paul Moy and Mark Walters (from 26 March 2014).

Only RemCom members are entitled to attend meetings, but the Director of Human Resources and the Chief Executive Officer, Matthew Wright, attend by invitation. The Director of Human Resources acts as Secretary to the RemCom on behalf of the Company Secretary.

No attendee participates in discussions regarding their own remuneration.

Details of the attendance during 2013–14 are shown in the table below:

Remuneration Committee attendance in 2013–14			
David Golden	3/3	Robert Armstrong	3/3
Robert Jennings (from 26 March 2014)	1/1	Paul Moy	2/3
		Bronte Somes (as alternate)	2/3
Peter Antolik (as alternate to Surinder Toor) (to 7 March 2014)	2/3	Mark Walters (from 7 March 2014)	1/1

Note – Attendance includes personal attendance and attendance by telephone.

### How the Remuneration Committee sets the remuneration policy

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

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

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

- The level of salary increase for the general employee population
- Company-wide benefit provision and any proposed changes
- Overall spend on management bonus arrangements

Investor representatives sit on the RemCom and are closely involved in setting remuneration levels, monitoring the performance of the executive directors, agreeing payments and approving any changes to reward packages. This close involvement ensures that shareholders play a key part in shaping remuneration policy and decisions, and that the link between pay and performance is robustly managed.

To ensure that the company's remuneration practices are market competitive, the RemCom annually calls upon experienced specialist consultants. The RemCom has received material advice from Towers Watson (a leading global professional services company), which has been appointed for the purpose of providing this advice.

### **Directors' pay and standards of performance**

As required by the Water Act 2003 and Regulatory Accounting Guidance from the Water Services Regulation Authority (Ofwat), additional information is given below regarding the remuneration of the directors of Southern Water Services.

Executive directors who served during the 2013–14 year are shown below:

Matthew Wright	Chief Executive Officer
Michael Carmedy	Chief Financial Officer

Details are given below of the remuneration policy for the directors of Southern Water Services and the amounts paid to them in the year ended 31 March 2014.

### **Remuneration Policy**

#### **Elements of remuneration**

The design of the total remuneration package for the executive directors ensures that a substantial proportion of the maximum opportunity is dependent on performance. Based on the maximum value of the 2011 long-term incentive plan award, and achievement of stretch performance against targets and personal objectives for the annual bonus, the total annual remuneration charged to the company (excluding pension benefits) is weighted at around 50 per cent performance-related and 50 per cent non-performance-related for Matthew Wright and 40 per cent performance-related and 60 per cent non-performance-related for Michael Carmedy.

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

Element of remuneration	Purpose and link to strategy	Policy and approach	Opportunity 2014–15	Change of policy from 2013–14
<b>Base salary</b>	<p>Takes into account experience and personal contribution to the company's strategy and performance.</p> <p>Attracts and retains executives of the quality required to deliver the company's strategy.</p>	<ul style="list-style-type: none"> <li>▪ The base salary is a fixed figure and does not vary in relation to business or individual performance.</li> <li>▪ Reviewed annually with changes effective from 1 April if applicable.</li> <li>▪ Consideration given to individual and company performance.</li> <li>▪ General pay increases to all employees taken into consideration.</li> <li>▪ Aim to pay within a mid-market range, but may pay higher salaries to attract and retain executives of the right calibre or for outperformance by the individual or company.</li> <li>▪ Referenced against UK companies of a similar size, utility companies and other water companies.</li> </ul>	Base salary increases are applied in line with the annual review.	No
<b>Annual incentive scheme (Bonus)</b>	Drives and rewards performance against personal objectives and selected customer, operational and financial KPIs which are directly linked to business strategy.	<ul style="list-style-type: none"> <li>▪ The performance measures included within the annual bonus scheme are selected to ensure that the company is focused on its strategic objectives.</li> <li>▪ The balance and nature of the objectives is reviewed annually.</li> <li>▪ The KPIs for 2013–14 are shown on page 73.</li> <li>▪ The threshold, mid-point and stretch targets are established annually by the RemCom, making sure they are sufficiently stretching whilst also recognising the nature and risk profile of the company.</li> <li>▪ Where applicable 60 per cent of the bonus is payable for achieving the mid-point target and 100 per cent for achieving the stretch target.</li> <li>▪ RemCom has discretion to amend or withdraw payments based on the consideration of other factors which could significantly impact business</li> </ul>	Maximum percentage of salary – shown in table on page 74.	No

		performance.		
<b>Long-term incentive plan (LTIP)</b>	Aligns interests of executives and shareholders	<ul style="list-style-type: none"> <li>▪ The current scheme covers a four-year performance period starting 1 April 2011.</li> <li>▪ Any award made will be paid in 2015–16, following assessment of performance against the targets shown on page 74.</li> <li>▪ Subject to continuing employment over the four-year period.</li> <li>▪ If the participant resigns during the period then participation in the scheme will lapse.</li> <li>▪ The RemCom has the discretion to make awards for 'good' leavers as appropriate subject to performance.</li> </ul>	<p>The annualised on-target award for each director is:</p> <p>Matthew Wright £250k</p> <p>Michael Carmedy £62.5k</p>	Yes – change in date of award to financial year 2015–16
<b>Pension</b>	Defined contribution scheme minimises the risk to the company associated with defined benefit pension plans	<ul style="list-style-type: none"> <li>▪ A company contribution into a defined contribution scheme; or</li> <li>▪ A cash allowance in lieu of pension.</li> </ul>	<p>Contribution of:</p> <p>Matthew Wright 18%</p> <p>Michael Carmedy 15%</p>	No
<b>Other benefits</b>	Provides market competitive benefits	<ul style="list-style-type: none"> <li>▪ Car allowance</li> <li>▪ Health cover</li> <li>▪ Disturbance or relocation allowances</li> </ul>	Based on individual circumstances	No

A basic pay increase of two per cent for Matthew Wright and three per cent for Michael Carmedy for 2014–15 was approved in May 2014 and will be applicable to the basic salaries of the executive directors with effect from 1 April 2014.

The terms of the contracts for the executive directors require a notice period of 12 months by the company and 12 months by the director. If the notice period is worked, no termination payment is payable, otherwise a payment of a maximum of 12 months' basic salary, plus pension and car allowance is payable.

## Annual remuneration report

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

Directors' remuneration for 2013–14						
£'000	Base salary	Benefits	Bonus	Total	DC pension contribution	Total including pension
Matthew Wright	348.5	42.8	233.3	<b>624.6</b>	32.6	<b>657.2</b>
Michael Carmedy	242.2	12.1	122.2	<b>376.5</b>	36.3	<b>412.8</b>

Directors' remuneration for 2012–13						
£'000	Base salary	Benefits	Bonus	Total	DC pension contribution	Total including pension
Matthew Wright	348.5	42.7	241.2	<b>632.4</b>	32.6	<b>665.0</b>
Michael Carmedy	230.6	23.6	92.9	<b>347.1</b>	34.6	<b>381.7</b>

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

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

£'000	2013–14			2012–13		
	Fees	Other	Total	Fees	Other	Total
Colin Hood (Chairman)	225.0	116.6	<b>341.6</b>	225.0	-	<b>225.0</b>
David Golden	60.0	17.9	<b>77.9</b>	60.0	14.4	<b>74.4</b>
Robert Armstrong	40.0	3.8	<b>43.8</b>	40.0	-	<b>40.0</b>
Cheryl Black	40.0	4.3	<b>44.3</b>	40.0	-	<b>40.0</b>
Robert Jennings	40.0	0.5	<b>40.5</b>	30.0	-	<b>30.0</b>
Paul Moy	-	-	-	-	-	-
Surinder Toor	-	-	-	-	-	-
Mark Walters	-	-	-	-	-	-

The other amounts payable to the non-executive directors in 2013–14 include taxable expenses incurred in the attendance at Board meetings, together with an additional payment to Colin Hood as compensation for loss of office, and payments to David Golden for consultancy services provided separately to his duties as the Senior Independent Non-executive Director.

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

### Annual performance related incentive scheme

The Southern Water Incentive Scheme focuses on the achievement of specific strategic goals which are designed to drive exceptional customer service, financial and operational performance. The structure of the scheme and specific target criteria, both corporate and individual, are set and reviewed on an annual basis by the RemCom. The corporate objectives and individual targets for 2013–14 were set and approved in May 2013.

Under the scheme, the executive directors each have a maximum bonus opportunity of which 60 per cent is linked to the achievement of the overarching corporate objectives with the remaining 40 per cent linked to individual performance targets. Performance against these corporate targets is reviewed annually in May by the RemCom and any bonus awarded in June.

Details of the targets agreed by RemCom for 2013–14 together with the maximum bonus opportunity available to each executive director are shown in the table below. The performance for 2013–14 was assessed in May by RemCom and the achievement against each target together with the overall payments made in relation to 2013–14 are also shown in the table below.

Performance measure		Weight for 2013–14 (as % of bonus)	2013–14 achievement (% of bonus)	
			Matthew Wright	Michael Carmedy
Service standards	<p>Deliver a targeted improvement in the Service Incentive Mechanism score for 2013.</p> <p>Purpose – to deliver significant improvements in customer service performance.</p> <p>Measure – Ofwat SIM score.</p>	12%	7.2%	7.2%
Performance assessment (serviceability)	<p>Achieving a stable assessment in all four categories (water above ground, water below ground, wastewater above ground, wastewater below ground) for 2013–14; no score for lesser assessment in any category.</p> <p>Purpose – to ensure that we provide a reliable and consistent service to our customers.</p> <p>Measure – Ofwat measure.</p>	12%	12%	12%
Business Plan	<p>Produce a high quality business plan for the period 2015–20, which is supported by all key stakeholders.</p> <p>Purpose – to ensure that our future plans deliver improved services for customers.</p> <p>Measure – Ofwat risk-based review.</p>	12%	7.2%	7.2%
Cash revenue	<p>Collect a targeted level of cash receipts from unmeasured and measured customers.</p> <p>Purpose – to ensure good financial performance and provide our customers with an affordable service and our ultimate shareholders with a return on their investment.</p> <p>Measure – financial information from the accounts.</p>	12%	nil	nil

Operating costs	Operate the business within a targeted level of total operational expenditure. Purpose – to ensure good financial performance and provide our customers with an affordable service and our ultimate shareholders with a return on their investment. Measure – financial information from the accounts.	12%	7.2%	7.2%
Personal performance	Individual performance targets	40%	33.3%	29.5%
	Total percentage of maximum bonus	100%	66.9%	63.1%
	Maximum bonus opportunity (% of base salary)		100%	80%
	Bonus percentage awarded (% of base salary)		66.9%	50.5%
	Base salary (£'000)		348.5	242.2
	Bonus paid (£'000)		233.3	122.2

### Long-term incentive plan

A Long-Term Incentive Plan (LTIP) for the period 1 April 2011 to 31 March 2015 was agreed by the RemCom in 2011–12. Performance payments under the LTIP will be based on the performance measures shown below:

Performance measure		Weight (% of LTIP)
Customer objectives:		
Performance assessment (serviceability)	The performance in all four categories (water above ground, water below ground, wastewater above ground, wastewater below ground) will be assessed over the four-year period in comparison to the other water and sewerage companies.	40%
Customer service standards (SIM)	The performance under the Ofwat SIM mechanism rated in comparison to the other water and sewerage companies.	15%
Operational objectives:		
Asset Management Assessment (AMA)	Our ability to effectively and efficiently manage the investment in, and maintenance of, our assets to ensure stable service levels. As this assessment is no longer made by Ofwat, an independent assessment will be made based on Ofwat's methodology.	30%
Operating efficiency	Our operating cost performance for water and wastewater services in comparison to the other water and sewerage companies. As this measure is no longer published by Ofwat, an independent assessment will be made using company accounts and returns for the period.	15%

To date, no payments have been made in relation to this scheme. An accrual has been made in the accounts for 2013–14, in anticipation of the final award under the LTIP, and the value of the total accrual accumulated for the first three years of the scheme is shown below:

Matthew Wright – accrual at March 2014 £450k

Michael Carmedy – accrual at March 2014 £100k

Actual performance against the scheme will be assessed in 2015–16 and the value of any awards made may differ from the accruals made. The Board intends to implement a new LTIP during 2014–15 to cover the period through to 31 March 2017. The content of this scheme has not yet been formally agreed; however, the intention is that the scheme would provide an equal balance between enhanced customer service and total shareholder return.

## Directors' report for the year ended 31 March 2014

The directors of Southern Water Services Limited (registered no. 02366670) present their report and the audited financial statements for the year ended 31 March 2014.

### Principal activities

The principal activities of the company, also referred to as SWS, are the provision of water supply and wastewater services in the South East of England. The company is regulated by the Water Services Regulation Authority (Ofwat) and supplies water to nearly 2.4 million people and provides wastewater services to nearly 4.5 million people.

### Strategic report

The information that fulfils the requirement of the Strategic Report can be found in our Annual Report on pages 12 to 52.

### Future developments

The information regarding future developments of the company can be found in our Annual Report on pages 12 to 52.

### Results and dividends

The profit and loss account on page 80 shows the company's results and profit for the year. Further details are also available in the Annual Report on pages 40 to 43.

The exceptional item in the year ended 31 March 2014 of £18.8 million relates to costs incurred in dealing with the high groundwater levels and storms experienced in the winter of 2013–14. The costs include tankering and pumping costs to remove the water and the cost of repairs to equipment as a result of the damage caused.

Interim dividends of £781.90 per ordinary share (2012–13: £771.76 per share), totalling £43.8 million (2012–13: £43.2 million) were paid during the year to Southern Water Services Group (SWSG). These dividends, along with associated group tax relief of £13.1 million, enable SWSG to pay the interest of £56.9 million due to Southern Water Services on an inter-company loan as disclosed in note 7 to the accounts.

The directors do not recommend payment of a final dividend for 2013–14 (2012–13: £nil). No dividends were paid to our ultimate investors for the third year in a row.

### Directors and their interests

The directors who held office during the year ended 31 March 2014 and up to the date of signing the financial statements were as follows and further details can be found on pages 59 to 62:

Colin Hood	(Chairman) (Resigned 1 April 2014)
Robert Jennings	(Independent Non-executive Director) (Appointed as Chairman 1 April 2014)
Matthew Wright	(Executive Director – Chief Executive Officer)
Michael Carmedy	(Executive Director – Chief Financial Officer)
David Golden	(Senior Independent Non-executive Director)
Robert Armstrong	(Independent Non-executive Director)
Cheryl Black	(Independent Non-executive Director)
Paul Sheffield	(Independent Non-executive Director) (Appointed 1 June 2014)
Paul Moy	(Non-executive Director)
Surinder Toor	(Non-executive Director) (Resigned 7 March 2014)
Mark Walters	(Non-executive Director) (Appointed 7 March 2014)
Bronte Somes	(Alternate Non-executive Director)
Peter Antolik	(Alternate Non-executive Director)

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

## Research and development

The improvement of existing services and processes, together with the identification and development of new technology and solutions, are important aspects of the company's strategy to enhance the quality of service to customers and improve methods of working. Research and development expenditure for the year amounted to £0.5 million (2012–13: £0.5 million).

## Financial risk management

The Financial Risk Management Policy is included in the Strategic Report on pages 12 to 52.

## Employees

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

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

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

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

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

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

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

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

## Environmental issues

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

The company's environmental performance is reported on pages 30 to 34. The company recognises its responsibility to operate within a framework that supports sustainable development and has established, where possible, indicator targets which are measurable. Performance against these targets is monitored and reported regularly.

### **Political donations**

No political donations were made.

### **Land and buildings**

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

### **Going concern**

The directors believe, after due and careful enquiry, that the company has sufficient resources for its present requirements and, therefore, consider it appropriate to adopt the going concern basis in preparing the financial statements to 31 March 2014. Further information is set out in note 1 'Going concern' on page 84.

### **Qualifying third party indemnity**

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

### **Directors' responsibilities statement**

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards 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 company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

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

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

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

### Responsibility statement

We confirm that to the best of our knowledge:

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

### Statement of disclosure of information to auditor

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

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

This confirmation is given and should be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

### Auditor

Deloitte LLP has indicated its willingness to continue in office.

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



Kevin Hall  
Company Secretary  
25 June 2014

## Financial statements

### Profit and loss account

For the year ended 31 March 2014

	Note	2014 £m	2013 £m
<b>Turnover</b>	2,3	<b>806.2</b>	778.7
Cost of sales	3		
- before exceptional item		(452.0)	(425.3)
- exceptional item	4	<u>(18.8)</u>	<u>-</u>
Cost of sales including exceptional item		<b>(470.8)</b>	(425.3)
Gross profit		<u>335.4</u>	<u>353.4</u>
Administrative expenses	3	<b>(29.4)</b>	(27.5)
Other operating income	3	<b>0.2</b>	5.1
<b>Operating profit</b>		<b>306.2</b>	331.0
Profit on disposal of fixed assets		<b>0.5</b>	1.0
<b>Profit on ordinary activities before interest and taxation</b>		<b>306.7</b>	332.0
Interest receivable and similar income	7	<b>61.8</b>	58.9
Interest payable and similar charges	7	<b>(229.0)</b>	(211.8)
<b>Profit on ordinary activities before taxation</b>	4	<b>139.5</b>	179.1
Tax on profit on ordinary activities	8	<b>30.3</b>	(22.2)
<b>Profit for the financial year</b>	20	<b>169.8</b>	<u>156.9</u>

The above results relate to continuing operations.

The notes on pages 84 to 109 form part of these financial statements.

There is no difference between the profit on ordinary activities before taxation for the years as stated above and their historical cost equivalents.

**Statement of total recognised gains and losses**  
 For the year ended 31 March 2014

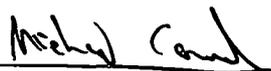
	Note	2014 £m	2013 £m
<b>Profit for the financial year</b>		<b>169.8</b>	156.9
Actuarial profit/(loss) recognised in the pension scheme	20,22	3.1	(7.3)
Movement on deferred tax relating to pension deficit	17	<u>(2.2)</u>	<u>1.2</u>
<b>Total recognised gains/(losses) for the year</b>		<b><u>170.7</u></b>	<b><u>150.8</u></b>

**Balance sheet**

As at 31 March 2014

	Note	2014 £m	2013 £m
<b>Fixed assets</b>			
Tangible assets	10	4,432.0	4,264.3
Investments	11	29.2	29.2
		<u>4,461.2</u>	<u>4,293.5</u>
<b>Current assets</b>			
Stocks	12	2.0	1.5
Debtors: amounts falling due within one year	13	198.0	416.6
Debtors: amounts falling due after more than one year	14	812.3	812.3
Cash at bank and in hand		135.5	139.9
		<u>1,147.8</u>	<u>1,370.3</u>
<b>Creditors: amounts falling due within one year</b>	15	<u>(300.6)</u>	<u>(505.9)</u>
<b>Net current assets</b>		<u>847.2</u>	<u>864.4</u>
<b>Total assets less current liabilities</b>		<u>5,308.4</u>	<u>5,157.9</u>
<b>Creditors: amounts falling due after more than one year</b>	16	<u>(3,836.4)</u>	<u>(3,767.5)</u>
<b>Provision for liabilities</b>			
Environmental obligations	17	(0.5)	(0.8)
Deferred taxation	17	(314.2)	(356.8)
<b>Grants and contributions</b>	18	(43.8)	(46.4)
<b>Net assets excluding pension deficit</b>		<u>1,113.5</u>	<u>986.4</u>
<b>Pension deficit</b>	22	(72.3)	(72.1)
<b>Net assets</b>		<u>1,041.2</u>	<u>914.3</u>
<b>Capital and reserves</b>			
Called up share capital	19	0.1	0.1
Share premium	20	46.3	46.3
Profit and loss account	20	994.8	867.9
<b>Total shareholder's funds</b>	20	<u>1,041.2</u>	<u>914.3</u>

The financial statements of Southern Water Services Limited (Registered no. 02366670) on pages 80 to 109 were approved by the Board and authorised for issue on 25 June 2014. They were signed on its behalf by:



Michael Carmedy  
Chief Financial Officer

**Cash flow statement**

For the year ended 31 March 2014

	Note	2014 £m	2013 £m
<b>Net cash inflow from operating activities</b>	21	<b>543.3</b>	499.8
<b>Returns on investments and servicing of finance</b>			
Interest received		62.2	58.5
Interest paid		(141.1)	(129.7)
Preference share dividends		(11.5)	(10.6)
<b>Net cash outflow from returns on investments and servicing of finance</b>		<b>(90.4)</b>	(81.8)
<b>Taxation</b>		<b>(22.9)</b>	(13.7)
<b>Capital expenditure and financial investment</b>			
Purchase of tangible fixed assets		(382.0)	(360.1)
Receipt of grants and contributions		9.9	10.1
Sale of tangible assets		0.3	0.6
Movement on loan to subsidiary		(15.9)	(227.1)
<b>Net cash outflow for capital expenditure and financial investment</b>		<b>(387.7)</b>	(576.5)
<b>Equity dividends paid</b>		<b>(43.8)</b>	(43.2)
<b>Net cash outflow before financing</b>		<b>(1.5)</b>	(215.4)
<b>Financing</b>			
Increase in borrowings		-	300.0
Repayment of loans		(2.8)	(15.4)
Issue costs of new loans		(0.1)	(4.7)
<b>Net cash (outflow)/inflow from financing</b>		<b>(2.9)</b>	279.9
<b>(Decrease)/increase in cash</b>		<b>(4.4)</b>	64.5
<b>Reconciliation to net debt</b>			
Net debt at beginning of year		(3,651.5)	(3,612.8)
(Decrease)/increase in cash		(4.4)	64.5
Short-term loan to subsidiary		(247.5)	247.5
Movements in borrowings		252.8	(284.6)
Debt issue costs		0.2	4.7
Other non-cash changes		(72.5)	(70.8)
<b>Net debt at end of year</b>		<b>(3,722.9)</b>	(3,651.5)

## Notes to the financial statements

For the year ended 31 March 2014

### 1 Accounting policies

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

#### Basis of accounting

The financial statements have been prepared on the going concern basis, under the historical cost convention, and in accordance with applicable UK accounting standards and, subject to the treatment of infrastructure grants and contributions described below, with the requirements of the Companies Act 2006.

#### Basis of preparation

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

#### Going concern

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

#### Tangible fixed assets and depreciation

Tangible fixed assets are stated at historic purchase cost less accumulated depreciation and any provision for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use; these include materials, labour and applicable overheads. Interest costs are not capitalised.

(i) Infrastructure assets (being mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines and sea outfalls) comprise a network of assets covering the company's geographic area.

Expenditure on infrastructure assets relating to increases in capacity or enhancement of the network and on maintaining the operating capability of the network in accordance with defined standards of service, is treated as an addition to fixed assets and is stated at cost after deducting grants and contributions. Staff costs that directly relate to the construction of a specific infrastructure asset are capitalised on the basis of the amount of time spent by individuals on projects.

The depreciation charge for infrastructure assets is the estimated level of annualised expenditure required to maintain the operating capability of the network and is based on the asset management plan determined by Ofwat as part of the price regulation process. The asset management plan is developed from historical experience combined with a rolling programme of reviews of the condition of the infrastructure assets.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**1 Accounting policies (continued)****Tangible fixed assets and depreciation (continued)**

(ii) Other tangible fixed assets (including above ground assets, plant and equipment) are stated at cost less accumulated depreciation and any provision for impairment. These assets are depreciated down to their residual values on a straight-line basis over their estimated operating lives which are principally as follows:

	<u>Years</u>
Buildings	10-60
Operational structures	15-80
Fixed plant	10-40
Vehicles, computers and mobile plant	3-10

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

(iii) Freehold land is not depreciated.

(iv) Assets in the course of construction are not depreciated until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor following completion of performance and take-over tests.

(v) Private sewers were adopted in October 2011 and have been valued at nil value, as permitted by UKGAAP and by reference to the net present value of the incremental cash flows as a result of the adoption. These assets form part of our infrastructure assets and expenditure associated with them has been treated as described above.

**Grants and contributions**

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate.

Capital grants and customer contributions in respect of additions to non-infrastructure tangible fixed assets are treated as deferred income and released to the profit and loss account over the estimated operational lives of the related assets in accordance with the provisions of the Companies Act.

Grants and capital contributions received relating to infrastructure assets have been deducted from the cost of tangible fixed assets as permitted by Statement of Standard Accounting Practice (SSAP) 4. This is not in accordance with Schedule 1 of the Companies Act 2006 which requires tangible fixed assets to be stated at their purchase price or production cost. The Act does not permit the deduction of contributions.

This departure from the requirements of the Act is, in the opinion of the directors, necessary for the financial statements to give a true and fair view because infrastructure assets do not have determinable finite lives. Accordingly related capital contributions would not be recognised in the profit and loss account. The effect of this treatment on tangible fixed assets is disclosed in note 10.

**Leased assets**

Where the company enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a "finance lease". The asset is recorded in the balance sheet as a tangible fixed asset and is depreciated over its estimated useful life or the term of the lease, whichever is shorter. Future instalments under such leases, net of finance charges, are included within creditors. Rentals payable are apportioned between the finance element, which is charged to the profit

## **Notes to the financial statements (continued)**

For the year ended 31 March 2014

### **1 Accounting policies (continued)**

#### **Leased assets (continued)**

and loss account, and the capital element which reduces the outstanding obligation for future instalments.

Rentals payable under operating leases are charged to the profit and loss account as incurred.

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

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

#### **Fixed asset investments**

Investments held as fixed assets are stated at cost, less provision, if appropriate, for any impairment in value other than a temporary impairment in value. The carrying values of fixed asset investments are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable.

#### **Stocks**

Stock is held for use in the production of water supply and treatment of wastewater. Stock is held at replacement cost.

#### **Deferred revenue**

Deferred revenue includes monies received from customers where the related turnover has not yet been recognised.

Amounts are deferred to the balance sheet and released to the profit and loss account in line with the period of the service provided.

#### **Provisions**

An environmental provision is made in accordance with Financial Reporting Standard (FRS) 12 for the costs relating to the decommissioning of abandoned sites. No reimbursement is expected.

#### **Taxation**

The taxation charge in the profit and loss account is based on the profit for the year as adjusted for disallowable and non-taxable items using current rates and takes into account tax deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred taxation is provided on all timing differences that have originated but not reversed by the balance sheet date, calculated at the rate at which it is expected the tax will arise in accordance with FRS19 'Deferred Tax'. Deferred taxation balances are not discounted. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

## Notes to the financial statements (continued)

For the year ended 31 March 2014

### 1 Accounting policies (continued)

#### Turnover

Turnover represents the income receivable (excluding value added tax) in the ordinary course of business for goods and services provided and, in respect of unbilled charges, includes accrued income.

Turnover relates to services provided in the year and excludes payments received in advance which are recorded as deferred revenue.

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

Turnover includes an estimate of the consumption between the date of the last meter reading and the period-end. The unbilled income accrual is based on estimated usage from the last meter reading date through to the end of the reporting period. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff.

#### Bad debts

The bad debt provision is calculated by applying estimated recovery rates to various categories of debt and reflecting past collections experience and expectations of future recovery of outstanding receivables at the year-end.

#### Pensions

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

In accordance with FRS 17 the pension deficit has been recognised on the balance sheet and operating and financing costs of pension and post-retirement schemes are recognised separately in the profit and loss account.

Pension scheme assets are measured using market values. Pension scheme liabilities are measured using the projected unit actuarial method and are discounted at the current rate of return on a high quality corporate bond of equivalent terms and currency to the liability. The increase in the present value of the liabilities of the company's defined benefit pension schemes expected to arise from employee service in the period is charged to operating profit. The expected return on the scheme's assets and the increase during the year in the present value of the scheme's liabilities arising from the passage of time are included in other finance income. Actuarial gains and losses are recognised in the statement of total recognised gains and losses.

Service costs are systematically spread over the service lives of the employees and financing costs are recognised in the period in which they arise. The costs of past service benefit enhancements, settlements and curtailments are also recognised in the period in which they arise.

The differences between actual and expected returns on assets and liabilities during the year, including changes in actuarial assumptions, are recognised in the statement of total recognised gains and losses.

The company also operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the company in an independently administered fund. Company contributions to the scheme are charged to the profit and loss account in the period to which they relate.

## Notes to the financial statements (continued)

For the year ended 31 March 2014

### 1 Accounting policies (continued)

#### Research and development

Expenditure on research and development is charged to the profit and loss account as it is incurred. Expenditure on fixed assets relating to development projects is written off over the expected useful lives of those assets.

#### Preference shares

Preference shares are classified as debt in accordance with FRS 25 'Financial instruments: disclosure and presentation'. The preference shares are redeemable on a specific date or at the company's option any time earlier. Dividends on preference shares classified as debt are recognised in the profit and loss account through interest payable. The value of the debt has been based on the original nominal value and share premium on issue of the shares.

#### Capital instruments

Interest-bearing borrowings are recorded at the proceeds received, net of direct issue costs. Finance charges are accounted for on an accruals basis in the profit and loss account and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

The issue costs of capital instruments are amortised over the life of the financial instrument to which they relate.

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

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

### 2 Segmental analysis

The directors believe that the whole of SWS's activities constitute a single class of business. The company's turnover is generated wholly from within the United Kingdom.

### 3 Classification of turnover and revenue costs

Turnover represents the income receivable for providing water supply and wastewater services and is generated wholly in the United Kingdom.

Cost of sales reflects the direct costs of providing water supply and wastewater services. Administrative expenses comprise the indirect costs of the business. Other operating income includes rents receivable and a management charge relating to the sale of an investment in a group company.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**4 Profit on ordinary activities before taxation**

Profit on ordinary activities before taxation is stated after charging/(crediting):	<b>2014</b> <b>£m</b>	2013 Restated* £m
Employee costs	<b>37.9</b>	35.9
Pension curtailment gain	-	(9.0)
Employee costs (note 5a)	<u>37.9</u>	<u>26.9</u>
Depreciation on		
- owned assets	<b>236.4</b>	215.4
- assets held under finance leases	<b>1.4</b>	0.8
	<u>237.8</u>	<u>216.2</u>
Rentals under operating leases:		
Vehicles	<b>2.2</b>	3.5
Research and development expenditure	<b>0.5</b>	0.5
Amortisation of grants and contributions (note 18)	<b>(2.9)</b>	(2.8)
Exceptional item (see note (a) below)	<b>18.8</b>	-
Fees payable to the company's auditor in respect of:		
- Statutory audit of the company's financial statements	<b>0.2</b>	0.2
- Other services pursuant to legislation	<b>0.1</b>	0.1
- All other services	<b>2.0</b>	0.1

- (a) The exceptional item of £18.8 million relates to costs incurred in dealing with the high groundwater levels and storms experienced in the winter of 2013–14. It includes tankering and pumping costs to remove the water as well as repairs to equipment as a result of the damage caused.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**5 Employee information**

	2014	2013
	£m	Restated* £m
<b>(a) Employee costs (including directors' emoluments):</b>		
Wages and salaries	65.9	60.7
Social security costs	6.1	5.6
Pension costs - Defined contribution	1.4	1.0
- Defined benefit	5.0	6.5
- Curtailment gain**	-	(9.0)
Total employee costs	<u>78.4</u>	<u>64.8</u>
Less: charged as capital expenditure	<u>(40.5)</u>	<u>(37.9)</u>
Charged to the profit and loss account	<u>37.9</u>	<u>26.9</u>

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

\* The prior year has been restated to include other pay allowances which were previously omitted. This is a note disclosure adjustment only and has no impact on the overall financial statements.

\*\*During 2012–13 a curtailment gain arose from changes made to the benefits accruing to employee members of the Southern Water Pension scheme; these changes are detailed in note 22.

**(b) Average number of persons employed by activity**

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

	2014	2013
	Number	Number
Operations	1,079	1,055
Customer services	480	461
Corporate centre	467	422
	<u>2,026</u>	<u>1,938</u>

**6 Directors' emoluments**

	2014	2013
	£000	£000
Aggregate emoluments (including benefits in kind)	1,549	1,389
Company pension contributions to money purchase pension schemes	<u>69</u>	<u>67</u>

No retirement benefits accrued to directors (2012–13: none) under a Southern Water defined benefit scheme. Retirement benefits accrued to two directors (2012–13: two) under a Southern Water defined contribution scheme.

Details of emoluments and benefits for the highest paid director:

	2014	2013
	£000	£000
Highest paid director's aggregate emoluments and benefits	<u>625</u>	<u>632</u>

During the year the company made contributions of £32,575 (2012–13: £32,575) to a money purchase pension scheme in respect of the highest paid director's qualifying services.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**7 Interest**

	2014 £m	2013 £m
<b>Interest payable and similar charges</b>		
Interest payable on other loans	8.9	7.2
Interest paid to group companies	134.1	123.1
Indexation	72.1	76.9
Amortisation of issue costs	10.2	2.7
Amortisation of gilt lock proceeds	(0.1)	(0.1)
Amortisation of deferred credits	(9.8)	(9.8)
Amortisation of bond premium	(0.6)	(0.6)
Amortisation of discount	0.3	0.3
Other finance expense (note 22)	2.4	1.5
Dividends on preference shares – (see note (a) and (b) below)	11.5	10.6
<b>Total interest payable and similar charges</b>	<u>229.0</u>	<u>211.8</u>
<b>Interest receivable and similar income</b>		
Interest receivable from Southern Water Services Group Limited	56.9	56.9
Deposit interest receivable	4.9	2.0
<b>Total interest receivable</b>	<u>61.8</u>	<u>58.9</u>

- (a) Class A1 preference share dividends amounted to £40 per share and Class B £70 per share totalling £9.0 million (2012–13: £9.0 million).
- (b) A dividend due to the Class A2 preference shareholders of £77.23 (2012–13: £49.68) per share totalling £2.5 million (2012–13: £1.6 million) was declared and settled in the year at base value plus an amount for out-performance and savings in the year ended 31 March 2013 (see note 16(v)).
- (c) The interest receivable from Southern Water Services Group Limited relates to the long-term debtor disclosed in note 14.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**8 Tax on profit on ordinary activities**

	2014 £m	2013 £m
<b>Current tax:</b>		
UK corporation tax on profits for the year	9.3	9.3
Adjustment in respect of prior years	1.7	(0.7)
<b>Total current tax</b>	<u>11.0</u>	<u>8.6</u>
<b>Deferred tax:</b>		
Origination and reversal of timing differences	16.2	24.3
Adjustment in respect of prior years	(11.7)	(1.5)
Pension cost relief in excess of pension charge	0.1	5.9
Effect of corporation tax rate change	(47.1)	(15.5)
Impact of rate change on pension charge	1.2	0.4
<b>Total deferred tax</b>	<u>(41.3)</u>	<u>13.6</u>
<b>Total tax on profit on ordinary activities</b>	<u>(30.3)</u>	<u>22.2</u>

The tax assessed for the year is different to the standard rate of corporation tax in the UK (23 per cent) due to the following factors:

	2014 £m	2013 £m
<b>Profit on ordinary activities before tax</b>	<u>139.5</u>	<u>179.1</u>
<b>Current tax:</b>		
UK corporation tax on profits for the year at 23 per cent (2012–13: 24 per cent)	32.1	43.0
Adjustment in respect of prior years	1.7	(0.7)
Pension cost relief in excess of pension charge	(0.1)	(5.9)
Group relief received	(12.1)	(13.1)
Permanent differences	5.7	9.6
<b>Tax charge on ordinary activities</b>	<u>27.3</u>	<u>32.9</u>
Timing differences	(16.3)	(24.3)
<b>Current tax charge for year</b>	<u>11.0</u>	<u>8.6</u>

Factors that may affect future tax charges:

On 20 March 2013 the UK Government announced a reduction in the main rate of corporation tax from 23 per cent to 21 per cent effective from 1 April 2014 and to 20 per cent effective from 1 April 2015. These rate changes were enacted in Finance Bill 2013 during the period, and deferred tax balances have been calculated using these reduced rates. A £47.1 million credit is recognised in the profit and loss account in the year to reflect the reduction in the deferred tax liability as a result of the rate change. In addition, charges of £1.2 million in the profit and loss account and £1.5 million in the statement of total recognised gains and losses are recognised to reflect the reduction in the deferred tax asset relating to the pension deficit.

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

Deferred tax liabilities have not been discounted.

The company pays group relief in full to Southern Water Services Group Limited and at a reduced rate of ten pence in the pound for certain losses in other group companies.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**9 Dividends per share**

	2014 £ per ordinary share	2013 £ per ordinary share	2014 £m	2013 £m
<b>Ordinary shares</b>				
Interim dividend – Q1	195.48	192.94	11.0	10.8
Interim dividend – Q2	195.48	192.94	11.0	10.8
Interim dividend – Q3	195.47	192.94	10.9	10.8
Interim dividend – Q4	195.47	192.94	10.9	10.8
Total interim dividend	<u>781.90</u>	<u>771.76</u>	<u>43.8</u>	<u>43.2</u>
Final dividend	-	-	-	-
<b>Total ordinary dividend</b>	<u><u>781.90</u></u>	<u><u>771.76</u></u>	<u><u>43.8</u></u>	<u><u>43.2</u></u>

The directors do not recommend payment of a final dividend for 2013–14 (2012–13: £nil).

The interim dividends totalling £43.8 million are paid to Southern Water Services Group Limited (SWSG). These dividends, along with associated group tax relief, enable SWSG to pay the interest of £56.9 million due to Southern Water Services Limited on an inter-company loan as disclosed in note 7.

**10 Tangible fixed assets and capital commitments**

(a) Tangible assets	Freehold land & buildings £m	Plant & machinery £m	Infra- structure assets £m	Assets in the course of construction £m	Other £m	Total £m
<b>Cost:</b>						
At 1 April 2013	1,343.1	1,973.7	2,002.3	605.3	634.9	6,559.3
Additions	0.4	57.3	67.0	249.8	41.0	415.5
Transfers	54.3	231.0	154.4	(459.6)	19.9	-
Grants and contributions	-	-	(9.7)	-	-	(9.7)
Disposals	(0.2)	(1.4)	(0.6)	-	(25.3)	(27.5)
<b>At 31 March 2014</b>	<u>1,397.6</u>	<u>2,260.6</u>	<u>2,213.4</u>	<u>395.5</u>	<u>670.5</u>	<u>6,937.6</u>
<b>Accumulated depreciation:</b>						
At 1 April 2013	489.6	723.5	693.6	-	388.3	2,295.0
Charge for the year	37.3	80.2	74.5	-	45.8	237.8
Disposals	-	(1.4)	(0.6)	-	(25.2)	(27.2)
<b>At 31 March 2014</b>	<u>526.9</u>	<u>802.3</u>	<u>767.5</u>	<u>-</u>	<u>408.9</u>	<u>2,505.6</u>
<b>Net book amount:</b>						
<b>At 31 March 2014</b>	<u><u>870.7</u></u>	<u><u>1,458.3</u></u>	<u><u>1,445.9</u></u>	<u><u>395.5</u></u>	<u><u>261.6</u></u>	<u><u>4,432.0</u></u>
At 31 March 2013	<u>853.5</u>	<u>1,250.2</u>	<u>1,308.7</u>	<u>605.3</u>	<u>246.6</u>	<u>4,264.3</u>

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**10 Tangible fixed assets and capital commitments (continued)**

Of the additions and transfers into infrastructure assets, the amount spent on infrastructure renewals net of contributions during the year ended 31 March 2014 and 31 March 2013 was £76.8 million and £78.2 million, respectively. The associated contributions were £2.6 million for the year ended 31 March 2014 and £2.6 million for the year ended 31 March 2013.

For the years ended 31 March 2014 and 31 March 2013, the net book value of infrastructure assets is stated after deducting grants and contributions since privatisation of £214.1 million and £204.4 million, respectively.

Freehold land is stated at a cost of £46.0 million and £46.0 million at 31 March 2014 and 31 March 2013, respectively, and is not depreciated.

Other assets relate primarily to computer equipment, meter reading devices and motor vehicles.

Assets held under finance leases have been capitalised and included in plant and machinery:

	2014 £m	2013 £m
Cost	18.6	16.3
Aggregate depreciation	(12.7)	(11.4)
Net book amount	<u>5.9</u>	<u>4.9</u>

Outstanding payments and interest associated with this lease are not material.

<b>(b) Capital commitments</b>	2014 £m	2013 £m
In respect of contracts placed	<u>124.0</u>	<u>184.7</u>

**11 Fixed asset investments**

Shares in group undertakings	2014 £m	2013 £m
At 1 April and 31 March	<u>29.2</u>	<u>29.2</u>

The investment represents a 100 per cent holding of the issued ordinary shares of Southern Water Services (Finance) Limited (SWSF), a company incorporated in the Cayman Islands but registered for tax in the UK. The principal activity of SWSF is to raise debt finance.

The directors are satisfied that the carrying value of the investment is supported by the underlying assets and activities of SWSF.

There are no indirect subsidiaries resulting from this investment.

**12 Stocks**

	2014 £m	2013 £m
Raw materials	1.6	1.0
Work in progress	0.4	0.5
	<u>2.0</u>	<u>1.5</u>

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**13 Debtors: amounts falling due within one year**

	2014 £m	2013 £m
Trade debtors	79.3	76.9
Loan to Southern Water Services (Finance) Limited	13.4	247.5
Amounts owed by group undertakings	4.8	8.6
Other debtors	11.2	9.0
Accrued income	75.6	62.7
Prepayments	13.7	11.9
	<u>198.0</u>	<u>416.6</u>

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

**14 Debtors: amounts falling due after more than one year**

	2014 £m	2013 £m
Loans owed by group undertakings	<u>812.3</u>	<u>812.3</u>

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

**15 Creditors: amounts falling due within one year**

	2014 £m	2013 £m
Trade creditors	21.0	19.4
Loans from group undertakings (see note (i) below)	30.3	30.3
Loan from Southern Water Services (Finance) Limited (see note (ii) below)	-	250.0
Amounts owed to group undertakings	38.7	48.8
Capital creditors and capital accruals	106.5	73.7
Taxation and social security	2.6	2.3
Debt issue costs (note 16 (vi))	(3.1)	(3.4)
Accruals and deferred revenue	94.5	74.7
Bond premium deferred	0.3	0.3
Deferred gilt lock proceeds (note 16 (vii))	0.1	0.1
Deferred proceeds	9.7	9.7
	<u>300.6</u>	<u>505.9</u>

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

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

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

(ii) The loan from Southern Water Services (Finance) Limited was repaid in March 2014. Up until the point of repayment interest was charged at 7.879 per cent.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**16 Creditors: amounts falling due after more than one year**

	2014 £m	2013 £m
Loans and other borrowings:		
Loan from Southern Water Services (Finance) Limited	3,426.0	3,356.6
Capex facility £150m – 6-month Libor plus 3% 2013	150.0	150.0
Class A1 Preference shares (see note (v) below)	32.6	32.6
Class B Preference shares (see note (v) below)	110.0	110.0
Debt issue costs (see note (vi) below)	(33.2)	(42.9)
Bond premium deferred	4.1	4.4
Deferred gilt lock proceeds (see note (vii) below)	5.3	5.4
Deferred proceeds*	124.7	134.5
Obligations under finance leases	1.6	1.3
Total loans and other borrowings	<u>3,821.1</u>	<u>3,751.9</u>
Deferred revenue (see note (viii) below)	15.3	15.6
<b>Total creditors falling due after more than one year</b>	<u><b>3,836.4</b></u>	<u><b>3,767.5</b></u>
	2014 £m	2013 £m
<b>Repayments fall due as follows:</b>		
Between two and five years	150.0	150.0
After five years not by instalments	3,568.6	3,499.2
	<u><b>3,718.6</b></u>	<u><b>3,649.2</b></u>

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

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**16 Creditors: amounts falling due after more than one year (continued)**

An analysis of the loans is shown below:

Loans	2014 £m	2013 £m
Class A £350m - £349.3m 3.350% index linked 2029/2037 & £0.7m 6.202% fixed rate 2029 (note (i) below)	395.8	384.7
Class A £150m - 3.716% index linked 2034	210.2	203.8
Class A £35m - 3.716% index linked 2034	49.7	48.2
Class A £350m - £141.9m 3.709% index linked & £208.1m 6.650% fixed rate 2026 (note (i) below)	367.2	362.7
Class A £150m - 3.826% index linked 2023	210.2	203.8
Class A £350m - £177.0m 2.070% index linked & £173.0m 5.010% fixed rate 2021 (note (i) below)	372.1	369.3
Class A £150m - 0.510% index linked 2041 (note (i) below)	201.1	195.9
Class A £200m - 0.070% index linked 2052 (note (i) below)	262.1	255.2
Class A £300m - 0.490% index linked 2056 (note (i) below)	362.3	351.4
Class A £300m - £195.0m Libor plus 3.029% 2019 & £105.0m 6.135% fixed rate 2019 (note (ii) below)	300.0	300.0
Artesian £165m - 4.086% index linked 2033	231.3	224.1
Artesian £156.5m - 3.645% index linked 2032	214.0	207.5
<b>Total Class A debt</b>	<b>3,176.0</b>	<b>3,106.6</b>
Class B £250m - 4.51% fixed rate 2022 (note (iii) below)	250.0	250.0
Senior Mezzanine £127.2m - 11.97% fixed rate 2038 (note (iv) below)	0.0	0.0
Debt issue costs (note (vi) below)	(33.2)	(42.9)
Bond premium deferred	4.1	4.4
Deferred gilt lock proceeds (note (vii) below)	5.3	5.4
Deferred proceeds*	124.7	134.5
<b>Total loans and other borrowings from SWSF</b>	<b>3,526.9</b>	<b>3,458.0</b>
Capex facility £150m – 6-month Libor plus 3% 2017	150.0	150.0
Class A1 Preference shares (note (v) below)	32.6	32.6
Class B Preference shares (note (v) below)	110.0	110.0
Obligations under finance leases	1.6	1.3
<b>Total loans and other borrowings</b>	<b>3,821.1</b>	<b>3,751.9</b>

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

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**16 Creditors: amounts falling due after more than one year (continued)**

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

In respect of the specific instruments above:

- (i) As at 31 March 2014, SWSF was party to various swap agreements converting a total of £1,318.2 million of Class A debt from the original fixed interest rate to a real interest rate linked to RPI (Retail Price Index) plus capitalised inflation on the nominal value of the underlying Class A debt.

The table below analyses the total value of swaps entered into by SWSF as at 31 March 2014:

Nominal value of debt	Original Fixed interest rate	Swapped Index Linked interest rate	Nominal value of debt plus capitalised RPI
£349.3m	6.192%	3.340%	£395.1m
£141.9m	6.640%	3.699%	£159.1m
£177.0m	5.000%	2.060%	£199.1m
£150.0m	5.000%	0.500%	£201.1m
£200.0m	4.500%	0.060%	£262.1m
£300.0m	5.125%	0.480%	£362.3m
<u>£1,318.2m</u>			<u>£1,578.8m</u>

- (ii) SWSF has entered into swap agreements that have converted £195 million of its Class A £300 million from a fixed rate of 6.125 per cent to floating rates of Libor plus a margin with a Libor cap at 5 per cent. This swapped rate has been reflected in the rate charged to SWS plus 0.01 per cent.
- (iii) The interest rate on the Class B £250 million is fixed at 4.51 per cent until March 2022 when it reverts to Libor plus a margin to be determined with a premium of 0.01 per cent.
- (iv) The interest rate on the Senior Mezzanine loan is fixed at 11.97 per cent until March 2022 when it reverts to Libor plus 6.25 per cent with a premium of 0.01 per cent.
- (v) The preference shares issued have been classified as loans in the financial statements as required by FRS 25. All shares are redeemable at the option of SWS at any time.

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

## Notes to the financial statements (continued)

For the year ended 31 March 2014

### 16 Creditors: amounts falling due after more than one year (continued)

Class A1 – £40 per share

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

Class B – £70 per share

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

It is anticipated that a dividend will be declared and paid to the A2 preference shareholders in September 2014 for out-performance in the year ended 31 March 2013.

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

- (vi) Debt issue costs represent issue fees paid to SWSF. Where these costs are attributable to a specific instrument they are being amortised over the life of that instrument. The remaining costs are being amortised over the weighted average life of the loan advances noted above. As at 31 March 2014 debt issue costs amounted to £36.3 million of which £3.1 million represents the short-term amount which is disclosed separately in note 15.
- (vii) Prior to the issue of the Class A £300 million bond in the year to 31 March 2008, SWSF entered into a gilt lock agreement, resulting in the receipt of £6.3 million, which was advanced to SWS along with the proceeds of the bond issue. The proceeds have been deferred in the financial statements of SWS and are being released to the profit and loss account over the life of the loan.
- (viii) Deferred revenue relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by SWS. The income will be credited to the profit and loss account evenly over the life of the lease.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**17 Provision for liabilities**

<b>(a) Environmental obligations</b>	<b>2014</b>	<b>2013</b>
	<b>£m</b>	<b>£m</b>
At 1 April	0.8	0.8
Utilised in year	<u>(0.3)</u>	<u>-</u>
<b>At 31 March</b>	<b><u>0.5</u></b>	<b><u>0.8</u></b>

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

<b>(b) Deferred taxation</b>	<b>2014</b>	<b>2013</b>
	<b>£m</b>	<b>£m</b>
Accelerated capital allowances	333.0	378.3
Other timing differences	<u>(18.8)</u>	<u>(21.5)</u>
<b>Deferred taxation</b>	<b><u>314.2</u></b>	<b><u>356.8</u></b>

<b>Movement in deferred tax provision</b>	<b>2014</b>	<b>2013</b>
	<b>£m</b>	<b>£m</b>
Deferred tax provided at 1 April	356.8	349.6
Prior year adjustment	(11.7)	(1.6)
Deferred tax charge in profit and loss account	16.2	24.3
Effect of corporation tax rate change	<u>(47.1)</u>	<u>(15.5)</u>
<b>Deferred tax provided at 31 March</b>	<b><u>314.2</u></b>	<b><u>356.8</u></b>

<b>Deferred tax asset relating to pension deficit</b>	<b>2014</b>	<b>2013</b>
	<b>£m</b>	<b>£m</b>
At 1 April	21.6	26.6
Deferred tax charge in profit and loss account	(0.1)	(5.9)
Deferred tax credited/charged to the statement of total recognised gains and losses	(0.7)	1.8
Impact of rate change:		
Charge in profit and loss account	(1.2)	(0.4)
Charged to the statement of total recognised gains and losses	<u>(1.5)</u>	<u>(0.5)</u>
<b>At 31 March</b>	<b><u>18.1</u></b>	<b><u>21.6</u></b>

The total deferred tax asset of £18.1 million (2012–13: £21.6 million) relating to the pension deficit has been deducted from the pension deficit and so has not been included in this balance.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**18 Grants and contributions**

	<b>£m</b>
At 1 April 2013	46.4
Receivable in year	0.3
Released to profit and loss account	(2.9)
<b>At 31 March 2014</b>	<b>43.8</b>

These grants and contributions relate to non-infrastructure assets.

**19 Called up share capital**

	2014 £m	2013 £m
<b>Equity shares</b>		
Authorised		
46,050,000 ordinary shares of £1 each	<u>46.1</u>	<u>46.1</u>
Allotted and fully paid		
56,000 ordinary shares of £1 each	<u>0.1</u>	<u>0.1</u>
Non-equity shares		
Issued		
<b>Preference shares</b>		
32,607 Class A1 shares of £1 each	0.0	0.0
32,607 Class A2 shares of £0.01 each	0.0	0.0
110,000 Class B shares of £1 each	<u>0.1</u>	<u>0.1</u>

The preference shares are classified as debt in line with FRS 25. They are disclosed within note 16 at an amount of £142.6 million including share premium of £142.5 million. The total statutory company share premium of £188.8 million includes ordinary share premium of £46.3 million.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**20 Reconciliation of movement in shareholder's funds**

	Called up share capital £m	Share premium £m	Profit and loss account £m	Total £m
At 1 April 2013	0.1	46.3	867.9	<b>914.3</b>
Profit after tax	-	-	169.8	<b>169.8</b>
Dividends paid	-	-	(43.8)	<b>(43.8)</b>
Actuarial gain on pension scheme	-	-	3.1	<b>3.1</b>
Movement on deferred tax relating to pension asset	-	-	(2.2)	<b>(2.2)</b>
<b>At 31 March 2014</b>	<b>0.1</b>	<b>46.3</b>	<b>994.8</b>	<b>1,041.2</b>

The profit and loss reserve includes recognised losses of £90.4 million (2012–13: £93.7 million) less deferred taxation of £18.1 million (2012–13: £21.6 million) in respect of pension scheme liabilities of the company pension fund.

	Called up share capital £m	Share premium £m	Profit and loss account £m	Total £m
At 1 April 2012	0.1	46.3	760.3	806.7
Profit after tax	-	-	156.9	156.9
Dividends paid	-	-	(43.2)	(43.2)
Actuarial loss on pension scheme	-	-	(7.3)	(7.3)
Movement on deferred tax relating to pension asset	-	-	1.2	1.2
At 31 March 2013	0.1	46.3	867.9	914.3

**21 (a) Cash flow from operating activities**

	2014 £m	2013 £m
<b>Continuing operations</b>		
Operating profit	<b>306.2</b>	331.0
Depreciation charge	<b>237.8</b>	216.2
Difference between pension charge and cash contributions	<b>(2.7)</b>	(11.4)
Amortisation of grants and contributions	<b>(2.9)</b>	(2.8)
Decrease in environmental provision	<b>(0.3)</b>	-
(Increase)/decrease in stocks	<b>(0.4)</b>	0.4
Increase in debtors	<b>(15.8)</b>	(25.8)
Increase/(decrease) in creditors	<b>21.4</b>	(7.8)
<b>Total net cash inflow from operating activities</b>	<b>543.3</b>	499.8

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**21 (b) Analysis of net debt**

	At 1 April 2013 £m	Cash Flow £m	Other non- cash changes £m	At 31 March 2014 £m
Cash deposits	139.9	(4.4)	-	135.5
Cash	139.9	(4.4)	-	135.5
Debt issue costs	46.3	0.2	(10.2)	36.3
Gilt lock proceeds (see note 16)	(5.5)	-	0.1	(5.4)
Loan to subsidiary	247.5	-	(247.5)	-
Loans due within one year	(290.3)	-	250.0	(40.3)
Loans due after one year	(3,788.1)	2.8	(62.1)	(3,847.4)
Finance leases	(1.3)	-	(0.3)	(1.6)
	<u>(3,651.5)</u>	<u>(1.4)</u>	<u>(70.0)</u>	<u>(3,722.9)</u>

The non-cash movement of £70.0 million relates to an increase in debt as a result of indexation, and a net movement on loans, which offset against each other, plus the amortisation of loan issue costs, gilt lock proceeds, deferred proceeds and an increase in finance lease obligations.

Loans due within one year relate to loans from group undertakings that are repayable on demand (see note 15).

**22 Pensions**

The company accounted for pension costs during the year under FRS 17. These disclosures show a net FRS 17 deficit (after deferred tax) of £72.3 million (2012–13 deficit: £72.1 million). The deficit has arisen mainly as a result of lower expected future returns on investments and turbulence in the stock market, including low interest rates. The FRS 17 deficit (before deferred tax) of £90.4 million (2012–13 deficit: £93.7 million) has decreased due to an increase in the yields on AA-rated corporate bonds, partially offset by interest on the deficit and a slight increase in the assumed life expectancy to reflect up to date mortality tables. These movements are analysed below. The overall net deficit shows a slight increase due to a reduction in the deferred tax asset as a result of the change in future tax rates from 23 per cent to 20 per cent as enacted in Finance Bill 2013. This movement is analysed in Note 17(b).

**Pension schemes operated**

The company principally operates two schemes, details of which are shown below:

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

The assets of the scheme are held separately from those of the company. Legal and General and Blackrock are unit registrars for Southern Water Pension Scheme unit holdings, and appoint custodians at individual pooled fund level (not client holding level).

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

Contributions made to the defined contribution scheme for the year ended 31 March 2014 amounted to £1.4 million (2012–13: £1.0 million). No contributions were outstanding at either year end.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**22 Pensions (continued)**

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

The latest actuarial valuation of the SWPS was carried out as at 31 March 2010 using the projected unit method. For closed schemes under this method the current service cost will increase as the members of the schemes approach retirement. The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on investments, and the level of inflation, which drives pension increases in the SWPS.

The principal assumptions in the valuation were as follows:

	<b>2010 SWPS % per annum (pa)</b>
Return on investments: pre-retirement	7.2
Return on investments: post-retirement (pensioner/non-pensioner)	5.2/5.25
Salary growth	5.2
Pension increases on the excess over guaranteed minimum pensions (where capped at 5% pa)	3.8

The assets of the scheme had a market value of £479.6 million at 31 March 2010. This was sufficient to cover 81 per cent of the scheme's benefits.

Expected employer and employee contributions to the defined benefit scheme for 2014-15 are £21.0 million and £0.3 million respectively under the current Schedule of Contributions. An actuarial valuation as at 31 March 2013 is currently underway, and a new Schedule of Contributions will be agreed as part of this valuation, which could result in a different level of contributions being paid.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**22 Pensions (continued)****FRS 17 – assumptions, asset, liability and reserves disclosures**

The formal actuarial funding valuation was carried out as at 31 March 2010 and updated to 31 March 2014 by a qualified independent actuary. The major assumptions used by the actuary are set out in the table below.

	<b>2014</b>	2013	2012
	<b>% pa</b>	% pa	% pa
Price inflation (RPI)	<b>3.2</b>	3.2	3.0
Price inflation (CPI)	<b>2.3</b>	2.3	2.1
Rate of increase in salaries (plus an age-related promotional scale)	<b>2.5</b>	2.5	3.0
Rate of increase of pensions in payment (MIS* members only)***	<b>2.3</b>	2.3	2.1
Rate of increase of pensions in payment (Old section** members only)***	<b>3.2</b>	3.2	3.0
Rate of increase of pensions in payment (all other members)***	<b>3.1</b>	3.1	3.0
Rate of increase for deferred pensions (MIS* members only)***	<b>2.3</b>	2.3	2.1
Rate of increase for deferred pensions (all other members)***	<b>3.1</b>	3.1	3.0
Discount rate	<b>4.5</b>	4.4	4.8
Expected return on assets	<b>5.1</b>	4.7	5.4

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

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

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

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. For 2013–14, the company has used the post-retirement mortality assumptions based on the standard SAPS mortality tables together with future improvements in line with the medium cohort projections with a 1 per cent per annum underpin, modified to reflect actual experience.

	<b>2014</b>	2013
	<b>Years</b>	Years
Longevity at age 65 for current pensioners		
Male	<b>22.9</b>	22.7
Female	<b>25.0</b>	24.6
Longevity at age 65 for future pensioners		
Male	<b>24.7</b>	24.6
Female	<b>26.9</b>	26.4

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**22 Pensions (continued)**

The assets and liabilities in the schemes and the expected rates of return at 31 March 2014 and 31 March 2013 were:

	Rate of return 2014	Rate of return 2013	Value at 2014 £m	Value at 2013 £m
Equities	7.1%	6.8%	256.6	261.7
Government bonds	3.1%	2.8%	132.3	128.8
Non-Government bonds	4.0%	4.1%	183.9	178.0
Cash	2.9%	3.2%	8.7	7.5
<b>Total market value of Plan assets</b>			<b>581.5</b>	<b>576.0</b>
Total value of Plan liabilities			(671.9)	(669.7)
<b>Accrued deficit in the Plan</b>			<b>(90.4)</b>	<b>(93.7)</b>
Related deferred tax asset			18.1	21.6
<b>Net pension liability</b>			<b>(72.3)</b>	<b>(72.1)</b>

The equity investments and bonds which are held in plan assets are quoted and are valued at the current bid price following the adoption of the amendment to FRS 17.

**Reconciliation of the present value of the scheme liabilities**

	2014 £m	2013 £m
At 1 April	669.7	616.1
Current service cost	5.0	6.5
Interest cost	29.1	29.2
Member contributions	0.3	0.3
Actuarial (gain)/loss on liabilities	(7.5)	50.3
Benefits paid	(24.7)	(23.7)
Curtailments	-	(9.0)
<b>Scheme liabilities at 31 March</b>	<b>671.9</b>	<b>669.7</b>

**Sensitivity analysis of scheme liabilities**

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

	Change in assumption	Impact on scheme liabilities (%)	Impact on scheme liabilities (£m)
Discount rate	+/- 1%	-/+ 14	-/+ 94
Rate of inflation*	+/- 1%	+/- 13	+/- 90
Rate of increase in pensions in payment	+/- 1%	+/- 11	+/- 75
Mortality	+/- 1yr	+/- 2	+/- 13

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

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**22 Pensions (continued)**

<b>Reconciliation of the fair value of the scheme assets</b>	<b>2014 £m</b>	<b>2013 £m</b>
At 1 April	576.0	519.8
Expected return on assets	26.7	27.7
(Loss)/gain on assets	(4.4)	43.0
Employer contributions	7.6	8.9
Member contributions	0.3	0.3
Benefits paid	(24.7)	(23.7)
<b>Bid value of scheme assets at 31 March</b>	<b>581.5</b>	<b>576.0</b>

The actual gain on scheme assets was £22.2 million (2012–13: £70.7 million).

<b>Analysis of amounts charged to operating profit</b>	<b>2014 £m</b>	<b>2013 £m</b>
Employer's current service cost	5.0	6.5
Expected return on pension scheme assets	(26.7)	(27.7)
Interest on pension scheme liabilities	29.1	29.2
Curtailments	-	(9.0)
<b>Total P&amp;L expense/(credit) before deduction for tax</b>	<b>7.4</b>	<b>(1.0)</b>

<b>Analysis of the amounts recognised in STRGL</b>	<b>2014 £m</b>	<b>2013 £m</b>
Actuarial return less expected return on pension scheme assets	(4.4)	43.0
Experience gain arising on scheme liabilities	-	1.1
Gain/(loss) on change of assumptions (financial and demographic)	7.5	(51.4)
<b>Total gain/(loss) recognised in STRGL before adjustment for tax</b>	<b>3.1</b>	<b>(7.3)</b>

The cumulative amount of actuarial losses recognised in the statement of total recognised gains and losses is £136.6 million (2012–13: £139.6 million).

<b>Analysis of the movement in the schemes' deficit during the year</b>	<b>2014 £m</b>	<b>2013 £m</b>
Deficit in the scheme at 1 April	(93.7)	(96.3)
Employer's contributions	7.6	8.9
Employer's current service cost	(5.0)	(6.5)
Curtailments	-	9.0
Other finance expense	(2.4)	(1.5)
Actuarial gain/(loss)	3.1	(7.3)
<b>Deficit in the scheme at end of year</b>	<b>(90.4)</b>	<b>(93.7)</b>
Deferred tax relating to scheme deficit	18.1	21.6
<b>Net deficit at end of year</b>	<b>(72.3)</b>	<b>(72.1)</b>

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**22 Pensions (continued)**

<b>History of gains and losses for the year to 31 March 2014</b>	<b>2014</b>	2013	2012	2011	2010
<b>a. Experience adjustment on planned assets</b>					
Amount (£m)	<u>(4.5)</u>	<u>(43.0)</u>	<u>0.5</u>	<u>(1.1)</u>	<u>(83.6)</u>
<b>b. Experience adjustment on scheme liabilities</b>					
Amount (£m)	<u>-</u>	<u>1.1</u>	<u>4.9</u>	<u>(6.0)</u>	<u>12.9</u>
<b>c. Total amount recognised in the STRGL</b>					
Fair value of assets at year-end (£m)	<b>581.5</b>	576.0	519.8	500.6	480.2
Actuarial value of liabilities at year-end (£m)	<b>(671.9)</b>	(669.7)	(616.1)	(560.7)	(589.0)
<b>Deficit in scheme at year-end (£m)</b>	<b><u>(90.4)</u></b>	<u>(93.7)</u>	<u>(96.3)</u>	<u>(60.1)</u>	<u>(108.8)</u>

The assets have been valued at bid value as per FRS 17 amendment.

**23 Contingent liabilities**

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

The company had no contingent liabilities for capital claims at the year-end (2012–13: £nil).

**24 Financial commitments**

As at 31 March 2014 and 2013, the company had annual commitments under non-cancellable operating lease agreements in respect of vehicles and land and buildings for which the payment extends over a number of years as follows:

	<b>Land and Buildings</b>		<b>Other</b>	
	<b>2014</b>	2013	<b>2014</b>	2013
	<b>£m</b>	£m	<b>£m</b>	£m
Expiring within one year	-	-	-	-
Expiring between two and five years	<b>0.1</b>	-	<b>0.1</b>	-
Expiring after more than five years	<b>1.4</b>	1.3	-	-
	<b><u>1.5</u></b>	<u>1.3</u>	<b><u>0.1</u></b>	<u>-</u>

Operating leases are charged to the profit and loss account over the lease term.

**25 Related party transactions and ultimate holding party**

The immediate parent undertaking is SWS Holdings Limited.

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

The major shareholders in Greensands Holdings Limited as at 31 March 2014 are IIF International SW UK Investments Limited (managed by JP Morgan Investments Inc.) and The Northern Trust Company.

**Notes to the financial statements (continued)**

For the year ended 31 March 2014

**25 Related party transactions and ultimate holding party (continued)**

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

The company has taken advantage of the exemption under FRS 8 'Related Party Disclosures' (revised) in not disclosing details of transactions with other companies which are 100 per cent owned on the basis that the consolidated financial statements in which the company is included are publicly available.

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

We have audited the financial statements of Southern Water Services Limited for the year ended 31 March 2014 which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet, the cash flow statement and the related notes 1 to 25. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

### **Respective responsibilities of directors and auditor**

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

### **Scope of the audit of the financial statements**

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

### **Opinion on financial statements**

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2014 and of its profit for the year then ended
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

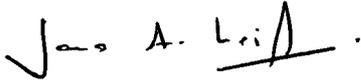
### **Opinion on other matter prescribed by the Companies Act 2006**

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.

**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.



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

26 June 2014