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Annual Report and Accounts 2014–15

Building on success



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Overview

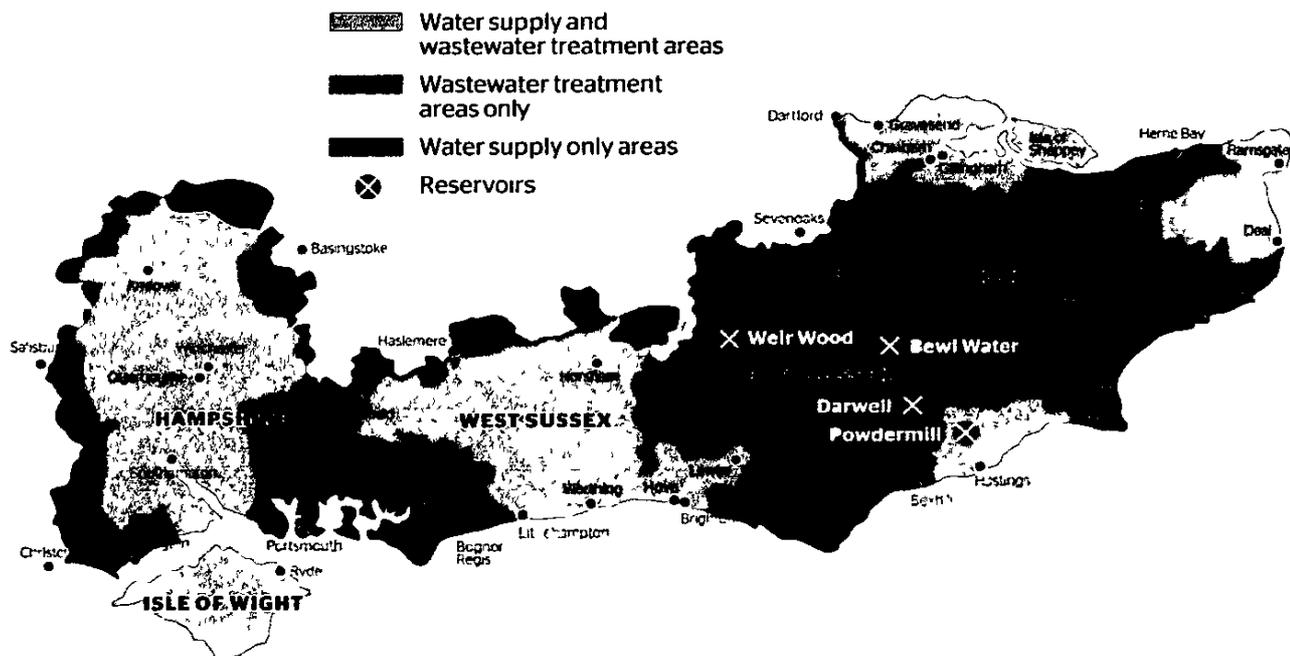
At a glance

Our business

We take care of life's essentials by providing 4.6 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



Water	
People served, millions	2.5
Number of properties, millions	1.1
Number of metered properties	906,313
Average daily water supply, millions of litres per day	524
Number of service reservoirs	204
Number of water treatment works	89
Length of water mains, kilometres	13,753

Wastewater	
People served, millions	4.6
Number of properties, millions	1.9
Average daily wastewater recycled, millions of litres per day	718
Length of sewers, kilometres	39,600
Number of wastewater treatment works	365
Number of pumping stations	2,375

Finance	2014–15	2013–14
Turnover*	£828.6m	£806.2m
Operating profit (before exceptional item)	£325.9m	£325.0m
Exceptional item (severe weather)	(£2.4m)	£18.8m
Profit on ordinary activities after tax	£167.2m	£169.8m
Capital investment	£323.1m	£415.5m
Average water and wastewater customer bill	£434	£424

* 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	2014–15	2013–14
Overall drinking water quality, calendar year	99.97%	99.94%
Leakage, millions of litres per day	82	85
Beaches meeting European water quality standards	100%	100%
Service Incentive Mechanism (SIM) ¹	78.7	75.2
Performance water non-infrastructure	Stable	Stable
Performance water infrastructure	Stable	Stable
Performance wastewater non-infrastructure ²	Stable	Deteriorating
Performance wastewater infrastructure ²	Stable	Deteriorating
Pollution incidents, calendar year	292	324

¹ This measure is based on the methodology used last year for comparative purposes. The calculation method changed during 2014–15 and under this new method, our score for 2014–15 was 72.

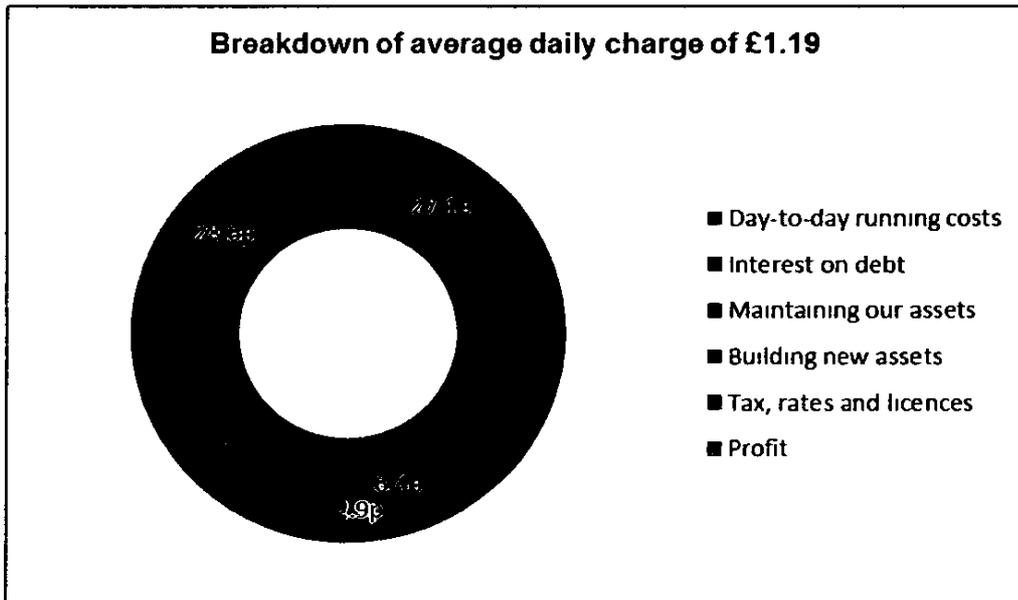
² Serviceability performance for wastewater infrastructure and non-infrastructure in 2013–14 was self-assessed by the Board as stable and reported as such in our Annual Report for 2013–14. Ofwat, in its final determination, assessed both sub-services as deteriorating, which is the view reflected in the table above.

Where your money goes

The average combined bill for our household water and wastewater customers in 2014–15 was £434 – equivalent to £1.19 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.

We recognise that it is important for customers to understand where their money goes and we have committed to increase awareness through our reporting.

The diagram below illustrates how an average annual bill contributes to our business, based on figures from our Final Determination for the Asset Management Plan covering 2010-15 (AMP5).



Day-to-day running costs – this includes wages for direct employees and people indirectly employed through our supply chain as well as power, chemicals and materials costs

Interest on debt – on money borrowed to help spread the cost for customers of improvements to our services over the longer term

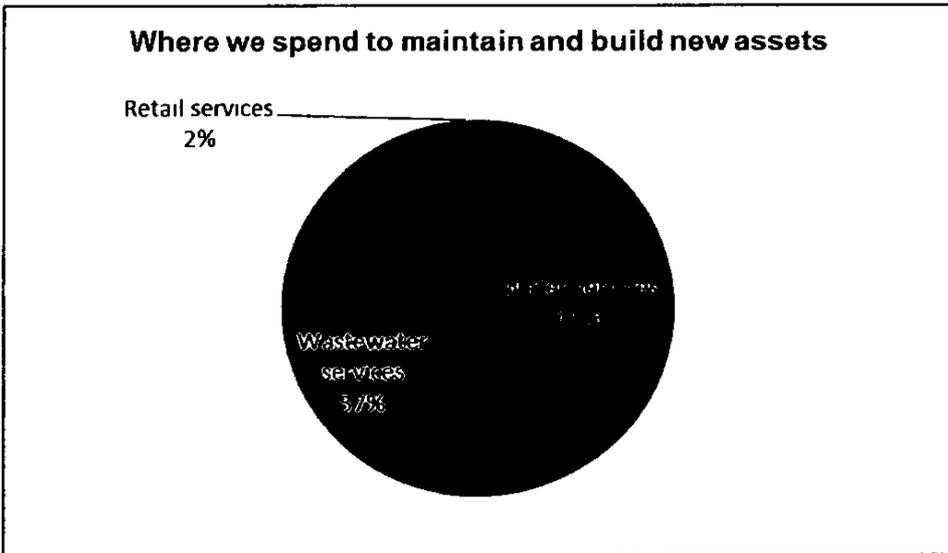
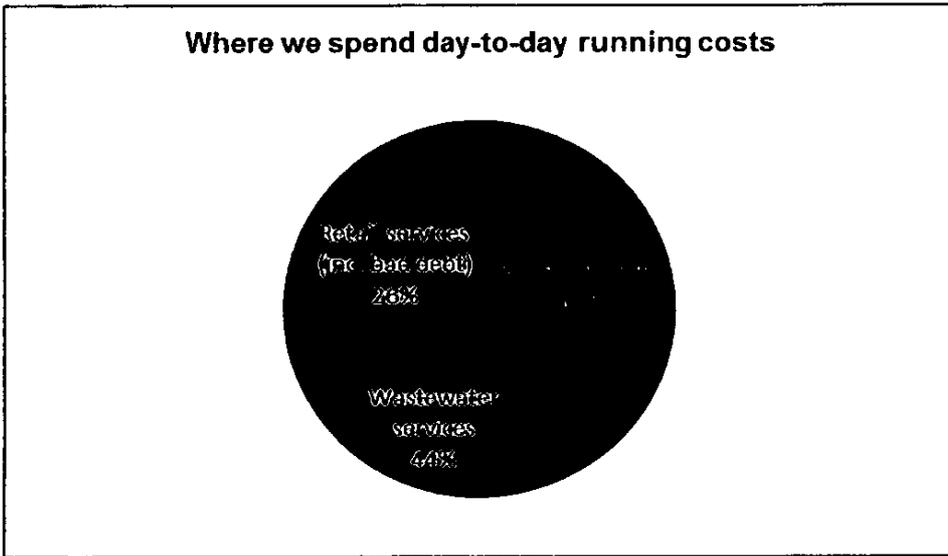
Maintaining our existing assets – capital expenditure to maintain our underground pipe network and treatment works, including capitalised employee costs

Building new assets – for example our new wastewater treatment works at Peacehaven and works to enhance treatment standards and cater for growth

Tax, business rates and licences – this includes corporate taxes, business rates on buildings, wastewater treatment works and water supply works and Environment Agency licences

Profit – return earned on shareholders' investment in the business

The charts below show a further breakdown of the average annual daily charge based on expenditure from 2010–2015. They illustrate the services on which we spend day-to-day running costs and the costs of maintaining and building our assets.



Welcome

Chairman's introduction

This Annual Report marks the final year of the five-year Asset Management Plan (AMP5) agreed with Ofwat for 2010–15 and the start of AMP6 for 2015–20

More than usual it seems appropriate that my review should provide both a look back over the year ended on 31 March 2015 and a look forward covering the forthcoming regulatory quinquennium to 2020

A look back

We have said on many occasions that Southern Water's vision is to be recognised as the UK's leading water company. We started the year with industry-leading credentials in health and safety, leakage and the roll-out of metering.

In operational terms, 2014–15 was our best year for a long time. We can legitimately claim to have sustained our performance in the areas where we were already a leader and have improved our performance in drinking water quality, minimising customer supply interruptions, bathing water quality and treatment works compliance to the point where we are now performing at or close to industry-leading standards.

Although we have also seen marked improvements in our customer service metrics and in pollution incidents, even after another strong year in 2014–15 our relative performance tells us that we are still not delivering at the levels to which we aspire in these parts of our business. We believe, though, that the gap is closing.

As we make headway in our operating metrics, greater benefit accrues to our customers, our other stakeholders and the regional economy we serve.

In order that these improvements in performance can be sustained, it is also crucial that our financial performance should be satisfactory. In this regard, I am pleased to note that our operating costs were stable relative to the prior year and that our operating profits and cash from operations showed healthy underlying increases.

External endorsement of our progress came from Moody's, the credit rating agency, who removed the negative outlook from our debt ratings in February of this year. This important milestone was greatly aided by the support of our shareholders in adopting a flexible dividend policy targeted at strengthening our financial position.

Our financial strength enabled us to make further significant investment amounting to £323 million in our assets, our people and our systems, a sum which is comfortably in excess of our profit after tax.

So, we leave AMP5 demonstrating continued improvement in our performance to the point where on several metrics we are now at industry-leading levels. It is only appropriate that I should take this opportunity, on behalf of our Board, to thank our management team, our employees and our contractor partners for their ingenuity and hard graft which underlie the good progress we have seen.

A look forward

A key focus for the Board in 2014–15 has been Ofwat's price review which took effect on 1 April 2015 and which imposes a significant reduction in our charges in real terms over the five years to 2020.

In order to accommodate lower revenues, our Executive Management Team had to identify ways by which we could reduce the cost of delivering services by over £200 million. To achieve efficiencies of this magnitude, all our operating models and practices have been subjected to challenge and review and many changes have been made and others are to follow.

After much review, challenge and deliberation, our Board endorsed the Business Plan, confident that it can deliver the necessary efficiency gains while also allowing us to meet our broader customer and other stakeholder commitments

Even so, it is clear that achievement of our plan represents an enormous management challenge, particularly in the current year. I am pleased, though, to note that all the important early initiatives on which the plan was predicated have been successfully delivered.

One of particular note is our new Customer Advisory Panel (CAP). Following the success of our independent Customer Challenge Group during the price review, we decided to continue with its role, albeit in a different format. This will ensure we have independent advice and challenge around how we engage with our customers and stakeholders.

Chaired by Anna Bradley, the new CAP will sit as an independent panel made up of members with a broad range of skills and experience. Its principal duty will be to monitor delivery of and provide assurance that the six priorities identified in the Business Plan are being met and that the 26 promises made by the company are being kept. The CAP will ensure its view of company performance is communicated in a clear and transparent way to the Board, customers, stakeholders and the broader community we serve.

As part of our preparation for AMP6 we also recognised we needed to refresh our Board, given that our independent non-executive directors, apart from me, had all served since 2008 or earlier.

In making new appointments we considered carefully the experience and skill sets which we felt would benefit us most. I am delighted to report that Paul Sheffield, Bill Tame, Rosemary Boot and Lisa Harrington all joined our Board between June 2014 and April this year. Their biographies are provided on pages 65 to 66 below. Collectively they bring truly impressive experience, including in capital projects, procurement, health and safety, the environment, finance, audit and treasury, customer services, community affairs and company and Board management.

Reflecting the potential for our independent non-executive directors to add further value through mentoring and broader support to our senior managers, we have also increased the time each commits to a minimum of 24 days per year. We are grateful that all our appointed directors have already demonstrated their willingness to commit the extra time needed to leverage their value to us.

Bob Armstrong and Cheryl Black left our Board at the end of January and David Golden will be stepping down from the end of June 2015. We are very grateful for the significant contribution each of them has made to our business over the past several years, not least through their input to the price review and our Business Plan for AMP6.

We are also strongly supported by our shareholder non-executive directors and here it is noteworthy that Paul Moy and Bronte Somes have switched roles. With effect from 1 April 2015, Bronte joined our Board and Paul became her alternate. We are grateful to Paul for his invaluable contribution to Southern Water Services.

To conclude, our business faces significant challenges in AMP6. We need to provide better levels of service from our ageing infrastructure and we know too that we have to improve our customer service capabilities even more than we have to date. Reform of the regulatory framework for the water sector also continues and we will use our influence to ensure the reforms adopted genuinely deliver customer benefits.

Nonetheless we are confident the momentum we have built up through strongly improved performance over the past four years, together with our rigorous planning and state of preparedness for AMP6, positions us well to meet the challenges of the next five years and to bring consequential benefit to the region, customers and other stakeholders we serve.



Robert Jennings
Chairman

Our Board

The Board is responsible for the overall strategic direction of the business. During 2014–15, 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 (EMT), which comprises the Chief Executive Officer, Chief Financial Officer, Company Secretary and General Counsel, and seven functional directors. None of these seven directors is a member 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.

The Board members and Company Secretary are
Kevin Hall, Company Secretary and General Counsel
Rosemary Boot, independent non-executive director
David Golden, senior independent non-executive director
Michael Carmedy, Chief Financial Officer
Robert Jennings, Chairman
Bill Tame, independent non-executive director
Matthew Wright, Chief Executive Officer
Bronte Somes, non-executive director
Lisa Harrington, independent non-executive director
Mark Walters, non-executive director
Paul Sheffield, independent non-executive director

Find out more about the Board on pages 64 to 68

Chief Executive's summary

We have come a long way in AMP5, closing the five-year period in a much better position than where we started it, both operationally and financially

Operationally, we have ended AMP5 with our performance firmly in the upper half of the sector for waste treatment compliance and water quality and we are leading the industry on leakage and health and safety. We have made strong improvements in terms of reducing the number of pollution and flooding incidents, traditionally weaker areas for us.

We have also improved the quality and responsiveness of our customer service, demonstrated by the increase in our score against Ofwat's measure of customer satisfaction, the Service Incentive Mechanism (SIM). However, we remain at the bottom end of the industry league table on SIM because our peers have been improving too. This does not diminish the significant efforts of the teams working hard to improve customer service but it does mean we have a lot more to do in an area where standards are constantly rising.

However, I am confident the investment and associated performance improvement we have made in AMP5 provide us with a platform for success in AMP6. When you combine our positive trend in performance with all the change initiatives that have been delivered or are in progress, I believe we can look forward with real optimism to AMP6 and the realisation of our ambition to be recognised as the UK's leading water company.

Delivering improved performance

We continued to work hard in 2014–15 to provide the high-quality, responsive customer service our customers expect.

We carried out a major review of every aspect of our work with customers and have made some key changes, including putting in place a new management team led by a newly appointed Chief Customer Officer.

During the past 12 months, customer complaints were reduced by 13 per cent with escalated complaints down eight per cent. Our abandoned call rate fell marginally and unwanted customer call volumes were reduced by 21 per cent.

Our performance against Ofwat's Service Incentive Mechanism improved by five per cent – or four points – from 75 to 79. This improvement represents the continuation of a positive trend, however our level of customer service performance remains behind that of our peers.

As part of our commitment to address this, during the second half of the year we completed a £13 million upgrade of our billing system to make it more efficient and effective. It will also provide our customers with the ability to manage their accounts online.

Our operational performance over the past 12 months was among the best we have achieved.

- Drinking water quality – we delivered 99.97 per cent compliance against the Drinking Water Inspectorate's measures, up from 99.94 per cent in the previous year. Our 2014 performance is predicted to rank us towards the top of the ten water and sewerage companies.
- Leakage – we remain the industry leader with the lowest percentage leakage level of any of the major UK water and wastewater companies. In 2014–15 we beat our target for the fourth year running, achieving 82 million litres per day against a target of 88 million.
- Metering – our industry-leading five-year metering programme entered its final stages. The number of meters fitted in the past five years is approaching 400,000 and more than 83 per cent of customers are now paying metered charges. At the start of 2010–11, average household consumption was 154 litres per person, per day. By the end of 2014–15 it had dropped to 135 litres per person, per day.
- Wastewater treatment – we achieved 99 per cent compliance with environmental standards, an

excellent performance and our best for 15 years

- Pollution – we delivered another strong performance with a further nine per cent fall in the number of incidents, following a reduction of 22 per cent in 2013, despite starting the year having to deal with the challenges posed by the wettest winter on record
- Coastal waters – in 2014, every beach in our region once again met European standards for bathing water quality. All 83 bathing waters achieved the European 'mandatory' standard during weekly sampling carried out by the Environment Agency between May and September
- Health and safety – we continued to lead the industry on health and safety performance and beat our own target of 0.35 reportable injuries per 100 full-time employees/contractors during the year. For the 16th consecutive year, we achieved the Royal Society for the Prevention of Accidents gold award and were again presented with an Order of Distinction, the first water company to receive such an accolade twice

Building on success

We have worked hard to put in place solid foundations from which to move forward and during AMP6 we will be investing more than £3 billion to build on our success. We have put in place a coherent change programme to enable us to deliver the performance improvements and cost efficiencies we have committed to in our Business Plan. This change programme is well under way and has already brought a number of significant improvements to our business.

Our initiatives include

- Rebuilding our in-house engineering and technical solutions team
- Updating our billing and customer service system
- Providing field staff with updated systems to enable them to work more efficiently
- Appointing a new strategic partner and delivery partners to support planning and design of capital projects and network maintenance

Taking the lead

Not only are we committed to delivering the promises in our Business Plan but we also intend to play a lead role in addressing some of the key challenges facing our sector. The areas where we will be placing greatest emphasis are

- Water resources management and planning – we are leading the industry in development of new approaches to water resource planning. We are committed to providing a system that is resilient, adaptive and environmentally sustainable and that meets the needs of our customers now and in the future
- Network resilience – we will embrace innovation and take the lead in working with others such as local authorities to make our network, for example our sewers, more resilient in the face of changing weather patterns
- Affordability and debt management – we are committed to delivering improvements for customers while keeping bills as low as possible. We will work with key policy-makers to tackle bad debt through data sharing and collaboration
- Value for money and performance reporting – we will provide clear, accessible and honest reporting of our performance against customer expectations

- Community engagement and education – we will build trust and standing in the communities we serve by developing a strong community brand built around education, staff volunteering and charitable support

Finances

During 2014–15, our operating profit before exceptional items was £326 million, a 0.3 per cent increase from the previous year when our profit was £325 million

This improvement was in line with expectations and largely reflects an increase in turnover of £22 million, resulting from our price increase, offset by a similar increase in depreciation charged against profits as a result of the significant investment we have made in our assets

Operating costs remained broadly in line with last year. Efficiencies of more than £11 million were delivered through our continued focus on controlling operating costs and these offset the impacts of inflation on costs and the additional expenditure incurred in operating our new wastewater treatment works at Peacehaven

I am particularly pleased that this performance, together with the operational improvements already mentioned and our plans for further improvements over the next five years, has resulted in Moody's stabilising our credit rating by removing the negative outlook

Over the past five years our shareholders have supported us in strengthening our financial position and in delivering improved operational performance by adopting a flexible dividend policy. This places us in a stronger position for the start of the next five-year period and allows us to resume payment of dividends from 2015–16

Local pride

I want to mention another aspect of the role we have played in our local communities over the past year, something which is very important to us. At the same time as providing essential services, we believe very much in giving something back to those we serve

This year we achieved a fantastic score of 98 per cent in the Business in the Community annual survey, which is a measure of our corporate responsibility performance and national recognition of our efforts in this area. We beat our own target of 90 per cent and came out joint top – with one other company – of all the utilities that took part

During 2014–15 we continued to support a wide range of good causes across our region, including the Air Ambulance Trusts, hospices and centres for children and adults with a range of disabilities. Even the money we give to national charities goes to benefit our region, for example the new cancer centre that Macmillan is building in Brighton. We continue to support the international charity WaterAid, helping to raise more than £100,000 for it this year. While this is very important, we are particularly proud to help worthwhile local causes – we raised nearly £150,000 for them during the past 12 months

Our employees put in 609 volunteer days this year, which was a record. Their efforts ranged from taking part in sponsored sporting events to environmental tasks such as clearing scrub on the South Downs and cleaning beaches, all good examples of the community spirit we work hard to foster right across our region. We look forward to this work continuing in the coming five-year period

Thanks to staff

All our achievements are, of course, thanks to the efforts of our hard-working employees. Our workforce has grown to 2,125 and we also indirectly employ more than 1,000 others, making us one of the largest local employers and contributors to the economy in the South East.

We have invested in our employees too, with a major focus over the year on development of their skills and expansion of functions including engineering and design. This will continue over the coming years.

The Southern Water Board has approved the Strategic Report from page 15 to page 57 and I hope it provides a clear insight into what we have achieved and will continue to achieve for our customers. 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: The next five years

Business Plan

Our Business Plan for 2015 to 2020 sets out the improvements we will make to deliver better water and wastewater services to 4.6 million people across Kent, Sussex, Hampshire and the Isle of Wight

It is based on detailed discussions with more than 34,000 customers and stakeholders and includes 26 promises about what we will achieve for them. These promises represent clear performance commitments that centre on what our customers told us they wanted. They will result in a wide range of improvements over this five-year period while average bills will drop by eight per cent before inflation.

Our promises align to six customer priorities: responsive customer service, a constant supply of high-quality drinking water, removing wastewater effectively, looking after the environment, providing customers with better information and advice and affordable bills.

During the next five-year period, AMP6, we will be spending £3.2 billion on improving performance in these areas, supporting thousands of jobs and boosting the local economy.

We are confident that delivery of our Business Plan will ensure we are among the leaders in the industry for customer service, operational performance and efficiency.

To find out more, visit our website at www.southernwater.co.uk/businessplan

Responsive customer service



- Quick and effective resolution of your queries – 90 per cent resolved first time by 2020
- 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
- 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
- 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, for example because of a burst water main
- Aim for 100 per cent compliance with drinking water quality standards – at least maintain performance of 99.93 per cent then 99.95 per cent from 2017–18
- No increase in the number of households suffering from persistent low water pressure
- 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
- Significant reduction of 25 per cent in sewer flooding inside your homes and businesses by 2020
- No increase in the number of incidents of sewer flooding affecting outside areas
- Reduction of five per cent in complaints about smells from our wastewater treatment works and pumping stations by 2020



Looking after the environment

- No 'serious pollution incidents' affecting local rivers, streams and beaches caused by our operations by 2020
- Aim for 100 per cent compliance by our wastewater treatment works with required standards – at least maintain performance at 98.6 per cent (2014–15 target level)
- Increase by seven the number of beaches with 'excellent' bathing water quality by 2020
- Increase the proportion of renewable energy we use to 16.5 per cent by 2020
- Reduce the amount of water we take from the environment by 1.4 per cent, despite predicted population growth of four per cent



Better information and advice

- Ten 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 (2012–13) 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
- 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 2015–2020 to help keep bills as low as possible
- Ten 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 (2012–13) 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

*Note this promise contributes to both better information and advice and affordable bills

Our performance in AMP6 will also be measured against the delivery of 15 performance commitments specified by Ofwat

Water service

- Mains bursts – no more than 2,383 bursts per year
- No less than 99.82 per cent compliance on levels of turbidity (cloudiness), iron and manganese
- Coliform bacteria compliance, water supply works – no less than 99.92 per cent compliance
- Coliform bacteria compliance, water service reservoirs – no less than 99 per cent compliance
- No more than six sites per year breaching turbidity (cloudiness) limits
- Discoloration – no more than 0.86 customer reports per 1,000 properties, per year

Wastewater service

- Sewer collapses – no more than 368 collapses per year
- Wastewater treatment works compliance – no less than 99.9 per cent of population served by works meeting discharge consents
- External flooding (other causes, including blockages and collapses) – no more than 10,974 incidents a year
- A reduction of minor (Category 3) pollution incidents to 158 per year by 2017–18
- At least maintain the number of beaches with 'excellent' water quality, as defined by the Environment Agency, at 54 each year
- Return any money not spent on the delivery of our planned bathing waters scheme to customers

Specified schemes

- Thanet sewers scheme – an £80 million upgrade of the area's sewer network
- Woolston Wastewater Treatment Works – a £63 million redevelopment which will ensure treated wastewater meets stringent new Environment Agency standards
- Millbrook sludge scheme – an £11 million scheme to provide additional sludge treatment capacity at our Millbrook Wastewater Treatment Works

Getting ready

As part of our commitment to keep bills low for our customers, we are promising more than £200 million in efficiency savings by 2020. This represents a saving of £20 a year for each household we serve.

To do this, and keep the promises made in our Business Plan, we have invested heavily over the past 12 months to improve our capability, our tools and systems and to change the relationship with our supply chain partners to bring greater skills and capability back in house.

During the past year we consolidated 16 initiatives into a coherent change programme and put in place formal management and review structures to enable us to deliver the efficiencies and improvements required in the next five-year period.

We have

- Updated our frontline systems, for instance by providing field staff with new handheld devices which allow them to carry out administration on site and on the move
- Updated our billing and customer service system to enable customers to manage their accounts online
- Supported our workforce by improving our workspaces, updating the computer desktop and ensuring we have the necessary skills and tools to do the job
- Improved the resilience of our systems which provide real-time monitoring of our operational sites

This work will continue into AMP6 and there will be a major focus on realising the benefits from our investment in these business improvements.

A new delivery model and new partners have put us in a strong position as we move into the next five-year period.

Significant changes have included reinstating our in-house engineering force, creating a multi-disciplinary skilled team. We took on 40 new people during the year and this number will increase to 100 within the first year of AMP6, further strengthening the department's capability.

We have mobilised the Southern Water partnership that will be the 'delivery vehicle' for the majority of our planned capital investment. A successful procurement exercise resulted in the appointment of partners who share our vision and aspirations for the next five years and beyond.

MWH joined us as our 'strategic solutions partner' to support our in-house engineering team on planning and designing capital projects and helping define what we need to build. We also appointed three delivery partners, all joint ventures involving leading suppliers in the water industry.

- CMDP (MWH and Costain) will maintain and improve our water supply and wastewater treatment works in Kent and East Sussex
- GTM (Galliford Try and Imtech) will do the same in West Sussex, Hampshire and the Isle of Wight
- MGJV (Morrison Utility Services and Galliford Try joint venture) will expand and maintain our network of water mains and sewers

We also appointed three 'react and maintain' partners, Clancy Docwra, Cappagh Browne and BTU. They will be looking after the day-to-day repair and maintenance of our network of water mains and sewers and our water supply and wastewater treatment works.

Market reform

In May 2014, the Water Act 2014 became law, signalling significant change for water companies.

Its purpose is to reform the industry to 'make it more innovative and responsive to customers and to increase the resilience of water supplies to natural hazards such as drought and floods' and also to ensure a smooth transition to a competitive retail market.

The Act provides for the introduction of retail competition for water and sewerage services to non-household customers in England. The market will open in April 2017, allowing these customers to choose where they buy their water and sewerage services. Some 90,000 of our customers will be affected.

Water companies will have to separate their wholesale and retail businesses and new retailers will be able to enter the market. When the market opens, Southern Water will continue to operate and maintain the water and sewerage networks in the region.

We have an extensive market readiness programme under way, with full executive management engagement. This will deliver the business change required to meet the challenge of the new market while remaining focused on keeping our promises to customers.

Customers

Responsive customer service

Our performance

	2014–15		2013–14
	Target	Achieved	Achieved
SIM score*	81	78.7	75.2
Quantitative score	38	34.6	32.6
Qualitative score	43	44.1	42.6

* This measure is based on the methodology used last year for comparative purposes. The calculation method changed during 2014–15 and under this new method, our score for 2014–15 was 72.

We continued to improve our service to customers in 2014–15. However, we had set ourselves a more challenging target to enhance our standing in the Ofwat league tables for customer service and, despite our best endeavours, this was not achieved. Our SIM score of 78.7 represents a five per cent increase on the previous year but we did not hit the 81 we hoped to achieve.

SIM – the Service Incentive Mechanism – is the measure Ofwat uses to assess how well we serve our customers. It is made up of two elements – quantitative and qualitative. The former takes into account written complaints and phone calls.

In total during the year we received almost two million phone calls and 400,000 letters and emails from customers. The number of written complaints dropped by 13 per cent compared with the previous year and unwanted phone calls by 21 per cent. These are calls that are unwanted from the customer's point of view, for example about an event that has caused them frustration, and also repeat or chase calls.

The qualitative score is based on the results of surveys conducted four times a year on behalf of Ofwat. Each survey asks 200 customers who have contacted us with a query or complaint what they thought of our service. This year, our average score based on 'resolved' contacts was 4.53 out of 5.0, an improvement on last year's score of 4.41.

We operate a Guaranteed Standards Scheme (GSS) which guarantees the minimum standard of service customers should receive from us. If we fail to provide an appropriate service we compensate customers accordingly. The number of failures and the value of payments recorded under the GSS and our own voluntary Customer Charter in 2014–15 are shown below. We conducted specific research to find out what customers found most frustrating in terms of service failure and, as a result, some financial redress payments are being enhanced from April 2015.

	2014–15	2013–14
Statutory GSS – number of events	3,680	4,380
Statutory GSS – number of payments made	3,604	4,315
Statutory GSS – payments made £k	379	433
Company Customer Charter – number of payments made	107	77
Company Customer Charter – payments made £k	3	4

Customer improvements

We continued to work hard in 2014–15 to provide the high-quality, responsive customer service people told us they expected

We carried out a major review of every aspect of our work with customers and have made some key changes, including putting in place a new management team led by a newly appointed Chief Customer Officer

To date we have

- Invested in a £13 million upgrade of our billing system to make it more efficient and effective and allow customers to manage their accounts online
- Gathered the views of hundreds of customers to help shape our new online services which are due to go live in 2015. We have been testing the services with 100 of these customers prior to roll-out. Once live, they will allow people to do things such as check their balances, set up direct debits, submit meter readings and notify us of changes, for example new bank details
- Set up a dedicated phone line to manage customer complaints. Complaints dropped by 13 per cent in the past year, though we acknowledge we have more work to do to reduce this figure further

Our Live Chat initiative, which enables customers to discuss their queries online with a member of our dedicated team, had its first full year and has proved hugely popular. Numbers have grown dramatically – we had more than 30,000 chats during the year, with a record of over 4,500 in March following the expansion of the Live Chat team

We continued to use the Your Voice customer forum, which we set up more than a year ago, to seek views on our services and ask how we can improve. We have more than 100 customers from across our region involved in the forum and they have their say via focus groups, online questionnaires and email surveys. We ask them for their views on things such as the design of leaflets and other customer materials, their preferred method of contact and how often they like to be billed

Affordable bills

Helping customers who struggle to pay their water bills continued to be an important area for us. During the year we strengthened our focus on affordability, giving practical support and advice to those in difficulties. We achieved this through our debt assistance schemes and tariffs.

Overdue bills and bad debt are a significant issue for the water industry as they have an impact on every customer's bill. Our work in this area means we help those in need, reduce the burden of non-payment on other customers and manage our costs.

The schemes and tariffs are

- **NewStart** – when qualifying customers pay their current water charges, we clear the same amount from their arrears. We broadened the qualifying criteria and this more inclusive approach increased the overall number of customers that we are helping this way to 12,502.
- **WaterSure** – this provides financial help to metered households that use large amounts of water for essential purposes, for example certain medical conditions. We helped 8,582 customers through this tariff.
- **Water Direct** – this scheme, where payments are taken directly from customers' benefits, helped 10,835 people reduce their debt.

Social tariff

We also developed a new social tariff – the Essentials Tariff – for customers who have genuine financial difficulty paying their water bills. During 2014–15 we ran a small pilot scheme in partnership with the Citizens Advice Bureau, aimed at testing the design of the tariff, customer communications and customer acceptability. There was further customer research and consultation with the Consumer Council for Water in the last half of 2014 and, in January, Ofwat approved our proposals. We have already seen a 79 per cent payment sustainability rate, which is the measure of customers adhering to an agreed payment plan.

Under the Essentials Tariff, introduced from 1 April 2015, customers spending at least five per cent of their household income on water services charges are eligible for a reduction in bills ranging from 20 to 90 per cent. When coupled with our NewStart scheme, this gives our most financially vulnerable customers a way out of debt while ensuring they make a contribution for the cost of water services.

In addition, the Southern Water Charitable Trust Fund, a registered charity set up to help customers in financial hardship, awarded grants worth a total of £165,000 to 342 people this year.

Our Debt Advice Team answered 68,489 calls from customers seeking help and more than 55,000 people visited the advice pages on our website, an increase of some 3,000 on the previous 12 months.

We worked with The Samaritans to train and support our staff who talk to customers who are in difficult and sometimes emotional circumstances. Sussex and South Central Citizens Advice Bureau provided further expert training for us on how to ask customers sensitive questions about income and expenditure. We also worked with StepChange, a national debt charity, to help people struggling with wider debt than their water bills. We referred these customers to the charity for more assistance.

Metering support

We continued to support customers who had a water meter fitted as part of our pioneering five-year universal metering programme to reduce consumption and secure water resources for the future.

To date, an impressive 63 per cent of households that have changed to metered charges have benefited from lower bills, significantly more than predicted, and the average annual saving is £176, also more than predicted.

Customers whose bills rise after having a meter installed are offered our Changeover Tariff, which introduces the increase gradually over three years. More than 29,617 households have taken this up.

Those 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. In the past year, 350 people were assisted in this way, bringing the total to date to 3,191. We have now secured a total of more than £3 million in benefits and tax credits for our customers.

We always offer help to those in genuine financial difficulty through our Debt Advice Team and support tariffs. However, we sometimes share information about non-paying customers with credit reference agency Experian and the defaults we register can affect personal credit ratings. Registering defaults has encouraged more customers to pay their outstanding bills in full, resulting in the collection of almost £7 million since September 2012.

Working more efficiently

We are working more efficiently to achieve cost savings that will help us keep customers' bills as low as possible. For example, we

- Set up a specialist energy team in Operations to look at our top 30 energy-consuming wastewater sites – those that use the most chemicals and power – and consider how to optimise the way they were run. The resulting changes meant we saved £1.2 million during the year. They included installing timers on machinery that prevent it running continuously, thus saving energy, and using recycled chemicals in our treatment process. The team came up with 300 initiatives and will continue to monitor and review our sites for further efficiencies.
- Use large volumes of power and are trying to find ways to keep the costs as low as possible. Our energy team monitors the energy markets to find the best time to buy power at the lowest price. We have also investigated the types and costs of installing additional renewable energy capacity to find investments that quickly pay for themselves and keep energy bills lower. We are looking again at the feasibility of installing solar cells on our sites to provide power for site processes such as pumping.
- Also regulate energy costs by managing the times we use power and avoiding times of expensive tariffs. For example, we pump water at night when energy is cheaper and switch off non-critical plant when the power network raises the price of energy during peak winter demand.
- Are redesigning some of the processes that support the core business. We want to make them more effective and efficient and remove duplication. Some of these business services had become too complex. We have already launched pilot studies into streamlining data capture and the way we monitor our investments.
- Have improved the way we work with colleagues and partners by redeveloping the workspace in our Falmer office. The new environment aims to encourage collaboration and innovation and includes contemporary features such as space for stand-up meetings and walls that can be written on. There are break-out areas so teams can resolve queries efficiently as they arise instead of having to arrange a formal meeting.

Better information and advice

Our customers have told us they want better information and advice about what we do, how we are performing and how we spend their money

We promised a range of improvements to achieve this and during the year we made substantial progress

More than 11 million people visited our website and benefited from a variety of changes we carried out to make information easier to access

We updated the website to make it mobile friendly, recognising the fact more people use tablets and other mobile devices to look at it on the move. The display adjusts to suit the device, meaning it is easier to see and read

We integrated some of our microsites, including Learn to Swim, climate change and the Brighton sewer tours, into the main website, making it more streamlined and clearer. It is now easier to manage and, in the case of the latter, has saved money as we no longer have to run a separate server for it

We also redesigned our popular Waterwise plant guide, which helps customers create water-efficient gardens by picking the right plants for their soil and location

We expanded our social media team, which uses Twitter and Facebook to answer customer queries. We now have more than 3,500 followers on Twitter. The number of customers contacting us via social media has trebled in the past year

Water efficiency

Water efficiency continues to be a top priority for us and during the year we devised additional ways to save water, energy and money and provided information and advice to thousands of customers

As part of our metering programme, more than 14,000 customers had water and energy audits in their homes conducted by trained advisers called Green Doctors from the charity Groundwork. The Green Doctors fitted water-saving showerheads and tap aerators and gave customers simple tips to help them save money on their water and energy bills

In the western part of our region we began innovative work with Eastleigh Borough Council and the Environment Agency on a voluntary watermark to encourage the highest water-efficiency standards for new housing. The award of a watermark will ensure future occupants of these homes will have lower consumption and cheaper water and energy bills

We took the lead in promoting the European Water Label, which aims to label products such as showers, taps and toilets according to their water efficiency. Our water efficiency manager chairs the UK steering group, consisting of manufacturers, retailers, regulators and Government. In this role, he represents all the UK water companies as well as Southern Water. The group is expanding the label to include products such as garden hoses and pressure washers

During the year we worked with the Green Alliance on a landmark UK report on the importance of water efficiency in aiding lower bills for customers and helping to maintain a more resilient service. Our Chief Executive was among the high-profile speakers at the launch in February where they discussed the report's findings and recommendations, including better use of the water label

Pain in the drain

We reached thousands of customers with our award-winning Pain in the Drain campaign, which aims to prevent sewer blockages, flooding and pollution

This year we teamed up with Waitrose and Sainsbury's in our drive to stop people pouring fat, oil and grease down their drains which can lead to blockages in our sewers. The supermarkets gave out 20,000 fat traps and funnels to customers as they bought their Christmas turkeys.

We worked with Brighton and Hove Food Festival to raise awareness among hotels, restaurants and other hospitality businesses of the consequences of putting fat down the sink. As part of this, we took a group of chefs and hoteliers underground for a tour of the Victorian sewers in Brighton.

In addition, we gave away thousands more funnels and informative 'fat packs' to the public, many of them at our mobile Water Café events. The café takes to the road each spring and summer to visit community events where our staff talk about our services, water efficiency and Pain in the Drain.

We also introduced Bruce, our sewer monster, to reinforce the message in a fun way. The large orange stuffed toy was found in our sewers at Peacehaven and became a campaign mascot. He has his own Twitter account to spread important Pain in the Drain news.

Most sewer blockages are caused by items that should not be put down sinks or toilets such as wet wipes, nappies and cooking fat. During the first half of the year alone we cleared more than 6,000 tonnes of debris from our sewer network – the equivalent in weight of 2,000 hippos.

ConnectRight

We continued our partnership with other water companies and the Environment Agency on the ConnectRight campaign. The campaign highlights the risk of pollution when sewers are wrongly connected to the surface water network, which is designed to carry only clean rainwater directly to rivers and the sea.

ConnectRight has a website, www.connectright.org.uk, which gives customers guidance on how to check for misconnections. It carries information and advice on how to rectify problems and gives links to plumbers.

Services

A constant supply of high-quality drinking water

Water quality

	2014		2013
	Target	Achieved	Achieved
Overall drinking water quality index	99.97%	99.97%	99.94%
Disinfection control index	99.99%	99.98%	100%
Process control index	99.97%	99.94%	99.96%
Taste and odour sample pass rate	-	99.98%	99.81%

Our water quality performance in 2014 was our best for four years

We achieved an overall rating of 99.97 per cent, which is among the best levels of compliance in the industry. This is excellent news for our customers who expect a constant supply of the highest-quality water from their taps.

We carried out more than 222,000 tests of water quality to meet the requirements of the Drinking Water Inspectorate. In addition, we conducted another 216,000 tests to measure samples against our own standards, which are more stringent than those set by our regulator. Combined, this is more than 1,000 separate tests every day to ensure our customers' drinking water supply is wholesome.

Taste and odour

The number of samples that passed our stringent tests regarding taste and odour improved significantly this year following the investment in new treatment facilities at our water supply works in Hastings. Our scores rose from 99.81 per cent to 99.98 per cent.

We have other investments planned which will further protect the water we provide to our customers. These include:

- Additional treatment systems in Hastings to protect drinking water against pesticides
- New systems to remove nitrate from water sources in Sussex and Kent
- Working in partnership with others, including farmers, to try to reduce the level of pesticides and nitrates entering some of the rivers and aquifers from which we abstract

We achieved a near-perfect performance in the disinfection control index rating, a measure of the effectiveness of disinfection at our treatment works. Our 2014 rating of 99.98 per cent was marginally down on the previous year's 100 per cent success due to a few single detections of bacteria at some of our works.

Water supply

	2014–15		2013–14
	Target	Achieved	Achieved
Performance water non-infrastructure	Stable	Stable	Stable
Performance water infrastructure	Stable	Stable	Stable
Distribution maintenance index (2014 calendar year)	99.96%	99.96%	99.94%
Security of supply index (critical period)	100	100	100
Security of supply index (annual average)	100	100	100

It was another successful year during which we continued to drive down consumption. This allowed us to keep abstraction levels at a similar low to those of the early 1970s, despite the population increase over the past 40 years.

Our universal metering programme entered its final stages and continued to surpass the benefits we had anticipated. A major study by economists at Southampton University found the initial impact of our programme on consumption has been significant, with our customers using, on average, 16.5 per cent less water, vastly better than the national average of ten per cent. We are working hard to help customers sustain these savings.

We are the first company in the country to develop a universal metering programme to install water meters for almost 90 per cent of our customers as part of our long-term work to secure water resources for the future.

The number of meters fitted as part of the programme and in use reached 392,061 in the past year. The programme is due to be completed in 2015 and by then we expect more than 20 million litres of water to be saved each day thanks to customers being more water efficient. At the start of the programme in 2010–11, the average consumption was 154 litres per person, per day. By the end of 2014–15, it had dropped to 135 litres. This reduction of 19 litres per person, per day would be enough to fill 12 Olympic-sized swimming pools.

Thanks to our investment and strategic planning, water resources across our region remained in a healthy position with no restrictions in place and none expected.

In September, our Water Resources Management Plan was approved by Defra. The plan sets out how we intend to secure healthy, reliable drinking water supplies for homes and businesses from 2015 to 2040. It was developed using an innovative modelling technique to help us plan for the more severe droughts of the future and was the culmination of more than two years' engagement with customers and stakeholders.

Burst mains

We maintained a stable performance on burst mains, recording 1,770 which was consistent with our target of 1,901 bursts per year.

However, we put in a very strong performance regarding the average time customers were without water because of bursts – the figure this year was about six minutes. It was our best result in the five years of AMP5, significantly better than the AMP target of 18 minutes and well down on the 11 minutes we averaged in 2013–14.

During the year we completed our five-year water mains replacement programme, bringing the total to some 250 kilometres of new mains. This work brings significant long-term benefits to customers in terms of a reduction in the number of bursts.

We also maintained our good performance on low water pressure. We manage pressure in our network because if it is too high, it can cause burst mains and increase leakage. However, we have a duty to customers to maintain a certain pressure so they can use their appliances easily. Once again, we kept the number of

to maintain a certain pressure so they can use their appliances easily. Once again, we kept the number of households experiencing low water pressure down. During the year just 254 properties experienced low pressure.

Leakage

	2014–15		2013–14
	Target	Achieved	Achieved
Leakage (million litres of water per day)	88	82	85

We continued to lead the UK water sector on leakage control, achieving a level of 82 million litres of water per day and beating our target of 88 million litres.

Last year we had the lowest leakage level of any of the water and sewerage companies based on the percentage lost from total supply. Our performance was 24 per cent better than the average for these companies.

For the fourth year running, we beat the leakage levels set by Ofwat, even during the key winter period.

Our excellent performance was thanks to hard work by our leakage teams, who worked around the clock to find and repair leaks on our network of water mains, which exceeds 13,700km. We repaired some 21,500 leaks, more than 14,500 of which were found by the leakage teams.

The effort was supported by our new water meters which automatically detect leaks in customers' pipes. This year, leaks were found in 1,519 properties where meters were installed. In many cases, free repairs were carried out.

Removing wastewater effectively

	2014–15		2013–14
	Target	Achieved	Achieved
Performance wastewater infrastructure	Stable	Stable	Deteriorating
Internal flooding (number of properties)	235	283	389
Properties on flood register	276	252	363

Note - Serviceability performance for wastewater infrastructure in 2013–14 was self-assessed by the Board as stable and reported as such in our Annual Report for 2013–14. Ofwat, in its final determination, assessed performance as deteriorating, which is the view reflected in the table above.

Our multi-million pound investment in our wastewater assets proved its worth during the year.

Despite many parts of the region having high groundwater levels for the third year running, there was significantly less impact on our customers. High groundwater can affect service to customers if it infiltrates the sewer network, which is more likely during prolonged heavy rainfall. This year we had only two tankers and one pump in use to remove excess wastewater from sewers inundated with groundwater compared with 40 tankers in the winter of 2012–13 when levels were similar.

Our customers saw the benefits of our carefully targeted maintenance programme. We spent more than £40 million on our pumping stations, manholes and sewers and, as a result, there was a reduction of 27 per cent (106 properties) in flooding from sewers inside homes and businesses and in customers' gardens.

Flood protection

We used our experiences from the previous challenging winter to develop robust contingency plans to deal with groundwater flooding.

During the year we delivered the latest phase of our £12 million programme to survey and seal sewers across our region, preventing rising groundwater, river and surface water from forcing its way into our pipework.

Despite a wetter than usual winter, our investment in the sewer network meant that we only needed to overpump in one of the 60 towns and villages affected by groundwater flooding the previous year.

We became the first company in the UK to develop dedicated infiltration reduction plans for the areas worst affected by groundwater flooding. These plans set out the local strategies for effective management of groundwater infiltration of the sewers and what we are doing to reduce it.

In addition, we continued investment to improve the reliability and resilience of our wastewater network. Our work included the refurbishment of 142 pumping stations and renovation or replacement of sewers, notably a £15 million project to reline chalk tunnels in Ramsgate.

We continued to work in partnership with the Environment Agency and local authorities in our area to protect homes and businesses from flooding. Though we are not a flood relief agency, we believe this multi-agency approach is the best way to solve flooding problems in the worst-hit areas. We worked with all the lead flood authorities in our region and contributed to these strategies.

Investment also continued in long-term initiatives to mitigate sewer flooding, including a £20 million flood alleviation scheme in Portsmouth to divert rainwater away from some of the city's sewers.

A significant amount of rainwater – more than 6,000 litres per second – which would normally go into the existing sewers is now diverted straight to the sea through surface water outfalls, easing the pressure on the sewers during storms and greatly reducing the risk of sewer flooding

This scheme was part of wider investment in our wastewater assets in Portsmouth where, to date, we have spent more than £70 million to improve the resilience of the network and reduce the risk of sewer flooding for our customers

Across our region, we were able to remove 111 properties from the At Risk Flood Register. This represents a reduction of 31 per cent in the number of properties on the register at the start of the year.

Ground-breaking mobile biological treatment tanks we developed to minimise the impact of the wettest winter on record won top honours at the Institute of Water regional innovation awards.

We designed the innovative tanks, a UK first, to treat wastewater pumped out of flooded sewers to a much higher quality than could previously be achieved on site, keeping environmental impact to a minimum. The tanks mean much higher volumes of wastewater can be removed from overloaded sewers – 20 litres per second compared with two litres a second by tanker.

Preventing smells

Tackling smells is always a priority for us and long-term prevention work continues to pay off.

We received fewer complaints about smells during the year, 359 compared with 472 in 2013. This continues a long-term trend in which complaints about smells have dropped by more than half in the past ten years. We have made a commitment in our Business Plan to reduce the figure by a further five per cent in the next five years.

During this five-year period, we completed four large schemes to significantly reduce smells from our Aylesford, Goddards Green, Paddock Wood and Peel Common wastewater treatment works, a total investment of some £10 million. The schemes reduced the number of complaints about these works dramatically – in Aylesford's case to nil.

We worked hard to prevent smells from all our 365 wastewater treatment works and 2,375 pumping stations and during 2014–15 we spent in excess of £500,000 on planned and reactive maintenance to keep complaints as low as possible.

When we needed to carry out essential maintenance at sites close to properties, we wrote to residents to warn them about the possibility of smells for short periods. In all cases we react to complaints as quickly as possible.

Environment

Looking after the environment

Our relationship with the environment is a vital element of our business. Ensuring we act in a responsible, sustainable way is an essential part of how we work.

Bathing water quality

In 2014, every beach in our region once again met European standards for bathing water quality. All 83 bathing waters achieved the European 'mandatory' standard during weekly sampling carried out by the Environment Agency between May and September. Eighty per cent also passed the 'guideline' standard, which is 20 times tighter.

This was the last year bathing waters will be assessed against the standards detailed in the original 1975 Bathing Water Directive. A revised Bathing Water Directive came fully into force on 24 March 2015 which sets out more stringent standards and the 2015 bathing season will be the first where compliance is assessed against these. The new classifications are excellent, good, sufficient or poor. Our customers have told us high-quality bathing water is extremely important to them and we have promised a 15 per cent increase in the number of beaches with 'excellent' bathing water quality by 2020.

Bathing waters around the UK initially predicted to be at risk of non-compliance with the new, tighter standards include Hastings and we have been working in partnership with the Environment Agency, Hastings Borough Council and other stakeholders to improve the water quality there. A significant programme of work is in progress to ensure our infrastructure does not compromise bathing water quality at Hastings in the forthcoming bathing season. We have spent £3 million on this, part of some £10 million worth of investment in Hastings to address issues with the sewerage system and identify misconnections.

During 2014, we continued to take part in a voluntary trial to alert local authority beach managers when we release storm water from combined sewer overflows (CSOs) during heavy rain. CSOs are sometimes needed because the water would 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 the new Bathing Water Directive and its higher quality standards.

The quality of bathing water can be affected by factors outside our control such as pollution in water running off roads and land or sewers wrongly connected to drains carrying rainwater. However, our environmental improvement programmes, including efforts to meet tighter discharge standards at our wastewater treatment works, continue to benefit the water along our coastline.

Preventing pollution

	2014		2013
	Target	Achieved	Achieved
All pollution incidents (wastewater), Category 1-3	267	292	320
Serious pollution incidents (wastewater), Category 1-2	7	12	9
Environmental Discharge permit compliance	98.6%	99.0%	95.9%

We have seen another strong improvement in pollution performance, with the number of incidents falling to 292 from 320 in 2013. Of these, 12 were serious.

Pollutions are monitored on a calendar year basis. One third of our pollution incidents in 2014 happened in the first three months of the year because of the severe weather – it was the wettest winter on record with rainfall in southern England more than 200 per cent above the long-term average.

In spite of these extreme conditions, we recorded 292 wastewater pollution incidents, missing our target of 267 but still 28 lower than the previous year. This was thanks to continued efforts by our Operations teams in improving the sewerage network and, in particular, our pumping stations.

Pollution incidents for the first three months of 2015 were nearly 60 per cent fewer than a year previously, reflecting both the level of improvement in the business and the more benign weather.

Wastewater treatment

	2014–15		2013–14
	Target	Achieved	Achieved
Performance wastewater non-infrastructure	Stable	Stable	Deteriorating

Note - Serviceability performance for wastewater non-infrastructure in 2013–14 was self-assessed by the Board as stable and reported as such in our Annual Report for 2013–14. Ofwat, in its final determination, assessed performance as deteriorating, which is the view reflected in the table above.

We began the year still feeling the effects of the 2013–14 winter's unprecedented torrential rain and storms yet, despite this, our wastewater compliance performance was strong. We recorded our best performance for 15 years with only one wastewater treatment works not meeting the requirements – Lidsey in Sussex. This beat our target of four and was the result of focused operations and continued targeted investment. Due to insufficient samples being taken, we also had two other 'technical' fails, at Sittingbourne and Eastchurch, both in Kent. Even so we still achieved 99 per cent compliance with standards, our best performance for a number of years and better than the industry average.

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. To this end, we spent more than £41 million to improve wastewater treatment and more than £38 million on maintenance.

Several major schemes contributed to our best results since 1999:

- During the year, our £13 million revamp of Ashford Wastewater Treatment Works in Kent was officially opened by the town's MP. In a two-year scheme we expanded the works, upgraded filter beds and installed new treatment tanks and screens.
- We also completed a £25 million improvement of Millbrook Wastewater Treatment Works in Southampton, one of our largest schemes in the 2010 to 2015 investment period. A new treatment tank, settlement tanks and nearly a mile of pipeline are bringing major environmental benefits and helping protect the water quality of the Solent.
- In September 2014, we began work on a £63 million redevelopment of Woolston Wastewater Treatment Works, also in Southampton. This scheme will ensure treated wastewater leaving the site meets stringent new standards set by the Environment Agency.
- We continued our improvements at East Worthing Wastewater Treatment Works where we are spending almost £20 million. In January, we installed a £200,000, ten-tonne storm pump which is capable of pumping 2,500 litres of water every second and will be used to protect homes and businesses from flooding during storms.

During the wastewater process, sludge is produced. This is solid matter which is treated and usually recycled to the environment – we work with farmers who use it as a source of fertiliser. We produce about 240,000 tonnes annually and sometimes it is necessary to send it to landfill, which is costly and means we lose the nutrient benefit of sludge applied to land.

Last year we sent 808 tonnes of sludge to landfill. This year, for the first time, we did not need to dispose of any in this way.

Our success in reducing this to zero in 2014–15 was thanks to improved reliability of our sludge treatment centres and the operational performance by our contractor MTS.

We had similar success with grit and screenings, which is the debris removed from wastewater. Investment in a new composting plant to treat our grit and screening waste allowed all of it to be recycled to reclamation sites rather than sent to landfill.

Water abstraction

We beat our already strong performance in water abstraction, taking even less water from the environment to supply our customers than we did in the previous year.

We abstracted 206,829 million litres in 2014–15, most of it from underground aquifers and the rest from rivers and reservoirs. This figure is 3,009 million litres less than in 2013–14, which was already the lowest since the water industry was privatised in 1989.

This record low is thanks to customers using less water as a result of our metering and water-efficiency programmes and to our continued efforts to keep leakage below our target.

Conservation

Caring for the environment is important to us and to our customers, who told us it was one of their top priorities. Our efforts to protect the environment were recognised this year when we once again achieved ISO 14001.

This internationally recognised standard for effective environmental management lasts three years. We have held it since 2008 and, in May 2014, we underwent a full recertification audit with inspectors visiting seven sites over six days to check our performance in environmental matters such as managing waste, avoiding pollution and maintaining effluent quality.

Sites of Special Scientific Interest

As a large landowner in the South East, we own ten Sites of Special Scientific Interest (SSSIs) of about one hectare or more plus many smaller sites.

We have been compiling conservation management plans for the ten bigger sites with the aim of winning a 'favourable condition' rating for them from Natural England. This demonstrates they are being adequately conserved and is the highest rating for an SSSI. One of them, Southampton Common, has already been approved.

Some of the sites offer protection to rare plants and animals, have a unique geology or are important wildlife habitats.

Biodiversity

We have been tackling invasive plant species such as Himalayan balsam at sites across our region. We needed to stop these weeds affecting the variety of plant and animals found there and keep them from spreading to neighbouring land. This was the first year of an initial three-year eradication and control programme at 17 important sites including Brede Water Supply Works, Powdermill Reservoir, Ashford Water Treatment Works and Bewl Water.

We also

- Continued to manage Groombridge Lagoons where we have important populations of rare animals, protected species such as great crested newts, grass snakes and adders and a healthy colony of frogs and toads
- Completed surveys of Ringmer Lagoons and found significant numbers of great crested newts and grass snakes and confirmed the presence of water shrew, a protected mammal
- Confirmed for the first time the presence of the rare and protected hazel dormouse at Brede Lagoons

Confirmation of these species at these three East Sussex sites was important for conservation plans that will protect and enhance important wildlife habitats on our land

We have also continued orchid conservation at many of our sites and adopted sympathetic management practices to protect the flower

Many of our staff volunteering days this year were spent helping conservation projects, including clearing Himalayan balsam from the RSPB's Pulborough Brooks nature reserve in West Sussex. Others involved cleaning beaches in Southampton, Brighton, Worthing and Margate and helping with gardening projects, for example at Chestnut Tree House children's hospice near Arundel

Climate change

Carbon performance

	2014–15		2013–14	
	Target	Achieved	Target	Achieved (restated)
Greenhouse gas emissions – ktCO ₂ e	386	281	377	293
KgCO ₂ e per person supplied with treated water	-	28.6	-	28.6
KgCO ₂ e per person supplied with wastewater services	-	41	-	44

Note - The prior year figures have been restated to reflect annual changes in carbon reporting and emission factors

We are proud of our continued excellent work to measure, manage and improve our carbon efficiency. We are a Carbon Trust Standard accredited company, which is recognition of our excellence in monitoring and managing our carbon emissions.

Our drive to be more efficient in the production and use of power helped us achieve a reduction in greenhouse gases from our operations.

During the year we produced carbon dioxide and other greenhouse gases equivalent to 281 kilotonnes of carbon dioxide. These emissions result from our consumption of grid electricity and natural gas, our transport and from our wastewater and sludge treatment processes. There was a reduction of four per cent on 2013–14 reflecting our increased generation and use of biogas for renewable energy.

This success was also helped by the better weather. We did not experience the heavy rainfall and flooding of the previous year which had an impact on power consumption from pumping and treating high levels of storm water.

We worked hard in 2014–15 to develop the most economic way to reduce carbon emissions during the coming five-year period. This included studying asset efficiency and prioritising those assets that need to be refurbished or replaced.

We also focused on renewable energy generation. Increased capacity for generating renewable energy has contributed to emitting lower levels of greenhouse gases. Our renewable energy represents more than 15 per cent of the volume of power we consume and it is a customer promise to maintain this during 2015–20, despite requirements for enhanced treatment standards which use more energy. We also considered new renewable energy opportunities such as solar and wind energy and how we will use these in the coming five years.

Low carbon design

Our in-house engineering team is challenged with reducing the use of materials that produce high levels of greenhouse gases when they are manufactured. This can be achieved by using innovative design and it means we are responsibly addressing greenhouse gas emissions for the whole life of our engineering assets.

Managing energy costs

We use large volumes of power and our specialist energy team ensures we buy it at the best value by monitoring the energy markets. It also seeks new cost-effective ways to buy and generate power.

Our energy team monitors power performance at all our sites to ensure efficiency and meet performance targets. We are investigating methods of achieving greater insight into energy performance, for example sub-

metering, which is monitoring consumption of individual pieces of equipment, energy auditing, energy modelling and analysis dashboards. These tools will allow our operational teams to become increasingly energy efficient.

About us

Our workplace

Health and safety

We continued to lead the industry with our excellent health and safety performance and achieved one of the lowest numbers of reportable injuries in our history

Our total of 0.24 reportable injuries per 100 full-time employees/contractors beat our target of 0.35 and was the result of commitment and focus on safety. Our employee-only total was 0.19, beating the industry average (based on available data) of 0.31.

For the 16th consecutive year, we achieved the Royal Society for the Prevention of Accidents gold award and were again presented with an Order of Distinction, the first water company to receive such an accolade twice.

Our Aim For Zero Injuries campaign played a vital part in our exemplary performance. Its initiatives included a two-day health and safety conference for more than 500 staff and contractors, which is now an annual event.

We continued our campaign to encourage staff to report hazards at work, donating £2 to charity for each one. This added up to more than £6,000 for the Air Ambulance Trusts in our region.

This year we increased the focus on health and wellbeing. We worked closely with our contractors and together produced our first Wellbeing Promise, which states clear joint aims for staff wellbeing.

During the year we

- Surveyed our staff to establish their key concerns. We had more than 700 responses and based our programme on the results, focusing on healthy eating and weight loss, stress and fitness.
- Ran two wellbeing weeks attended by hundreds of staff and contractors. One was run by the British Heart Foundation and raised awareness of health issues, the other offered practical advice on finding help locally.
- Toured our sites with mobile health monitoring kiosks which allowed all staff to measure information such as their BMI and blood pressure.
- Had more than 2,000 staff and supply chain partners take part in our pedometer challenge to see how many steps they were taking each week.
- Worked with the Amateur Swimming Association to promote swimming among adults, complementing our long-running Learn to Swim programme for children.

Our people

We directly employed 2,125 people in Kent, Sussex, Hampshire and the Isle of Wight as of 31 March 2015 and many more through our suppliers. This included more than 400 in our UK-based contact centres.

We actively promote diversity among our workforce and are pleased that during the year the number of women on our Board and Executive Management Team increased significantly. We now have three women directors on the ten-strong EMT. Also, nearly 40 per cent of our business lead roles are now filled by women, which is above the national average of 33 per cent.

People development

We are committed to expanding and building on our workforce's skills and experience and this year we continued to implement our Leadership Development Roadmap, an initiative to develop talented employees. In addition, 34 first-line managers completed the Leaders For Tomorrow scheme and 27 middle managers completed the Inspired Leader Programme. We also introduced an induction programme specifically for new managers.

Sixty-four people took part in our Employee Development Programme, a five-day residential course which allows some of our most talented employees to put forward their business ideas. This year, four of the suggested projects were sponsored by the Executive Management Team and pursued.

In our Operations team, eight apprentices graduated from our award-winning water and wastewater operations, mechanical, electrical and ICA (instrumentation control and automation) apprenticeships programme. In addition, we continued to increase the knowledge of our operators in wastewater processes and 43 of them completed an NVQ Level 2 in wastewater operations.

We also delivered our Ambassador Programme to Operations staff – 153 employees attended during the year. This scheme provides training in customer service skills and continues to contribute significantly to our customer service improvements in Operations.

Our initiative to improve processes across the business resulted in a further 28 people enrolling in the Business Improvement Techniques NVQ, which is recognised as best practice in the UK.

We continued our commitment to develop employees' potential during the year, with four talent pools initiated and sponsored by the Executive Management Team. We held a Skills Journey workshop with 78 employees to identify their development needs to further their careers. This culminated in a personal development plan for each of them.

Working with a leading training provider, we developed a new Level 4 qualification in water and wastewater management. This is now being used across the industry. Five of our operational graduates are more than halfway through the 18-month diploma course, which has been incorporated into our Graduate Development programme. We are working with the provider and universities to develop a Level 5 qualification, which is degree level.

We also had coaching, mentoring and secondments along with speaking opportunities at industry conferences including the Institute of Water's summer school.

Employee engagement

During the year we continued to focus on improving employee engagement and becoming an employer of choice. We want to make Southern Water a better place to work and aim to achieve 'Ones to watch' status in The Sunday Times' 100 Best Companies to Work For annual survey.

We had an excellent response rate to our own annual engagement survey this year with 77 per cent of the workforce having their say, up five per cent on the previous year. The results were largely positive. Our biggest directorate, Operations, showed a significant increase in its overall engagement score and its members provided more than 1,000 written comments that described why they considered Southern Water a good place to work.

In response to feedback from the engagement survey we introduced a development process for managers focusing on how they motivate, care for, consider and converse with their teams.

Once again we held our Staff Thanks And Recognition (STAR) awards and received more than 300 nominations for 15 honours. Staff are nominated by their colleagues and the award categories align with the company's principles: customers first, everyone matters, always improving, local pride, taking ownership and succeeding together.

Our suppliers

This has been an important year during which we put in place major changes in the way we work with our suppliers

Led by our new Procurement Director, we focused on establishing our supply chain for the next five-year period. The new appointment emphasised the important role our supply chain plays in delivering our commitments.

Our aim was to become true partners with our contractors and work collaboratively with them rather than them simply providing us with a service. The procurement team changed the way it works so it looks at managing the whole contract from its inception to its end.

This fresh approach means we have a much closer relationship with our supply chain and they work with us rather than for us.

We approach the next five-year period with confidence that together we will provide excellent services for our customers and maintain our outstanding health and safety record.

Our community

Community and education

We pride ourselves on being rooted in and contributing to the communities where our customers live and work and we do so through a variety of initiatives

Our efforts in the past year were recognised by the Business In The Community charity, which uses a detailed survey to measure companies on their contributions in the community, workplace and marketplace. We scored an outstanding 98 per cent, surpassing our target of 90 per cent and, along with one other company, beating all the other utilities that took part. We also beat most of the big household names including Marks & Spencer.

Learn to Swim

Our region includes 700 miles of coastline so helping children learn to swim is important to us. Our award-winning Learn to Swim programme has been running for 23 years and in the past 12 months it helped another 25,000 youngsters secure this life-saving skill. Former Olympic gold medallist Duncan Goodhew continued as a scheme ambassador and in February he joined TV doctor Hilary Jones at our annual instructors' seminar where they spoke about the benefits of swimming for health and wellbeing.

Learn to Swim now operates at 85 pools and clubs across the South East and seven of our staff volunteer as co-ordinators. They helped host our two annual achiever of the year events where nearly 50 youngsters were honoured for their success and efforts in the pool.

South and South East in Bloom

Once again we sponsored the annual South and South East in Bloom competition and it was a record year with 400 entries from across our region, including 131 in the Blooming Schools section.

Our awards ceremony at Brighton and Hove Albion's American Express Stadium was hosted by celebrity gardeners Jim Buttress and Chris Collins. Our winners included public parks, a nature reserve and a memorial garden. Winners were judged on their horticulture and gardening, environmental responsibility and community participation.

Education programmes

We are committed to educating youngsters about how to use water wisely and our mime show The Drops continued to spread the word in an entertaining way. It visited 29 schools and reached more than 4,400 children, with additional messages this year around flushing only the three Ps – pee, poo and paper. More than 350 youngsters attended a special performance at Brighton's Theatre Royal in July.

In addition we

- Devised a 45-minute interactive presentation called Sewerwise about the history of the sewerage and wastewater systems which complements our established Waterwise talks about water efficiency. During the year our team of volunteer community speakers gave nearly 100 talks to more than 4,600 children and adults.
- Worked in partnership with Hampshire Wildlife Trust, which manages our Testwood Lakes reserve in Hampshire. We donated interactive education materials so it could include water efficiency and wastewater messages to visiting school groups.
- Continued our Aqua Innovation competition which encourages secondary school pupils to come up with water-saving ideas and campaigns. Ten schools from Kent, Sussex and Hampshire took part and 2014–15's winner was The St Leonards Academy in East Sussex.
- Supported the STEM ambassadors' programme. Our staff volunteered to go into schools to help engage pupils in science, technology, engineering and maths. We helped run ten STEM days for 400 pupils across Sussex and Kent. Students worked with our team to devise a method of separating non-disposable materials from liquid – reflecting our Pain in the Drain initiative.

Community campaigns

Other community campaigns 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 children in Medway primary schools with basic literacy and number skills while putting over our key messages in fun, accessible ways. We linked up with Kent Cricket Club to deliver Pain in the Drain messages to schools and with Portsmouth FC and Sussex County Cricket Club to run water-efficiency and Sewerwise workshops for students.

Our Water Café hit the road during the summer, visiting 22 community events where we spoke to more than 12,000 people about water and wastewater. We gave away advice literature and water-saving devices such as save-a-flush bags, shower timers and fat traps and funnels for used cooking fat and oil.

Charity support

We continued our long-standing tradition of giving back to communities in our area through charity work and fundraising. A record number of staff volunteering days and a focus on the centenary of the outbreak of the First World War made it a memorable year during which we distributed a quarter of a million pounds to good causes.

Our staff picked the organisations to benefit and they included national charities such as WaterAid and Macmillan Cancer Support. They also chose regional charities such as Chestnut Tree House children's hospice in West Sussex, The Rainbow Centre in Hampshire for children with cerebral palsy, Air Ambulance Trusts in Kent, Sussex, Hampshire and the Isle of Wight and Chailey Heritage School in Sussex for youngsters with complex needs.

Annual events

The three biggest charity events of the year were our annual ball, golf day and race day. The 'winter wonderland' ball raised £71,000 for WaterAid, Macmillan and the Air Ambulance while our golf day brought in another £10,500 for WaterAid. Our military-themed race day at Fontwell in West Sussex raised £54,000 for the Queen Alexandra Hospital Home in Worthing, which cares for disabled ex-servicemen and women. It was the region's biggest event marking 100 years since the Great War broke out and guests included past and present members of the Armed Forces.

Staff took part in all kinds of other fundraisers including a sponsored bike ride across the South Downs, Santa Suit Day and the WaterAid 200 Mountain Challenge. In total, we helped raise more than £100,000 for WaterAid during the year.

For the second year running, each of our directorates chose its own charity to support and the company matched the first £1,000 they raised. The result was more than £15,000 donated to causes including the Teenage Cancer Trust, The Royal Marsden, Heart of Kent Hospice, The Martlets Hospice in Hove, Mane Cure and Ferring Country Centre in West Sussex, which offers training and work experience for people with learning difficulties.

We also made smaller donations totalling £12,000 through our Community Chest programme. The money went to schools, residents' groups and other organisations for projects related to aspects of our business, for example water efficiency.

Volunteering

Our staff are allowed two days' paid leave every year to work for causes close to their hearts. The past 12 months were a record breaker with more than 600 days spent helping worthy projects ranging from cleaning a woodland garden for disabled children to picking up litter. Some staff used their days for raising funds through sponsored activities such as skydives and cycle rides. We set another record when 54 members of one team – our largest group to date – gave a day's labour to a country centre which works with adults with learning disabilities.

Access and recreation

Our region includes many beaches, reservoirs and important natural habitats, many of which attract thousands of visitors.

We own four reservoirs – Darwell, Powdermill and Weir Wood in East Sussex and Bewl Water on the Kent/Sussex boundary – and they all offer outdoor activities such as fishing and sailing. Bewl is the biggest stretch of open water in the South East and our largest reservoir. Each year it attracts an estimated 98,000 visitors who take part in windsurfing, sailing, fishing, cycling, walking and boat trips.

We have a long-standing partnership with the Hampshire and Isle of Wight Wildlife Trust which manages our Testwood Lakes site, near Southampton, on our behalf. It was previously used for extracting gravel but is now a 130-acre nature reserve. This year the trust has been building a small-scale wetland complex there for insects such as dragonflies and damselflies. The area is also important for birds, including wildfowl and waders.

Testwood Lakes has a purpose-built education centre and more than 3,800 children, many of them on school visits, benefited from environmental activities there during 2014–15. These include Bronze Age recreation days, which use the wealth of archaeological finds and social history stories from the area to immerse the children in day-to-day life 3,500 years ago. The education team has also been promoting forest school activities at the site. These lessons are based on a Scandinavian approach to outdoor teaching and allow youngsters to develop their own way of completing tasks.

Other visitor attractions in our region include the historic steam pumping engines at our water treatment works in Brede, East Sussex, which are cared for and displayed by Brede Steam Engine Society.

Sewer tours

Our tours of the Victorian sewer network in Brighton remained highly popular and during the year we accompanied more than 1,600 visitors underground. Guests included the Orchestra of the Age of Enlightenment, who took their baroque instruments with them, and music hall singer-turned-rapper Ida Barr. We used the tours to give out information and advice about our Pain in the Drain campaign. The sewers were also the setting for a filmed appearance by our singing sewer men performing their latest Christmas carol, which reinforced the campaign message.

Financial performance

Financial performance

Accounting policies

The accounting policies of the company, which are consistent with the prior year, are set out on pages 93 to 97

Profit and loss account

Our profit and loss account is summarised in Table 1 below

Table 1	Years ended 31 March		Change
	2015 £m	2014 £m	%
Turnover	828.6	806.2	2.8
Operating costs before exceptional items	(245.5)	(246.5)	(0.4)
Depreciation, net of amortisation	(257.4)	(234.9)	9.6
Other income	0.2	0.2	-
Operating profit before exceptional items	325.9	325.0	0.3
Exceptional item	2.4	(18.8)	-
Operating profit	328.3	306.2	7.2
Profit on disposal of fixed assets	1.3	0.5	160.0
Net interest	(125.7)	(167.2)	(24.8)
Profit before tax	203.9	139.5	46.2
Tax	(36.7)	30.3	-
Profit after tax	167.2	169.8	(1.5)

Turnover increased by 2.8 per cent to £828.6 million (2013–14 £806.2 million) principally because of the average tariff increase on metered and unmetered income of 2.5 per cent. This increase was applied from 1 April 2014 and was based on the annual RPI of 2.6 per cent at November 2013 offset by a negative K factor (price limit) of 0.1 per cent.

Operating costs before exceptional items decreased by 0.4 per cent to £245.5 million (2013–14 £246.5 million) and the major reasons for this movement of £0.9 million are described below and in Table 2.

Following the completion of our £300 million scheme at Peacehaven, operating costs are now being incurred. These amounted to £3.3 million in 2014–15 (2013–14 £1.6 million), the increase over the prior year reflecting the fact that this was the first full year of operation of the site.

Overall efficiencies totalling £11.4 million have been achieved through business process reviews, contract renegotiations and a focus on maintaining tight budgetary controls. These include initiatives to reduce power consumption and increase our energy generation through the use of Combined Heat and Power (CHP) plants at our treatment works. Reducing the amount of chemicals we use and reducing the work issued to external contractors through more efficient use of our own internal resources.

Table 2 Increase/(decrease) in operating costs	£m
Inflation	5.9
Increased bad debt charge (including inflation £0.6m)	2.2
Peacehaven – operating costs of new site	1.7
Power efficiencies	(0.7)
Contract renegotiations	(1.9)
Process improvements	(8.8)
Other	0.7
Movement in operating costs	(0.9)

Depreciation increased by 9.6 per cent to £257.4 million (2013–14 £234.9 million) as a result of the continuing significant capital investment programme. This included the first full year of depreciation on our new wastewater treatment works at Peacehaven, which increased the annual charge for this scheme by £5.4 million. As we reached the end of our five-year capital investment programme a large number of schemes were commissioned during the year, adding a further £14.8 million to the depreciation charge. In addition, there was an increase in the infrastructure renewal charge of £1.9 million, reflecting the greater level of capital expenditure on private sewers.

Operating profit before exceptional items for 2014–15 increased to £325.9 million (2013–14 £325.0 million), a 0.3 per cent improvement as a result of the factors set out above.

During the period from December 2013 to February 2014, 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. As a result of this exceptional weather, significant additional costs were incurred during 2013–14 for pumping and tankering to alleviate the flooding and to ensure we continued to serve our customers. These costs were reported in the accounts for 2013–14 as an exceptional item of £18.8 million. During 2014–15 we received insurance proceeds totalling £2.4 million in relation to this event and these are recorded as an exceptional item in the results for this year.

The operating profit for 2014–15 increased to £328.3 million (2013–14 £306.2 million), reflecting the impact of the exceptional costs on our results from last year.

The profit on disposal of fixed assets of £1.3 million (2013–14 £0.5 million) mainly relates to the sale of land and buildings surplus to operational requirements.

Net interest payable of £125.7 million decreased by 24.8 per cent (2013–14 £167.2 million). This is largely driven by lower indexation on the inflation-linked bonds as a result of lower RPI in 2014–15, which accounted for £23.6 million of the reduction and lower net interest payable of £16.3 million following the repayment of a £250 million bond at March 2014.

We have recognised a total tax charge to the profit and loss account of £36.7 million (2013–14 £30.3 million credit). This differs from the charge that may be expected of £42.8 million, based on the profit before tax of £203.9 million and the current period tax rate of 21 per cent, as described in note 8, and is primarily the result of the company paying for tax losses of other group companies at the reduced rate of ten pence in the pound. The current tax charge for the period is also reduced by £25.2 million largely as a result of capital allowances arising from our capital investment programme.

The profit after taxation for the year amounted to £167.2 million (2013–14 £169.8 million).

Cash flow statement

Our cash flow statement is summarised in Table 3 below

Table 3	Years ended 31 March	
	2015 £m	2014 £m
Net cash inflow from operating activities	544.4	543.3
Net cash outflow from returns on investment and servicing of finance	(81.8)	(90.4)
Taxation	(36.9)	(22.9)
<i>Capital expenditure and financial investment</i>		
Purchase of tangible fixed assets	(348.6)	(382.0)
Receipt of grants and contributions	12.3	9.9
Sale of tangible assets	0.3	0.3
Movement on loan to subsidiary	(1.7)	(15.9)
Net cash outflow for capital expenditure and financial investment	(337.7)	(387.7)
Equity dividends paid	(44.9)	(43.8)
Net cash inflow/(outflow) before financing	43.1	(1.5)
Net cash outflow from financing	(5.1)	(2.9)
Increase/(decrease) in net cash	38.0	(4.4)

Net cash inflow from operating activities is broadly in line with last year, increasing marginally to £544.4 million for 2014–15 from £543.3 million in 2013–14. The impact of the improvement in operating performance in 2014–15 is masked by the timing of payments associated with the exceptional weather experienced at the end of the last financial year, a one-off benefit in 2013–14 arising from a change in payment terms for maintenance contracts and a reduction in the level of unmeasured receipts in advance as we have switched more customers to a metered supply.

The net cash outflow from returns on investment and servicing of finance decreased to £81.8 million for 2014–15 from £90.4 million in 2013–14. This decrease results from a reduction of net interest payable following the repayment of a £250.0 million bond in March 2014 offset by 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 £36.9 million were made during 2014–15 (2013–14 £22.9 million). These relate to payments for group relief for taxable losses across the Greensands group. Of this, a payment of £12.0 million (2013–14 £13.1 million) was made to Southern Water Services Group (SWSG). This, together with the interim dividend of £44.9 million (2013–14 £43.8 million), is offset by interest received from SWSG of £56.9 million (2013–14 £56.9 million).

The outflow of cash relating to the purchase of tangible fixed assets was £348.6 million (2013–14 £382.0 million). The decrease in cash outflow results from the decrease in the overall capital programme during the year as we came to the end of our five-year programme.

Overall these resulted in a net cash inflow before financing in 2014–15 of £43.1 million (2013–14 outflow £1.5 million).

The net cash outflow from financing of £5.1 million (2013–14 £2.9 million) relates to the repayment of accrued indexation on some of our bonds.

Balance sheet

Our balance sheet is summarised in Table 4 below.

Table 4	Years ended 31 March	
	2015 £m	2014 £m
<i>Fixed assets</i>		
Tangible assets	4,483.0	4,432.0
Investments	29.2	29.2
	4,512.2	4,461.2
<i>Current assets</i>		
Stocks	2.2	2.0
Debtors falling due within one year	216.8	198.0
Debtors falling due after more than one year	812.3	812.3
Cash at bank and in hand	173.5	135.5
	1,204.8	1,147.8
Creditors falling due in one year	(246.5)	(300.6)
Net current assets	958.3	847.2
Creditors falling due after one year	(3,872.7)	(3,836.4)
Provisions for liabilities and charges	(337.3)	(314.7)
Grants and contributions	(41.4)	(43.8)
Pension deficit	(89.9)	(72.3)
Net assets	1,129.2	1,041.2
Capital and reserves	1,129.2	1,041.2

At the end of the year to 31 March 2015, we had fixed assets of £4,512.2 million (2013–14 £4,461.2 million), an increase of £51.0 million from March 2014. This increase largely results from capital investment of £323.1 million offset by depreciation of £260.3 million and grants and contributions of £11.8 million.

Debtors falling due within one year increased to £216.8 million (2013–14 £198.0 million). This increase largely arises from our metering programme which results in customers being billed in arrears rather than in advance and having an element of accrued income at the year end. The impact of metering accounted for £9.0 million of the increase in the debtor balance with new connections £4.8 million and the effect of our tariff increase £5.4 million covering the rest.

Creditors falling due within one year decreased to £246.5 million (2013–14 £300.6 million). This reduction was expected and results from lower capital expenditure in the year, which in turn reduced the level of capital creditors at March 2015, the payment of accruals made at March 2014 for costs associated with the flooding events over the winter of 2013–14 and lower unmeasured receipts in advance as we have switched more customers to a metered supply.

As at 31 March 2015 creditors falling due after one year increased by £36.3 million to £3,872.7 million. This increase principally resulted from RPI on inflation-linked bonds of £48.5 million.

The net pension deficit increased in value to £89.9 million (2013–14 £72.3 million) following the latest actuarial valuation, as described in note 22.

Overall net assets increased from £1,041.2 million to £1,129.2 million.

Dividend policy

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

Our 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.

Our 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 2014–15 (2013–14 nil) and no dividends were paid to the shareholders of our ultimate parent company, Greensands Holdings Limited.

Over the past five years, our shareholders have supported us in strengthening our financial position and in delivering improved operational performance by adopting a flexible dividend policy. This places us in a stronger position for the start of the next five-year period to resume dividend payments from 2015–16.

Taxation

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

All companies within the Southern Water and wider Greensands groups are UK tax resident, ensuring that each company is subject to UK tax. Tax planning is always aligned with our commercial and economic activity. This practice continues to be recognised by HMRC, which assesses us as a low-risk 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 us, accommodate population growth in the South East. 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 for our assets. This has the effect of reducing the amount of tax we pay, the benefit of which is passed to our customers through reduced 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 £60.5 million. These are explained below:

- Business rates of £25.1 million paid to local authorities (2013–14: £24.4 million) and payments to the Environment Agency of £8.4 million (2013–14: £8.2 million), which reduce profits chargeable to corporation tax.
- Employment taxes of £23.3 million (2013–14: £21.5 million) paid to the Exchequer under PAYE (Pay As You Earn) and National Insurance contributions.
- Carbon Reduction Commitment of £3.7 million (2013–14: £3.0 million) levied on our power cost, which reduces profits chargeable to corporation tax.

Payments have also been made to other group companies of £36.9 million for tax losses surrendered to the company. Of these, £12.0 million was paid to SWSG and then repaid to us 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

Within 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 net cash income to net interest cost.

The net debt to RCV ratio is calculated as short and long-term senior borrowings, less cash and short-term deposits to the RCV (all values taken from our Regulatory Accounts). The RCV is set by Ofwat at each five-year periodic review and reflects forecast growth in the asset base from capital investment and inflation. The RCV can be adjusted at each periodic review for relevant changes to the level of expenditure or performance.

during the five-year period. The ratio of senior debt to RCV is targeted to be maintained at around 80 per cent, comfortably within our debt covenants.

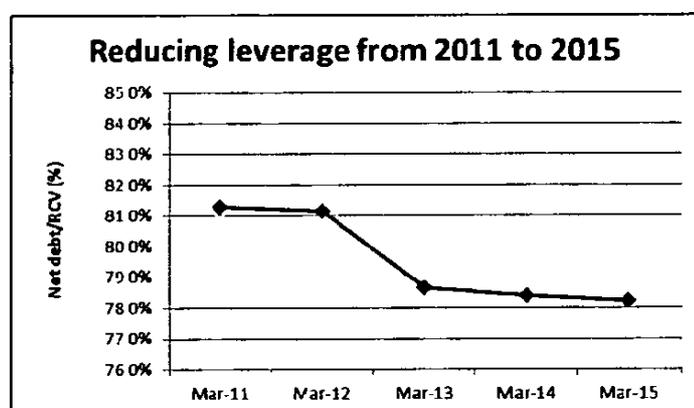
Senior adjusted cash interest cover (measured as net cash inflow from operating activities less current cost depreciation and the infrastructure renewals charge to senior debt interest) is targeted to be maintained above 1.1 times to meet covenanted levels.

Net debt / RCV	%	Senior adjusted cash interest cover	Times
2011–12 performance	81	2011–12 performance	1.6
2012–13 performance	79	2012–13 performance	1.5
2013–14 performance	78	2013–14 performance	1.6
2014–15 performance	78	2014–15 performance	1.6
Covenanted lock-up level	<85	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 Class B debt Ba1

In February 2015, Moody's removed the negative outlook on our credit ratings following an assessment of the PR14 Final Determination (the regulatory Business Plan for the period April 2015 to March 2020), including a recognition of our improved operational and financial performance in recent years. All credit ratings are now 'stable'.

During the current five-year regulatory period from 2010 to 2015 we have faced financial risks such as a material shortfall in revenues compared with 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 2013 through to February 2014. Shareholders have been extremely supportive during this period by voluntarily forgoing 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

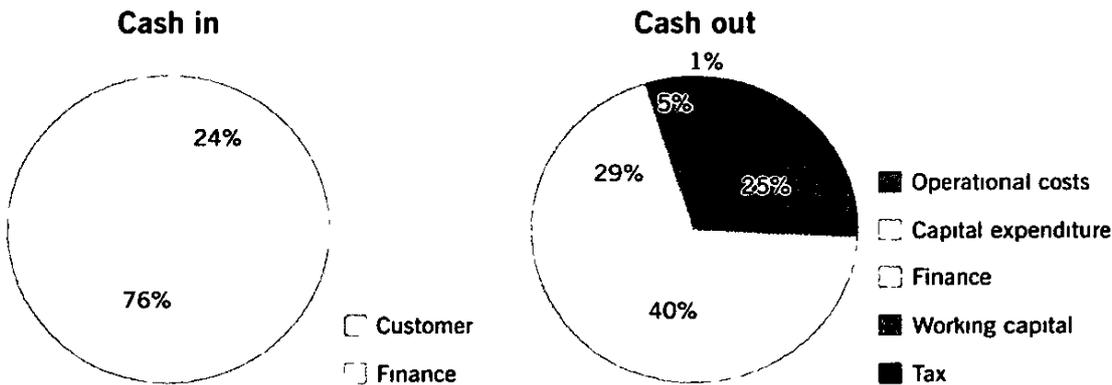
Why Southern Water raises finance

Significant capital investment has been a feature of our business since privatisation in 1989. We have invested in both maintaining our existing asset base and constructing new assets in order 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 and secure sources of finance. This was achieved by replacing a short-term parent company loan with a series of listed bonds issued under a long-term framework for sustainable future financing, which continues to be in place today.

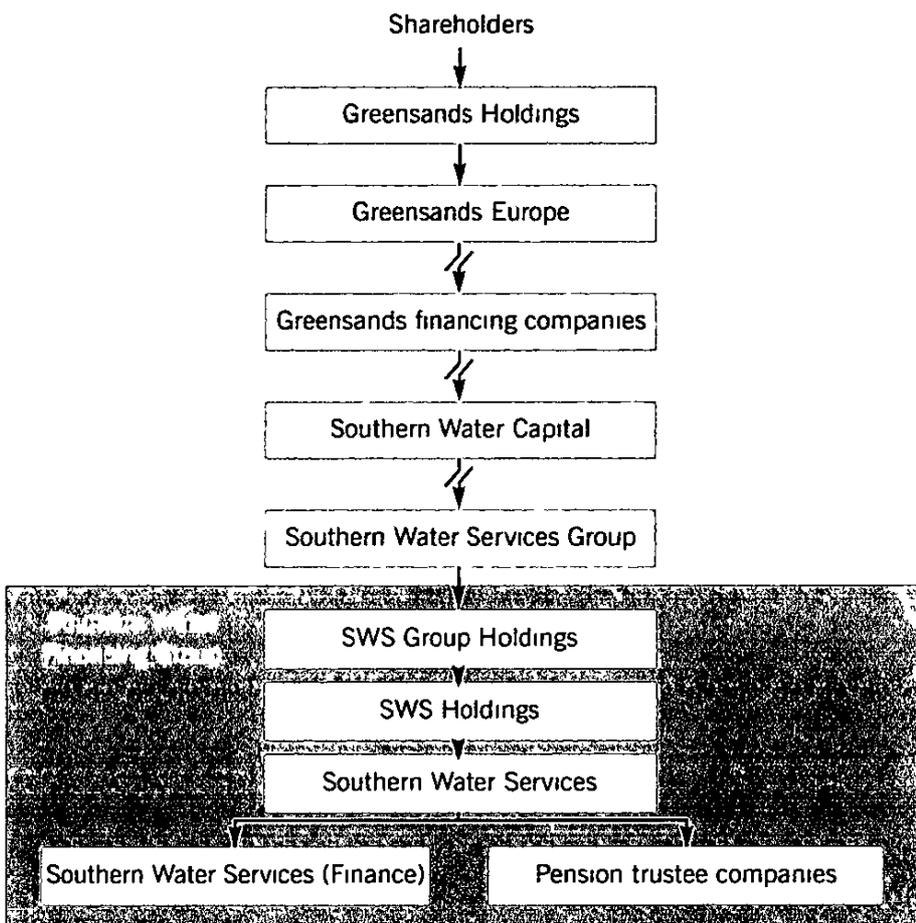
Our financing subsidiary Southern Water Services (Finance) (SWSF) was established for the express purpose of raising debt finance on our behalf. The Southern Water Financing Group (see ownership chart below) was also established at that time to create a financial ring-fence to protect our ongoing operation.

The financing group, whose immediate parent is 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

In 2003, a Common Terms Agreement (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 our 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 if a precautionary limit is breached. We ensure that we operate with sufficient financial headroom against these limits and have not breached a limit at any time since the implementation of the financing framework in 2003.

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.

Shareholders of Greensands Holdings are represented on our Board through two non-executive directors. During 2014–15 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. Find out more about them on page 64.

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 2015 and 31 March 2014. 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.

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 to interest rate volatility 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.

We ensure 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. In November 2014, we renewed our committed bank credit facility and increased the size of the facility from £200 million to £350 million. This facility supports our liquidity and was undrawn at 31 March 2015 (£350 million) and 31 March 2014 (£200 million).

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 and minimum credit ratings for each 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 the most secure rating of AAA rated.

In addition to our loans as analysed in note 16, we have in issue a loan of £812.3 million to SWSG which was issued 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 2015, the dividend was £44.9 million and the tax payment, in respect of the taxable losses incurred by SWSG, amounted to £12.0 million. This loan provides no tax benefit to either us or the Greensands Group, with the tax payment we make 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 diagram below as part of the Greensands financing companies, and Eurobonds issued by Greensands Europe. Interest on these loans may result in a tax expense which can be used within the Greensands Holdings group of companies.

Interest and dividends payments 2014-15

Figure 1

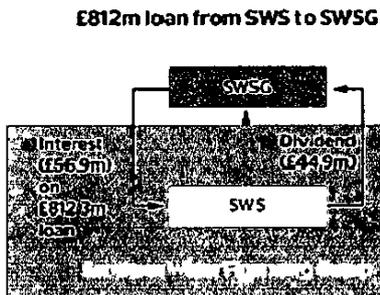
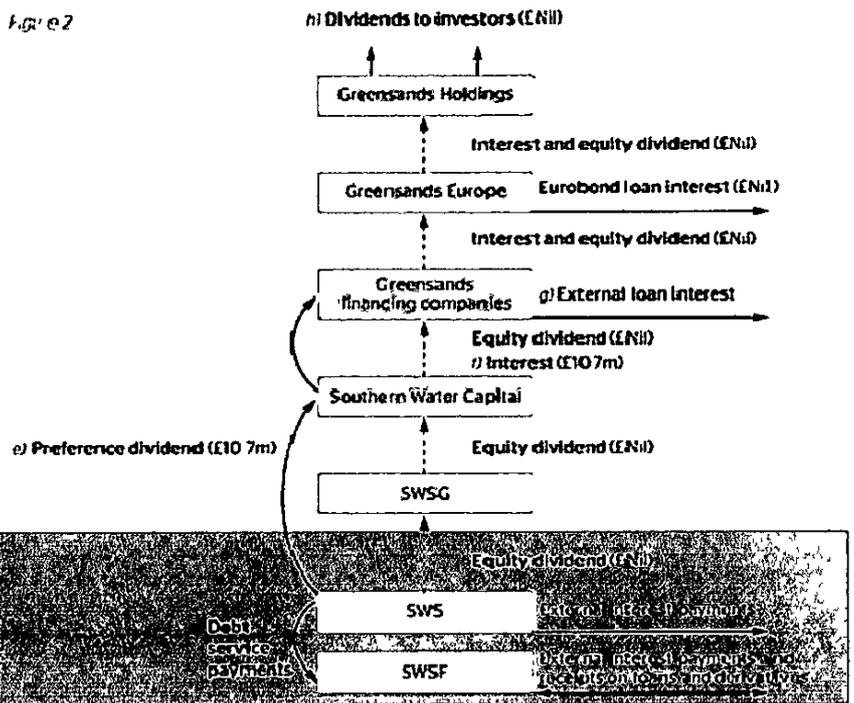


Figure 2



Footnote

- a) Interest paid by SWSG to SWS on £812m loan
- b) Dividend paid by SWS to SWSG
- c) Payment of group tax relief by SWS to the South Western SWSG
- d) Interest payments from SWS to SWSF on the loans taken out by SWSF on behalf of SWS. This is returned by SWSF to pay the interest on these external loans
- e) Interest payable on an inter-company loan
- f) External interest payable based on interest receivable and cash held in the Greensands financing companies
- g) Dividend with respect to loans

Risks

In order to provide a reliable and consistent service for our customers it is important we identify, monitor and mitigate 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 risks 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 included

Market reform

From 1 April 2017, the retail market for non-domestic customers will be opened. This will require significant structural changes within the company to allow us to continue to comply with regulatory requirements and to anticipate the shift in customer base. Further details of the requirements for operating in this new market have been published during the course of the year and as such, there remain areas of uncertainty. If we do not make adequate preparations to operate in this new market we could face significant reputational damage and financial penalties from Ofwat.

Mitigation

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

Delivery of our capital investment programme

We have a capital investment programme of £1.8 billion between 2015 and 2020. We have plans in place to ensure we will be on target to deliver this, however we have to ensure our focus is maintained to complete all 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, to meet the promises that we have made in our Business Plan and possible action by the Environment Agency, Drinking Water Inspectorate or Ofwat.

Mitigation

We have transformed our asset management capability during the course of the current AMP to bring significant capital investment capability in-house. This includes the establishment of an in-house engineering function, a specialist programme management function and asset planning systems, processes and capabilities. Progress against the capital programme is overseen by our Investment Committee and we have adapted our monthly reporting procedures to ensure the delivery of the Business Plan is given the greatest level of focus within the company. We work closely with our regulators and other interested parties to resolve issues as they arise.

Compliance with legislation

We are a highly regulated business with three main regulators: Ofwat, the Environment Agency and the Drinking Water Inspectorate. If we do not meet the standards set by these bodies, we could 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 relevant industry standards, including ISO 9001 and ISO 14001. Internal monitoring and assurance is undertaken during the year and annual reporting is supported by external verification through our financial and technical auditors to provide assurance on compliance with our obligations. Awareness training is provided throughout our company for critical compliance issues, such as the Bribery Act and Competition Law, to ensure everyone understands our legal obligations. All sections of the business review 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 such as these can also affect our ability to deliver the promises set out in our Business Plan, with the potential for financial penalties associated with Outcome Delivery Incentives, 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 from 2015–20 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 that, if there are problems, we can minimise the impact to our customers and the environment. Performance against our regulatory targets is monitored on a monthly basis by both our Board and Executive Management Team.

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. We supply 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 maintain adequate water resources to continue to do so now and in the future.

Mitigation

In 2011 we 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 continued to drive down leakage below our company target and are on track to install water meters for the majority of our customers by the end of 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 we operate our sources. Our Water Resources Management Plan uses 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, both from our wastewater network and from watercourses and groundwater, with significant implications for our customers. 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 risk, we have prioritised schemes for investment in 2015–20. We will be investing £426 million to provide a reliable and effective wastewater service, part of which will be used to keep our 39,600 kilometres of sewers and 2,375 wastewater pumping stations well maintained. It will also fund our replacement or refurbishment of about 224 kilometres of sewers, with the parts of our network most in need of repair and of most structural use targeted first. We will also carry out more sewer cleaning to prevent blockages and put more resources into keeping our drainage plans up to date to fully understand how much capacity we will need for the years ahead.

We are also focusing on reducing the risk of blockages, which are a major cause of flooding from sewers. This will include providing our customers with better information about the causes of blockages and how they can prevent them, carrying out targeted surveys of our sewers using cameras and regular sewer-cleaning work. Through investment of £268 million, we intend to ensure there is no increase in the number of blockages in our sewer network.

Regional growth

The population in the South East has grown considerably during the past 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 in the region. 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. 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

Mitigation

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. While the current economic conditions have resulted in a decline in the housing market, we expect the population will increase in line with forecasts. By 2020, we anticipate the rate of housing development will have quickened again. We work closely with local planners and developers to ensure we have the necessary infrastructure in place to cater for new developments.

Bad debt

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

Mitigation

We understand that some customers may experience financial difficulties, particularly in difficult economic times. We encourage customers who are struggling to make payments to contact our Debt Advice Centre as early as possible. To assist those in difficulty we offer a range of flexible instalment plans and tariffs, including a new social tariff from April 2015. 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 efficiently finance our capital investment programme at risk in the future. The industry requires access to capital markets as a result of negative cash flows resulting from our capital investment programme and the requirement to finance debt maturities when they fall due. As a minimum, we intend to maintain our current risk profile.

Mitigation

We maintain a level of cash reserves and liquidity facilities sufficient to finance our business and to finance scheduled debt maturities for at least the next 12 months, without the need to raise additional finance during the 12-month period. This practice ensures we maintain a strong position of liquidity, protecting our business from any short-term financial market volatility and supporting our long-term planning horizon. We also manage our liquidity exposure to debt maturities by ensuring that the aggregate nominal value of debt maturities does not exceed 40 per cent of Regulatory Capital Value (RCV) in any single five-year regulatory period and 20 per cent of RCV in any 24-month period. Exposure to interest rate rises on our current borrowings is also hedged by a subsidiary company, SWSF, and the majority of current borrowings are at either fixed or index-linked interest rates. We ensure that sufficient funds are available for our operational and capital investment programme through monitoring and forecasting of our cash flow and we take steps to manage this when necessary.

We only enter into treasury transactions to manage inherent risk and support prudent funding, not to speculate.

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, Class B debt, Ba1, Corporate family rating Baa2

Mitigation

We have reduced leverage from levels at the start of the AMP5 period, in April 2010, and improved operational performance. This positive action has stabilised our credit for the start of the next AMP6 regulatory period, commencing April 2015. A primary duty of Ofwat when setting prices is to ensure companies can efficiently finance their business. If necessary, a company can apply to reset customer prices during the five-yearly regulatory periods through an interim determination of price limits.

Health and Safety

The health and safety of our employees and the public in the provision of our services and on our sites is our utmost priority. The nature of our work requires that our employees and contractors undertake activities or use equipment which, if uncontrolled, has the potential to cause significant harm. Failure to comply with our health and safety management system could result in death, serious injury or adverse health effects. In addition to the personal impact these would have, we could be susceptible to prosecution under the Health and Safety at Work and Corporate Manslaughter acts.

Mitigation

Along with our contractors we have comprehensive processes and procedures to prevent injury and occupational ill health. We have taken all necessary steps to ensure the potential health and safety risk is suitably mitigated and controlled. We have a clearly defined strategy, safety protocols and standards that are set. These are monitored and reported to the Board on a monthly basis and to the Board Health and Safety Committee. The Executive Management Team monitors health and safety performance via detailed reports at the monthly health and safety management review meeting. This group ensures there is an adequate system for meeting our responsibilities to staff, customers and members of the public. These services have been developed and are continuously reviewed to ensure they meet the needs of the business and our employees at work.

Additionally, every employee has ready access to a copy of the corporate policy statement and health and safety processes and procedures. All staff receive suitable health and safety training and we have a campaign to encourage staff to report near misses or hazards at work to help further reduce the risk of injuries or ill health. Over the past few years we have increasingly focused on our employees' wellbeing as well as their physical safety through the establishment of a company-wide wellbeing forum as well as a series of physical and mental health initiatives.

Water quality

We supply drinking water to more than two million people. Should operational treatment processes fail, or should the supply become contaminated, there is a risk that water could be supplied to customers that is unfit for consumption. Any problem affecting drinking water quality (for example a bacteriological failure) could cause our customers to become ill and would require a widespread 'boil water notice' to protect public health, causing disruption to our customers and potentially a prosecution.

Mitigation

Significant effort is made to prevent such an incident occurring through investment in assets and technology and through staff adherence to company processes and procedures. New staff are trained in these processes and procedures and their importance. We consistently have a drinking water compliance of over 99.9 per cent. Our 2015–20 Business Plan includes schemes to add carbon filters and other more advanced filters at our water treatment works in high-risk areas such as Hastings to help improve the taste and smell of water. Part of our activities to improve water quality includes upgrades to wells and boreholes, service reservoirs and water supply works as well as flushing mains and cleaning service reservoirs which store water underground before it is pumped to customers' taps.

To avoid problems associated with nitrates and pollutants being washed into rivers from high surface run off after heavy rain, we have processes to cease water abstraction during and after heavy storms. Drinking Water Safety Plans have been 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.

Customer service

Customers will become dissatisfied if we are unable to deliver the level of service they expect, which can be caused by interruptions to supply and services or quality deterioration as well as shortcomings in our communications and response. The Service Incentive Mechanism (SIM) was developed by Ofwat to incentivise improvements in customer service and compares the water sector companies' performances across the industry. Financial penalties may be applied under SIM for failure to achieve the requisite level of service to our customers.

Our performance as measured by SIM has continued to improve, although not as fast as our peers and still not at the desired level. We have set ourselves challenging targets and our improvement programmes are working to deliver these for our customers.

Mitigation

Improvements to customer service are being made on a continuous basis. Staff are being provided with increased training and development and we are carrying out our ongoing research to better understand our customers' experiences, both the services they are being provided with and also when contacting us to define key local areas of improvement.

We are also informing the public when we are working in their area and strengthening our links with local organisations such as councils and community groups.

We are reducing the need for customers to contact us by providing facilities for them to manage their accounts online and where customers do need to speak to us directly we have ensured the opening hours of our contact centre are convenient. Additionally, our bills have been redesigned to make them easier to understand.

Cyber security

We provide water and wastewater services to customers across our regional infrastructure, which is considered critical national infrastructure. As a result, we recognise our operational and enterprise IT systems may be a potential target for cyber threats which could have a significant impact on our business reputation and operational digital assets.

Mitigation

We manage this risk through IT security standards, ongoing monitoring of threats to and activities on our IT infrastructure as well as incident management plans. We continue to invest in cyber threat mitigation strategies in response to the changing risk landscape and we work with the Centre for Protection of National Infrastructure (CPNI). Over the past 12 months we have also undertaken employee campaigns to raise awareness of IT security and data protection risks.

Defined benefit pension scheme

We operate a defined benefit pension scheme which has been closed to new entrants from 1 April 2005. We remain liable for rights earned by past and present members of the scheme. Changes in demographics and fluctuations in investment markets may affect our ability to fund pension promises.

Mitigation

We have agreed a deficit and risk management strategy with the Trustees. This is monitored regularly by the company and Trustees and mitigating actions are reviewed and implemented as appropriate.

The risk of a sustained period of negative inflation

Our wholesale revenues, capital value and the return on our capital value are linked to inflation. A sustained period of negative inflation could result in a reduction of returns relative to the cost of financing our business. A sustained period of negative inflation could also lead to pressure on the financial headroom we have between our capital value, linked to inflation (our RCV), and our financial structure.

Mitigation

This risk is reduced by the inclusion of index-linked debt and derivatives, within our financial structure, which makes up approximately two thirds of our borrowings. These financial instruments are linked to inflation, whereby interest cost, and loan value, rise and fall in line with the movement in inflation.

Corporate Governance

Chairman's overview

Introduction

We are 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

The Board readily adopted Ofwat's suggestion in 2013 to develop our own code. In the Southern Water Code of Board leadership, transparency and governance, we have fully reflected the Ofwat Principles (published in January 2014) and drawn extensively on the appropriate principles of the UK Corporate Governance Code. 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. We continue to have regard to corporate governance practices and developments in other areas and will review the Southern Water Code again in the current year 2015–16.

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

Board membership

During the year we are reporting, I was the independent non-executive Chairman, appointed with effect from 1 April 2014. I was previously one of four independent non-executive directors and, following my appointment as Chairman, we appointed Paul Sheffield in my place.

Our Nomination Committee was tasked to consider candidates for the independent non-executive directorship I vacated and to recommend the appointment to the Board, which it did following an appropriately formal, rigorous and transparent process. This began with agreeing the principal characteristics required by the Board overall and evaluating the current strengths and balance. Following Paul Sheffield's appointment, the opportunity was also taken to plan for succession in anticipation of the retirements of Bob Armstrong and Cheryl Black, which were expected later in the year. Accordingly, we appointed Bill Tame (from 1 January 2015) and Rosemary Boot (from 1 March 2015). We also appointed Lisa Harrington with effect from 1 April 2015, in anticipation, later in 2015, of David Golden's retirement. In the appointment of its independent non-executive directors, the Board is pleased to continue its pursuit of diversity.

By 31 March 2015, the Board comprised an independent Chairman, two executive directors (the Chief Executive Officer and Chief Financial Officer) and six non-executive directors, of whom four are independent. I believe that overall, during the year, we comprised a balanced and rounded Board, giving independent support and advice as well as providing new ideas and healthy challenge. The presence of the non-executive directors, only two of whom are not 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 64 to 68.

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. I have ensured that the new members of the Board receive appropriate induction and ongoing training.

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 has chaired the Remuneration Committee, of which he remains a member, and is a member of the Health and Safety and Audit and Risk Review Committees. He would chair Board meetings in the event that I am unable to do so for any reason and is available to discuss matters or concerns with investors as required. David has been a non-executive director for 11 years. The Board recognises that his character and judgement show him to be independent and values his continuing contribution during the recent quinquennial price review process and to the new Business Plan and operating model that we are now implementing. David proposes to resign at the end of June and will be succeeded by Paul Sheffield as senior independent non-executive director. I wish to thank him for his commitment and assistance over the years.

Independent non-executive directors

The 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 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 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 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 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 our 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 the 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, Defra's Open Water programme, procurement and people management 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

On my appointment as Chairman, I took on the process of Board evaluation which was already under way and, with the members of the Nomination Committee, identified where and how we wanted to add to the capabilities of the Board. In the autumn of 2014, I wanted to review progress and to carry out the next annual Board evaluation, this time with external facilitation. The Board agreed to the engagement of Duncan Reed, Condign Board Consulting, who conducted face-to-face interviews with all directors and attended Board meetings. The report was presented to the Board at its February meeting and painted an encouraging picture, reflecting that the overall functioning of the Board is at a good level and that governance is in good order. No areas of major concern or weakness were identified but helpfully a number of suggestions had been made by individuals to improve Board effectiveness further. These are being trialled and will be reviewed during this year.

Subsequently, David Golden, senior independent non-executive director, led a review and appraisal of my performance as Chairman, without my participation. I am pleased to record that my chairmanship is supported by the Board overall and no areas of major concern or weakness were identified.

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)
- 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 2014–15, 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 ten 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 company's positions on further stages in the PR14 process, which has continued to be such an important process for the Board during 2014–15. This culminated in our decision not to seek referral of Ofwat's Final Determination to the Competition and Markets Authority.

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 monthly Board meetings in 2014–15			
Robert Jennings	10/10		
Robert Armstrong (resigned 31 January 2015)	8/8	Cheryl Black (resigned 31 January 2015)	7/8
Michael Carmedy	10/10	David Golden	9/10
Paul Sheffield (appointed 1 June 2014)	8/8	Matthew Wright	10/10
Bill Tame (appointed 1 January 2015)	2/3	Rosemary Boot (appointed 1 March 2015)	1/1
Paul Moy	9/10	Mark Walters	10/10
Bronte Somes (as alternate)	1/1		

Note – Attendance includes attendance in person and 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 2014–15 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 that have taken place in the regulatory environment in 2014–15, 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 73 to 84

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.

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

Appointed Chairman in April 2014, Robert joined the Board as an independent non-executive director in July 2012

Robert is also 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 and 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 Scottish Power'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 a director of Knutsford Academy Limited

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

Paul Sheffield

Independent non-executive director

Paul Sheffield joined the Board in June 2014 In addition to this role he is currently managing director of the Northern Hub for Laing O'Rourke - the engineering and construction enterprise

In his career Paul enjoyed more than 30 years with Kier Group Plc, the construction, property and services business, starting as a graduate civil engineer in 1983 He spent 15 years working on a series of significant infrastructure projects around the world and then led 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 Following that he took up a new role with Laing O'Rourke to lead the expansion of their activities across the UK, Middle East and Canada

Paul has a wealth of knowledge about the construction and maintenance of infrastructure assets and the delivery of major programmes of capital works

Bill Tame

Independent non-executive director

Bill Tame joined the Board in January 2015

He is currently Chief Executive of the Babcock Group's International Division, having joined the Babcock Board as Group Finance Director in 2002

Bill is a member of the Institute of Chartered Accountants and is also a non-executive director of Carlco plc

Rosemary Boot

Independent non-executive director

Rosemary Boot joined the Board in March 2015

She is chief financial officer of Future Cities Catapult, one of a network of technology and innovation centres established by the UK Government

Previously she worked at Circle Housing Group and was involved in setting up the Government-owned Low Carbon Contracts Company and Electricity Settlements Company. From 2001 to 2011 she was group finance director of the Carbon Trust, the independent company set up in 2001 to work with business and the public sector to accelerate the move to a sustainable, low carbon economy. Prior to that, she worked for 16 years as an investment banker, primarily advising large listed UK companies on mergers and acquisitions.

Rosemary is also a governor of the Conservatoire for Dance and Drama, the higher education institution for the performing arts, and a trustee of Green Alliance, the environmental think tank

Lisa Harrington

Independent non-executive director

Appointed in April 2015, Lisa is the managing director of Customer Service and CIO of British Telecom's Wholesale division

Lisa has a real passion for customers and a strong track record of delivering customer service improvement in a variety of transformation and operational roles

Before BT, Lisa spent 12 years with Andersen Consulting (now Accenture), specialising in customer service consulting and delivering big transformation projects for companies such as Microsoft, Compaq, Vodafone and Sainsbury's

She also served as a non-executive director for the NHS West London Mental Health Trust

Bronte Somes

Non-executive director

Bronte Somes joined the Board in April 2015 having previously held shareholder representative positions within the wider Southern Water group over the past four years and having served as alternate non-executive director to Paul Moy on the Southern Water Board

Bronte is a senior investment principal for UBS Infrastructure and Private Equity, a division of UBS Global Asset Management. Based in London, Bronte is responsible for principle investment activity across Europe

Before joining asset management, Bronte worked for more than a decade in UBS Investment Bank's infrastructure group where she gained extensive experience as an adviser within the infrastructure sector. Before that, Bronte worked as a finance lawyer at Clifford Chance in London

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 past 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 principle 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 Ltd, 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 Scottish Power

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 2014–15 were

Robert Armstrong – Independent non-executive director (resigned 31 January 2015)

Robert Armstrong joined the Board in May 2008 and served as an independent non-executive director until his resignation

Cheryl Black – Independent non-executive director (resigned 31 January 2015)

Cheryl Black joined the Board in May 2008 and served as an independent non-executive director until her resignation

Paul Moy – Non-executive director (resigned 31 March 2015)

Paul Moy joined the Board in February 2010 and served as a shareholder-nominated non-executive director until his resignation

Executive Management Team

Reporting to Matthew Wright, the Executive Management Team in 2014–15 consisted of

Michael Carmedy – Chief Financial Officer

Kevin Hall – Company Secretary and General Counsel

Philip Barker – Director of Operations

Mel Karam – Director of Infrastructure

Chris Maloney – Director of People

Simon Oates – Director of Strategy and Communications

Lesley Ottery – Director of Transformation

Jennie Reglar – Director of Procurement

Susan Stockwell – Chief Customer Officer

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 Bill Tame (from 24 February 2015, and Chairman from 24 March 2015, previously Robert Jennings), Robert Jennings, David Golden, Lisa Harrington (from 1 April 2015), Bronte Somes (from 1 April 2015) and Mark Walters, whose experience and background are set out on pages 64 to 67. Previous members during the reporting year were Cheryl Black (resigned 31 January 2015) and Paul Moy (resigned 31 March 2015)

The members of the committee receive updates on financial reporting and the regulatory framework in various forms throughout the year. The Chief Executive Officer, the Chief Financial Officer, the Head of Audit and Risk, 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 Audit and Risk, the Company Secretary and external professional advisers to assist it in performing its duties.

The ARRC met three times in 2014–15 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 2014–15			
Robert Jennings	3/3	Cheryl Black (resigned 31 January 2015)	2/2
David Golden	3/3	Paul Moy (resigned 31 March 2015) Bronte Somes (as alternate)	2/3 1/1
Mark Walters	3/3	Bill Tame (appointed 24 February 2015)	1/1

Note – Attendance includes attendance in person and 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 and general IT controls, before making a recommendation to the Board to approve the annual results. There were no significant issues to be addressed.

The ARRC has also reviewed and discussed the changes to the financial statements that will result from the transition to International Financial Reporting Standards (IFRS) in 2015–16.

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, our risk management processes and arrangements are also monitored and 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 53.

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 Audit and Risk 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 Audit and Risk is free to raise any issues with the ARRC or its Chairman at any time during the year.

External auditor

Deloitte LLP was appointed our auditor 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 its 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. We 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 3 to the accounts on page 98.

Health and Safety Committee

The Health and Safety Committee (H&SC) is responsible for reviewing and advising on our 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 Paul Sheffield (from 22 July 2014 and Chairman from 26 November 2014; previously David Golden), Matthew Wright, David Golden and Rosemary Boot. Robert Armstrong had been a member during the reporting year and resigned on 31 January 2015.

The H&SC met on two occasions in 2014–15

Health and Safety Committee attendance in 2014–15			
David Golden	2/2	Matthew Wright	2/2
Robert Armstrong (resigned 31 January 2015)	2/2	Mark Walters	2/2
Paul Sheffield (appointed 22 July 2014)	1/1		

Note – Attendance includes attendance in person and 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 the capabilities required and leads the process for identifying and nominating candidates for the approval of the Board.

The members of the Nomination Committee are Robert Jennings (Chairman) Paul Sheffield (from 24 February 2015 and deputy Chairman from 24 March 2015), and all non-executive directors.

The Nomination Committee met on ten occasions in 2014–15.

Nomination Committee attendance in 2014–15			
Robert Jennings	10/10	David Golden	9/10
Robert Armstrong (resigned 31 January 2015)	8/8	Paul Moy (resigned 31 March 2015)	7/10
		Bronte Somes (as alternate)	3/3
Paul Sheffield (appointed 24 February 2015)	1/1	Mark Walters	10/10
Rosemary Boot (appointed 24 March 2015)	1/1	Bill Tame (appointed 24 February 2015)	1/1

Note – Attendance includes attendance in person and 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 2015. 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 Regulatory Accounts Guidance (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 2015, 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 2015.

Throughout the year, the committee was chaired by David Golden. Following David's announcement that he intended to stand down from his position on the Board in June 2015, I was appointed chairman of the committee with effect from 24 February. I would like to take this opportunity to thank David for his contribution over many years to the Remuneration Committee.

Following the annual review of the committee's effectiveness, the structure and membership has been revised. From April 2015, four new independent non-executive directors have joined the committee. Each one brings significant experience to Southern Water from various sectors and professions. This should provide an additional balance of skills, experience and knowledge to enable them to provide sound judgement and decision making in matters related to the company's short and long-term remuneration strategy. In particular, additional strengths in both customer focus and sustainability have been added to the committee.

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 2014–15 were assessed to be between 63 per cent and 70 per cent of annual bonus potential.

As part of a strategy to improve the links between achievement of personal objectives and reward outcomes, a new bonus scheme design was implemented in 2015 for both executive and senior management who are eligible for a payment under the incentive arrangements. This focused the executive and senior management on improving business effectiveness through improvements in service to customers, operational efficiency and performance while ensuring sufficient financial returns to maintain investor confidence and enable the company to finance the business at competitive rates.

Remuneration in 2015–16

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.

The committee has recently been working on 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. The details of the plan are yet to be formally agreed however the intention is that it will be a three-year rolling plan with overlap to allow for a smooth payment profile.



Paul Sheffield
23 June 2015

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. 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 have an important role to play in determining and challenging remuneration policy and practice. In 2014–15 we revised the membership of the RemCom to ensure that the independent non-executive directors represented a majority on the committee.

The RemCom is chaired by senior independent non-executive director Paul Sheffield (appointed 24 February 2015). Paul took over the role of chairman from David Golden, following David's decision to step down from the Board in June 2015. The other members are Robert Jennings, Robert Armstrong (to 31 January 2015), Bill Tame (from 24 March 2015), Rosemary Boot (from 24 March 2015), Paul Moy (to 31 March 2015) and Mark Walters. From April 2015 Lisa Harrington also joined the committee along with Bronte Somes who replaced Paul Moy.

Only RemCom members are entitled to attend meetings, but the Director of People and the Chief Executive Officer, Matthew Wright, attend by invitation. The Director of People 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 2014–15 are shown in the table below.

Remuneration Committee attendance in 2014–15			
David Golden	2/3	Robert Armstrong (resigned 31 January 2015)	1/1
Robert Jennings	3/3	Paul Moy Bronte Somes (as alternate)	2/3 1/1
Paul Sheffield (appointed 24 February 2015)	2/2	Mark Walters	3/3
Bill Tame (appointed 24 March 2015)	1/1	Rosemary Boot (appointed 24 March 2015)	1/1

Note – Attendance includes attendance in person and by telephone.

How the Remuneration Committee sets remuneration policy

The primary objective of our 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 SWS.

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 relative 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 that benefit both customers and

shareholders. In setting the remuneration policy for 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.

In particular the RemCom is kept informed on a regular basis of

- 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 our 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 Ofwat, additional information is given below regarding the remuneration of the directors of SWS.

Executive directors who served during the 2014–15 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 SWS and the amounts paid to them in the year ended 31 March 2015.

Remuneration Policy

Purpose

The remuneration policy of SWS applies to all its employees. The Board of Directors has adopted the remuneration policy at the recommendation of the Remuneration Committee. The policy applies to remuneration earned from 1 April 2014.

The policy reflects the Board's objectives for good corporate governance as well as sustained and long-term value creation for shareholders. In addition, it ensures that

- SWS is able to attract, develop and retain high-performing and motivated employees in a competitive market
- Employees are offered a competitive and market median-aligned remuneration package making fixed salaries a significant remuneration component
- Employees feel encouraged to create sustainable results and that a link exists between shareholders/customers and employee interests

The policy focuses on ensuring sound and effective risk management through

- A stringent governance structure for setting goals and communicating these goals to employees
- Alignment with our business strategy, values, key priorities and long-term goals
- Alignment with the principle of protection of customers and investors ensuring prevention of conflict of interests

Remuneration components

At an annual performance appraisal interview, individual employees and managers evaluate and document performance in the past year and set new goals. Decisions on adjustment, if any, of the employee's fixed salary or on annual performance-based pay are made on the basis of this appraisal. The various remuneration components are combined to ensure an appropriate and balanced remuneration package.

The five remuneration components are

- Fixed remuneration (including fixed supplements)
- Performance-based remuneration (variable percentage of salary)
- Pension schemes, where applicable
- Other benefits in kind
- Severance payment, where applicable

The fixed remuneration is determined on the basis of the role and position of the individual employee, including professional experience, responsibility, job complexity and local market conditions.

The performance-based remuneration motivates and rewards high performers who significantly contribute to sustainable results, perform according to set expectations for the individual in question, strengthen long-term customer relations and generate income and shareholder value.

The Board of Directors has determined a maximum percentage of performance-based remuneration relative to the fixed remuneration for the executive management positions. This percentage varies through the other management levels of the organisation according to the type of position held by the employee and the business directorate in which they are employed. The maximum limit on variable remuneration remains at 100 per cent of fixed salary inclusive of pension. This level of variable remuneration will, in practice, only apply to a small minority of employees and will only be offered to enable SWS to match market terms. Performance-based remuneration is disbursed as a cash bonus. Executive directors are covered by two times salary death in service benefit within their contract of employment.

The Defined Benefit Pension Scheme, which was closed to new entrants on 1 April 2005, guarantees employees a four times salary cover for death in service and pension payment on retirement after the age of 55. In general, employees are covered by the defined benefits pension scheme or through the defined contribution plans with a pension insurance company. The death in service cover for the defined contribution scheme is two times salary. The pension contributions of employees subject to collective bargaining agreements are regulated by the collective agreement.

Other benefits are awarded on the basis of individual employment contracts and local market practice.

Severance payments are payable in accordance with relevant legislation and applicable collective agreements. Severance payments may include variable remuneration, pension or other benefits on a discretionary basis.

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 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 is weighted at around 60 per cent performance-related and 40 per cent non-performance-related for Matthew Wright and 50 per cent performance-related and 50 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 2015–16	Change of policy from 2014–15
Base salary	<p>Takes into account experience and personal contribution to our strategy and performance.</p> <p>Attracts and retains executives of the quality required to deliver our strategy.</p>	<ul style="list-style-type: none"> ▪ The base salary is a fixed figure and does not vary in relation to business or individual performance. ▪ Reviewed annually with changes effective from 1 July if applicable. ▪ Consideration given to individual and company performance. ▪ General pay increases to all employees taken into consideration. ▪ Aim to pay within a mid-market range, but may pay higher salaries to attract and retain executives of the right calibre or for out-performance by the individual or company. <p>Referenced against UK companies of a similar size, utility companies and other water companies.</p>	Base salary increases are applied in line with the annual review.	Annual review of salary changed from 1 April to 1 July effective from July 2016.
Annual incentive scheme (Bonus)	Drives and rewards performance against personal objectives and selected customer,	<ul style="list-style-type: none"> ▪ The performance measures included within the annual bonus scheme are selected to ensure that we are focused on our strategic objectives. ▪ The balance and nature of the 	Maximum percentage of salary – shown in table on page 82.	No

operational and financial KPIs which are directly linked to business strategy	<p>objectives is reviewed annually</p> <ul style="list-style-type: none"> ▪ A 'bonus pool' is created at a corporate level based on the achievement of the company against these objectives and any individual payment is based on personal performance ▪ The KPIs for 2014–15 are shown on page 82 ▪ The threshold, mid-point and stretch targets are established annually by the RemCom, making sure they are sufficiently stretching while also recognising the nature and risk profile of the company ▪ Where applicable, 60 per cent of the bonus pool is created for achieving the mid-point target and 100 per cent for achieving the stretch target ▪ RemCom has discretion to amend or withdraw payments based on the consideration of other factors which could significantly affect business performance 			
Long-term incentive plan (LTIP)	Aligns interests of executives, customers and shareholders	<ul style="list-style-type: none"> ▪ The current scheme has just been assessed and covered a four-year performance period starting 1 April 2011. The award will be paid in June 2015 and further details of this are given on page 83 ▪ Subject to continuing employment over the four-year period ▪ If the participant resigns during the period then participation in the scheme will lapse ▪ The RemCom has the discretion to make awards for 'good' leavers as appropriate subject to performance ▪ A new scheme for the period to 31 March 2018 was introduced from 1 April 2015 	<p>The annualised maximum award for each director is</p> <p>Matthew Wright £500k</p> <p>Michael Carmedy £125k</p>	No
Pension	Defined contribution scheme minimises the risk to the company	<ul style="list-style-type: none"> ▪ A company contribution into a defined contribution scheme ▪ A cash allowance in lieu of pension 	<p>Contribution of</p> <p>Matthew Wright 18%</p>	No

	associated with defined benefit pension plans		Michael Carmedy 15%	
Other benefits	Provides market competitive benefits	<ul style="list-style-type: none"> ▪ Car allowance ▪ Health cover ▪ Disturbance or relocation allowances 	Based on individual circumstances	No

A basic pay increase of 2.5 per cent for Matthew Wright and Michael Carmedy for 2015–16 was approved in May 2015 and will be applicable to the basic salaries of the executive directors with effect from 1 April 2015. This is in line with the average pay increase for the remainder of staff in the business.

The terms of the contracts for the executive directors require notice periods of 12 months by both parties for Matthew Wright and six months by both parties for Michael Carmedy. If the notice period is worked, no termination payment is payable, otherwise a payment up to a maximum equivalent to the notice period of 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 2014–15							
£'000	Base salary	Benefits	Annual Bonus	LTIP award 2011–15	Total	DC pension contribution / compensation	Total including pension
Matthew Wright	355.5	12.5	226.6	1,250.0	1,844.6	68.4	1,913.0
Michael Carmedy	249.4	11.3	139.7	313.2	713.6	37.4	751.0

Directors' remuneration for 2013–14							
£'000	Base salary	Benefits	Annual Bonus	LTIP award 2011–15	Total	DC pension contribution / compensation	Total including pension
Matthew Wright	348.5	12.6	233.3	0.0	594.4	62.8	657.2
Michael Carmedy	242.2	12.1	122.2	0.0	376.5	36.3	412.8

A Long-Term Incentive Plan (LTIP) has been in place for the period from 2011 to 2015. The Remuneration Committee considered performance against this in April 2015 and has agreed for the payments disclosed above to be made in June 2015. These payments are single one-off payments and cover the performance over the four years of the LTIP. Further details can be found on page 83.

The Chairman and the independent non-executive directors each receive a fee and do not participate in any of our 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	2014–15			2013–14		
	Fees	Other	Total	Fees	Other	Total
Robert Jennings (Chairman)	225.0	0.9	225.9	40.0	0.5	40.5
Colin Hood	-	-	-	225.0	116.6	341.6
David Golden	60.0	24.4	84.4	60.0	17.9	77.9
Robert Armstrong	41.7	8.8	50.5	40.0	3.8	43.8
Cheryl Black	41.7	8.0	49.7	40.0	4.3	44.3
Paul Sheffield	41.7	0.0	41.7	-	-	-
Rosemary Boot	4.2	0.0	4.2	-	-	-
Bill Tame	12.5	0.0	12.5	-	-	-
Paul Moy	-	-	-	-	-	-
Mark Walters	-	-	-	-	-	-

The other amounts payable to the non-executive directors include taxable expenses incurred in the attendance at Board meetings, together with payments to David Golden for consultancy services provided separately to his duties as the senior independent non-executive director. In 2013–14 an additional payment was made to Colin Hood, our previous Chairman, as compensation for loss of office.

None of the directors who held office during the financial year had any disclosable interests in the shares of Southern Water 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

Our 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 used for the creation of a bonus pool and individual objectives, are set and reviewed on an annual basis by the RemCom. The bonus pool targets for 2014–15 were set and approved in May 2014.

A balanced scorecard approach was used for the creation of the bonus pool for the first time this year. Four measures were used in the scorecard: cash revenue, operational expenditure (Opex), Service Incentive Mechanism (SIM) and the successful delivery of key AMP6 change programmes. The weighting of each was set equally at 25 per cent to balance the financial, operational and customer focus of the company and keep these on track while delivering the Change Programme.

Performance-based remuneration is awarded in a manner which promotes sound risk management and does not induce excessive risk-taking. Performance-based pay is granted to reflect our financial results, the results of the business directorate in which the employee is employed and the individual employee's performance. Further, both financial and non-financial factors shall be taken into consideration when determining the individual's bonus, i.e. compliance with internal guidelines and procedures, including customers and investor-related guidelines. A discretionary assessment is always made to ensure that other factors, including factors which are not directly measurable, are considered, including maintaining and promoting corporate values.

Performance-based pay is granted to employees with particular influence on our results and shareholder value. As an overall starting point, we ensure a balanced split between fixed salary and variable pay.

Details of the targets agreed by the RemCom for 2014–15 together with the maximum bonus opportunity available to each executive director are shown in the table below. The performance for 2014–15 was assessed in April and May 2015 by the RemCom and the achievement against each target together with the personal achievement level and payments made in relation to 2014–15 are also shown below.

Performance measure		Weight for 2014–15 (as % of bonus pool)	Achievement 2014–15 (as % of bonus pool)
Service standards	<p>Deliver a targeted improvement in the Service Incentive Mechanism score for 2014–15</p> <p>Purpose – to deliver significant improvements in customer service performance</p> <p>Measure – Ofwat SIM score</p>	25%	7.5%
Key projects	<p>Completion of a number of key projects and contract arrangements in readiness for the next AMP</p> <p>Purpose – to ensure that key enablers are in place as part of our plans to deliver improved services for customers</p> <p>Measure – achievement of agreed project milestones</p>	25%	22.5%
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>	25%	13.75%
Operating costs	<p>Operate the business within a targeted level of total operational expenditure</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>	25%	20%

Bonus 2014–15	Matthew Wright	Michael Carmedy
Maximum bonus opportunity (% of base salary)	100%	80%
Percentage of maximum bonus awarded	63.75%	70%
Bonus percentage awarded based on personal performance (% of base salary)	63.75%	56%
Base salary (£'000)	£355.5	£249.4
Bonus paid (£'000)	£226.6	£139.7

The RemCom has agreed to continue the scheme in 2015–16 and has set the performance measures for inclusion in the balance scorecard approach as cash revenue, operational expenditure (Opex), Service Incentive Mechanism (SIM) and Operational Delivery Incentives (ODIs). The weighting of each will continue to be 25 per cent.

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 are based on the performance measures shown below.

Performance measure		Weight (% of max. LTIP)	Award (% 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 with the other water and sewerage companies	40%	20%
Customer service standards (SIM)	The performance under the Ofwat SIM mechanism rated in comparison with the other water and sewerage companies	15%	0%
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 was made based on Ofwat's methodology	30%	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 was made using company accounts and returns for the period	15%	12.5%
Total maximum / actual award		100%	62.5%

LTIP	Matthew Wright	Michael Carmedy
Maximum LTIP opportunity (£m)	£2.0m	£0.5m
Percentage of maximum LTIP awarded	62.5%	62.5%
LTIP paid (£m)	£1.25m	£0.3m

Performance against the LTIP was reviewed at the RemCom meeting in April 2015. Following changes in comparative reporting to other water companies, and as Ofwat does not review the serviceability outcomes as self-assessed by water companies, the RemCom recognised that an alternative approach was required to assess performance against the serviceability, AMA and operating efficiency elements.

In determining its assessment, the RemCom has taken into consideration the following significant improvements which have been delivered since 2011:

- Significant efficiency improvements resulting in improved operating cost relative efficiency ranking to A Upper for water and B Lower for wastewater
- Top AMA ranking achieved compared to PR09 scores, assessed independently by Strategic Management Consulting
- Top-half performance achieved in many key operational areas including wastewater treatment compliance and mean zonal compliance
- Significant improvement in pollutions (30 per cent improvement)
- Stabilisation of Moody's credit rating
- Industry-leading leakage performance achieved since 2011–12
- Industry-leading health and safety performance

When the LTIP was put in place, a maximum target achievable for Matthew Wright was set based on 150 per cent of average salary over a four-year period. For Matthew Wright the maximum potential achievable was £2.0 million. The maximum potential achievable for Michael Carmedy was set at £0.5 million.

As a result of the performance assessment made, an award of 62.5 per cent of the overall maximum has been made and the payments shown below are due to be made under the scheme in June 2015.

Matthew Wright – £1,250k

Michael Carmedy – £313k

The Board intends to implement a new LTIP from 1 April 2015 to cover the period through to 31 March 2018. The scheme will be a three-year rolling scheme, with overlap, to provide a smoother payment profile while still aligning with the needs of customers and shareholders. The content of this scheme has not yet been formally agreed, however, the intention is that the scheme would be based on the following performance measures and weightings:

- Total shareholder return – 50 per cent
- AMP6 delivery plan efficiencies of the company – 25 per cent
- Service Incentive Mechanism (qualitative element only) ranking of the company – 25 per cent

Directors' report for the year ended 31 March 2015

The directors of Southern Water Services Limited (registered no 02366670) present their report and the audited financial statements for the year ended 31 March 2015

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 2.5 million people and provides wastewater services to nearly 4.6 million people.

Strategic report

The information that fulfils the requirement of the Strategic Report can be found in our Annual Report on pages 15 to 57.

Future developments

The information regarding future developments of the company can be found in our Annual Report on pages 15 to 57.

Results and dividends

The profit and loss account on page 89 shows the company's results and profit for the year. Further details are also available in the Annual Report on pages 42 to 48.

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. During 2014–15 we received insurance proceeds totalling £2.4 million in relation to this event and these are recorded as an exceptional item in the results for this year.

Interim dividends of £802.21 per ordinary share (2013–14 £787.90 per share), totalling £44.9 million (2013–14 £43.8 million) were paid during the year to Southern Water Services Group (SWSG). These dividends, along with associated group tax relief of £11.9 million, enable SWSG to pay the interest of £56.9 million due to SWS on an inter-company loan as disclosed in note 6 to the accounts.

The directors do not recommend payment of a final dividend for 2014–15 (2013–14 £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 2015 and up to the date of signing the financial statements were as follows and further details can be found on pages 64 to 68.

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) (resigned 31 January 2015)
Cheryl Black	(Independent non-executive director) (resigned 31 January 2015)
Rosemary Boot	(Independent non-executive director) (appointed 1 March 2015)
Lisa Harrington	(Independent non-executive director) (appointed 1 April 2015)
Paul Sheffield	(Independent non-executive director) (appointed 1 June 2014)
Bill Tame	(Independent non-executive director) (appointed 1 January 2015)
Paul Moy	(Non-executive director) (resigned 31 March 2015) (alternate non-executive director from 1 April 2015)
Mark Walters	(Non-executive director)

Bronte Somes	(Non-executive director) (appointed 1 April 2015) (previously alternate non-executive director)
Peter Antolik	(Alternate non-executive director) (resigned 7 January 2015)
Andrew Truscott	(Alternate non-executive director) (appointed 7 January 2015)

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 innovatory 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 £0.4 million (2013–14 £0.5 million)

Financial risk management

The Financial Risk Management Policy is included in the Strategic Report on pages 15 to 57

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, safety and wellbeing: 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 35. 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 2015.

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

- The company's business activities, together with the factors likely to affect its future development, performance and position, which are set out in the Strategic Report on pages 15 to 57.
- The financial position of the company, its cash flows, liquidity position and borrowing facilities, which are described in the Financial Performance review on pages 42 to 52.
- The company has available a combination of cash and committed undrawn bank facilities totalling £523.4 million at 31 March 2015 (2014: £335.5 million). These funds are sufficient to fund the operating and capital investment activities of the company for the 12 months from the date of signing the financial statements.
- The company operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities. The Final Determination for the period April 2015 to March 2020 has now been agreed by Ofwat.

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

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

Qualifying third party indemnity

Following shareholder approval, the 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 Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the

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
- 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
- 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

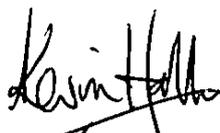
- (1) So far as the director is aware, there is no relevant audit information of which the company's auditor is unaware
- (2) He/she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the 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
23 June 2015

Financial statements

Profit and loss account

For the year ended 31 March 2015

	Note	2015 £m	2014 £m
Turnover	2	828.6	806.2
Cost of sales			
- before exceptional item		(476.1)	(452.0)
- exceptional item	3	<u>2.4</u>	<u>(18.8)</u>
Cost of sales including exceptional item		(473.7)	(470.8)
Gross profit		<u>354.9</u>	<u>335.4</u>
Administrative expenses		(26.8)	(29.4)
Other operating income		0.2	0.2
Operating profit		<u>328.3</u>	<u>306.2</u>
Profit on disposal of fixed assets		1.3	0.5
Profit on ordinary activities before interest and taxation		<u>329.6</u>	<u>306.7</u>
Interest receivable and similar income	6	58.2	61.8
Interest payable and similar charges	7	(183.9)	(229.0)
Profit on ordinary activities before taxation	3	<u>203.9</u>	<u>139.5</u>
Tax on profit on ordinary activities	8	(36.7)	30.3
Profit for the financial year	20	<u>167.2</u>	<u>169.8</u>

The above results relate to continuing operations

The notes on pages 93 to 118 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 2015

	Note	2015 £m	2014 £m
Profit for the financial year		167.2	169.8
Actuarial (loss)/gain recognised in the pension scheme	20,22	(42.9)	3.1
Movement on deferred tax relating to pension deficit	17	<u>8.6</u>	<u>(2.2)</u>
Total recognised gains/(losses) for the year		<u>132.9</u>	<u>170.7</u>

Balance sheet

As at 31 March 2015

	Note	2015 £m	2014 £m
Fixed assets			
Tangible assets	10	4,483.0	4,432.0
Investments	11	29.2	29.2
		<u>4,512.2</u>	<u>4,461.2</u>
Current assets			
Stocks	12	2.2	2.0
Debtors amounts falling due within one year	13	216.8	198.0
Debtors amounts falling due after more than one year	14	812.3	812.3
Cash at bank and in hand		173.5	135.5
		<u>1,204.8</u>	<u>1,147.8</u>
Creditors: amounts falling due within one year	15	<u>(246.5)</u>	<u>(300.6)</u>
Net current assets		<u>958.3</u>	<u>847.2</u>
Total assets less current liabilities		<u>5,470.5</u>	<u>5,308.4</u>
Creditors: amounts falling due after more than one year	16	<u>(3,872.7)</u>	<u>(3,836.4)</u>
Provision for liabilities			
Environmental obligations	17	(0.5)	(0.5)
Deferred taxation	17	(336.8)	(314.2)
Grants and contributions	18	<u>(41.4)</u>	<u>(43.8)</u>
Net assets excluding pension deficit		<u>1,219.1</u>	<u>1,113.5</u>
Pension deficit	22	<u>(89.9)</u>	<u>(72.3)</u>
Net assets		<u>1,129.2</u>	<u>1,041.2</u>
Capital and reserves			
Called up share capital	19,20	0.1	0.1
Share premium	20	46.3	46.3
Profit and loss account	20	1,082.8	994.8
Total shareholder's funds	20	<u>1,129.2</u>	<u>1,041.2</u>

The financial statements of Southern Water Services Limited (Registered no 02366670) on pages 89 to 118 were approved by the Board and authorised for issue on 23 June 2015. They were signed on its behalf by



Michael Carmedy
Chief Financial Officer

Cash flow statement

For the year ended 31 March 2015

	Note	2015 £m	2014 £m
Net cash inflow from operating activities	21a	544.4	543.3
Returns on investments and servicing of finance			
Interest received		58.1	62.2
Interest paid		(129.2)	(141.1)
Preference share dividends		(10.7)	(11.5)
Net cash outflow from returns on investments and servicing of finance		<u>(81.8)</u>	<u>(90.4)</u>
Taxation		(36.9)	(22.9)
Capital expenditure and financial investment			
Purchase of tangible fixed assets		(348.6)	(382.0)
Receipt of grants and contributions		12.3	9.9
Sale of tangible assets		0.3	0.3
Movement on loan to subsidiary		(1.7)	(15.9)
Net cash outflow for capital expenditure and financial investment		<u>(337.7)</u>	<u>(387.7)</u>
Equity dividends paid		(44.9)	(43.8)
Net cash inflow/(outflow) before financing		<u>43.1</u>	<u>(1.5)</u>
Financing			
Repayment of loans		(5.0)	(2.8)
Capital element of finance lease payments		(0.1)	-
Issue costs of new loans		-	(0.1)
Net cash outflow from financing		<u>(5.1)</u>	<u>(2.9)</u>
Increase/(decrease) in cash		<u>38.0</u>	<u>(4.4)</u>
Reconciliation to net debt			
Net debt at beginning of year		(3,722.9)	(3,651.5)
Increase/(decrease) in cash		38.0	(4.4)
Short-term loan to subsidiary		-	(247.5)
Movements in borrowings		5.1	252.8
Debt issue costs		-	0.2
Other non-cash changes		(41.7)	(72.5)
Net debt at end of year	21b	<u>(3,721.5)</u>	<u>(3,722.9)</u>

Notes to the financial statements

For the year ended 31 March 2015

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. More detail can be found in the Directors' Report on page 87

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

- (ii) 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

Notes to the financial statements (continued)

For the year ended 31 March 2015

1 Accounting policies (continued)

Tangible fixed assets and depreciation (continued)

(iii) 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

	Years
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.

(iv) Freehold land is not depreciated.

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

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

Notes to the financial statements (continued)

For the year ended 31 March 2015

1 Accounting policies (continued)

Leased assets (continued)

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 valued at the lower of cost and net realisable value.

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 2015

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 2015

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.

Notes to the financial statements (continued)

For the year ended 31 March 2015

3 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging/(crediting)	2015 £m	2014 £m
Employee costs (note 4a)	40.2	37.9
Depreciation on		
- owned assets	258.7	236.4
- assets held under finance leases	1.6	1.4
	<u>260.3</u>	<u>237.8</u>
Rentals under operating leases		
Vehicles	2.1	2.2
Research and development expenditure	0.4	0.5
Amortisation of grants and contributions (note 18)	(2.9)	(2.9)
Exceptional item (see note below)	(2.4)	18.8
Fees payable to the company's auditor in respect of		
- Statutory audit of the company's financial statements	0.2	0.2
- Other services pursuant to legislation	0.1	0.1
- All other services	0.5	2.0

Note

The exceptional item of £18.8 million for the prior year 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. During 2014–15 we received insurance proceeds totalling £2.4 million in relation to this event and these are recorded as an exceptional item in the results for this year.

Notes to the financial statements (continued)

For the year ended 31 March 2015

4 Employee information

	2015 £m	2014 £m
(a) Employee costs (including directors' emoluments):		
Wages and salaries	69.6	65.9
Social security costs	6.5	6.1
Pension costs - Defined contribution (note 22)	2.0	1.4
- Defined benefit (note 22)	4.8	5.0
Total employee costs	<u>82.9</u>	<u>78.4</u>
Less transferred to fixed assets as capital expenditure	<u>(42.7)</u>	<u>(40.5)</u>
Charged to the profit and loss account	<u>40.2</u>	<u>37.9</u>

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

(b) Average number of persons employed by activity

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

	2015 Number	2014 Number
Operations	1,096	1,079
Customer services	422	480
Corporate centre	598	467
	<u>2,116</u>	<u>2,026</u>

5 Directors' emoluments

	2015 £000	2014 £000
Aggregate emoluments (including benefits in kind)	1,464	1,549
Amounts receivable under long-term incentive plans	1,563	-
Company pension contributions to money purchase pension schemes	-	69

No retirement benefits accrued to directors (2013–14 none) under a Southern Water defined benefit scheme
No retirement benefits accrued to directors (2013–14 two) under a Southern Water defined contribution scheme

A long-term incentive plan has been in operation for the four-year period from 1 April 2011 to 31 March 2015. The Remuneration Committee assessed performance against this plan in April 2015 and agreed for the payments shown above to be made in June 2015. Further details can be found in the Directors' Remuneration Report on pages 73 to 84.

Details of emoluments and benefits for the highest paid director

	2015 £000	2014 £000
Highest paid director's aggregate emoluments and benefits	663	625
Amounts receivable under long-term incentive plans	1,250	-
	<u>1,913</u>	<u>625</u>

During the year the company made contributions of £nil (2013–14 £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 2015

6 Interest receivable and similar income

	2015 £m	2014 £m
Interest receivable from Southern Water Services Group Limited	56.9	56.9
Deposit interest receivable	1.3	4.9
Total interest receivable	58.2	61.8

The interest receivable from Southern Water Services Group Limited relates to the long-term debtor disclosed in note 14

7 Interest payable and similar charges

	2015 £m	2014 £m
Interest payable on other loans	12.8	8.9
Interest paid to group companies	118.4	134.1
Indexation	48.5	72.1
Amortisation of issue costs	3.1	10.2
Amortisation of gilt lock proceeds	(0.1)	(0.1)
Amortisation of deferred proceeds	(9.8)	(9.8)
Amortisation of bond premium	(0.6)	(0.6)
Amortisation of discount	0.3	0.3
Other finance expense (see pensions note 22)	0.6	2.4
Dividends on preference shares	10.7	11.5
Total interest payable and similar charges	183.9	229.0

Dividends on preference shares

- (a) Class A1 preference share dividends amounted to £40 per share and Class B £70 per share totalling £9.0 million (2013–14 £9.0 million)
- (b) A dividend due to the Class A2 preference shareholders of £53.11 (2013–14 £77.23) per share totalling £1.7 million (2013–14 £2.5 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 2014 (see note 16(v))

Notes to the financial statements (continued)

For the year ended 31 March 2015

8 Tax on profit on ordinary activities

	2015 £m	2014 £m
Current tax:		
UK corporation tax on profits for the year	9.5	9.3
Adjustment in respect of prior years	3.2	1.7
Total current tax	<u>12.7</u>	<u>11.0</u>
Deferred tax:		
Origination and reversal of timing differences	24.1	16.2
Adjustment in respect of prior years	(1.4)	(11.7)
Pension cost relief in excess of pension charge	1.3	0.1
Effect of corporation tax rate change	-	(47.1)
Impact of rate change on pension charge	-	1.2
Total deferred tax	<u>24.0</u>	<u>(41.3)</u>
Total tax on profit on ordinary activities	<u>36.7</u>	<u>(30.3)</u>

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

	2015 £m	2014 £m
Current tax charge for the year		
Profit on ordinary activities before tax	<u>203.8</u>	<u>139.5</u>
Current tax:		
UK corporation tax on profits for the year at 21 per cent (2013–14 23 per cent)	42.8	32.1
Adjustment in respect of prior years	3.2	1.7
Pension cost relief in excess of pension charge	(1.4)	(0.1)
Group relief received	(10.5)	(12.1)
Permanent differences	3.8	5.7
Tax charge on ordinary activities	<u>37.9</u>	<u>27.3</u>
Timing differences	(25.2)	(16.3)
Current tax charge for year	<u>12.7</u>	<u>11.0</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, and deferred tax balances have been calculated using these reduced rates. A £47.1 million credit was recognised in the profit and loss account in the previous 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 were 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 2015

9 Dividends

	2015 £ per ordinary share	2014 £ per ordinary share	2015 £m	2014 £m
Ordinary shares				
Interim dividend – Q1	200.56	195.48	11.3	11.0
Interim dividend – Q2	200.55	195.48	11.2	11.0
Interim dividend – Q3	200.55	195.47	11.2	10.9
Interim dividend – Q4	200.55	195.47	11.2	10.9
Total interim dividend	<u>802.21</u>	<u>781.90</u>	<u>44.9</u>	<u>43.8</u>
Final dividend	-	-	-	-
Total ordinary dividend	<u>802.21</u>	<u>781.90</u>	<u>44.9</u>	<u>43.8</u>

The directors do not recommend payment of a final dividend for 2014–15 (2013–14 £nil)

The interim dividends totalling £44.9 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 6.

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
Cost:						
At 1 April 2014	1,397.6	2,260.6	2,213.4	395.5	670.5	6,937.6
Additions	1.7	44.2	73.1	163.1	41.0	323.1
Transfers	8.6	224.5	18.8	(290.0)	38.1	-
Grants and contributions	-	-	(11.8)	-	-	(11.8)
Disposals	-	(6.3)	(7.5)	-	(5.5)	(19.3)
At 31 March 2015	<u>1,407.9</u>	<u>2,523.0</u>	<u>2,286.0</u>	<u>268.6</u>	<u>744.1</u>	<u>7,229.6</u>
Accumulated depreciation:						
At 1 April 2014	526.9	802.3	767.5	-	408.9	2,505.6
Charge for the year	37.3	92.5	76.2	-	54.3	260.3
Disposals	-	(6.3)	(7.5)	-	(5.5)	(19.3)
At 31 March 2015	<u>564.2</u>	<u>888.5</u>	<u>836.2</u>	<u>-</u>	<u>457.7</u>	<u>2,746.6</u>
Net book amount:						
At 31 March 2015	<u>843.7</u>	<u>1,634.5</u>	<u>1,449.8</u>	<u>268.6</u>	<u>286.4</u>	<u>4,483.0</u>
At 31 March 2014	<u>870.7</u>	<u>1,458.3</u>	<u>1,445.9</u>	<u>395.5</u>	<u>261.6</u>	<u>4,432.0</u>

Notes to the financial statements (continued)

For the year ended 31 March 2015

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 2015 and 31 March 2014 was £65.0 million and £76.8 million, respectively. The associated contributions were £3.8 million for the year ended 31 March 2015 and £2.6 million for the year ended 31 March 2014.

For the years ended 31 March 2015 and 31 March 2014, the net book value of infrastructure assets is stated after deducting grants and contributions since privatisation of £225.9 million and £214.1 million, respectively.

Freehold land is stated at a cost of £51.7 million and £51.7 million at 31 March 2015 and 31 March 2014, 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.

	2015 £m	2014 £m
Cost	19.4	18.6
Aggregate depreciation	<u>(14.3)</u>	<u>(12.7)</u>
Net book amount	<u>5.1</u>	<u>5.9</u>

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

(b) Capital commitments	2015 £m	2014 £m
In respect of contracts placed	<u>113.3</u>	<u>124.0</u>

11 Fixed asset investments

	2015 £m	2014 £m
Shares in group undertakings	29.2	29.2
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.

12 Stocks

	2015 £m	2014 £m
Raw materials	1.5	1.6
Work in progress	<u>0.7</u>	<u>0.4</u>
	<u>2.2</u>	<u>2.0</u>

Notes to the financial statements (continued)

For the year ended 31 March 2015

13 Debtors: amounts falling due within one year

	2015 £m	2014 £m
Trade debtors	90.7	79.3
Loan receivable from Southern Water Services (Finance) Limited	15.1	13.4
Other amounts owed by other group undertakings	2.8	4.8
Other debtors	6.5	11.2
Accrued income	88.8	75.6
Prepayments	12.9	13.7
	<u>216.8</u>	<u>198.0</u>

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

14 Debtors: amounts falling due after more than one year

	2015 £m	2014 £m
Loans owed by group undertaking	<u>812.3</u>	<u>812.3</u>

Loans owed by group undertaking represents 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 seven per cent per annum

15 Creditors: amounts falling due within one year

	2015 £m	2014 £m
Trade creditors	23.8	21.0
Loans from group undertakings (see note (i) below)	30.3	30.3
Amounts owed to group undertakings	16.7	38.7
Capital creditors and capital accruals	80.7	106.5
Taxation and social security	2.4	2.6
Debt issue costs (note 16 (vi))	(3.1)	(3.1)
Accruals and deferred revenue	85.6	94.5
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>246.5</u>	<u>300.6</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

Notes to the financial statements (continued)

For the year ended 31 March 2015

16 Creditors: amounts falling due after more than one year

	2015 £m	2014 £m
Loans and other borrowings		
Loan from Southern Water Services (Finance) Limited	3,469.4	3,426.0
Debt issue costs (see note (vi) below)	(30.0)	(33.2)
Bond premium deferred	3.8	4.1
Deferred gilt lock proceeds (see note (vii) below)	5.2	5.3
Deferred proceeds*	115.0	124.7
Amounts due to group undertaking	3,563.4	3,526.4
Term Facility Agreement 2013 £150m – 6-month Libor plus 3% 2017	-	150.0
Term Facility Agreement 2014 £150m – 6-month Libor plus 1.95% 2021	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
Obligations under finance leases	1.8	1.6
Total loans and other borrowings	3,857.8	3,821.1
Deferred revenue (see note (viii) below)	14.9	15.3
Total creditors falling due after more than one year	3,872.7	3,836.4
	2015 £m	2014 £m
Repayments fall due as follows.		
Between two and five years	-	150.0
After five years not by instalments	3,762.0	3,568.6
	3,762.0	3,718.6

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 below.

Notes to the financial statements (continued)

For the year ended 31 March 2015

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

An analysis of the loans is shown below

Loans	2015 £m	2014 £m
Class A £350m - £349.3m 3.345% index linked 2029/2037 & £0.7m 6.202% fixed rate 2029 (note (i) below)	402.7	395.8
Class A £150m - 3.716% index linked 2034	215.5	210.2
Class A £35m - 3.716% index linked 2034	49.6	49.7
Class A £350m - £141.9m 3.709% index linked & £208.1m 6.650% fixed rate 2026 (note (i) below)	370.0	367.2
Class A £150m - 3.826% index linked 2023	215.5	210.2
Class A £350m - £177.0m 2.070% index linked & £173.0m 5.010% fixed rate 2021 (note (i) below)	375.6	372.1
Class A £150m - 0.510% index linked 2041 (note (i) below)	204.4	201.1
Class A £200m - 0.070% index linked 2052 (note (i) below)	266.3	262.1
Class A £300m - 0.490% index linked 2056 (note (i) below)	363.3	362.3
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	237.1	231.3
Artesian £156.5m - 3.645% index linked 2032	219.4	214.0
Total Class A debt	3,219.4	3,176.0
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
Debt issue costs (note (vi) below)	(30.0)	(33.2)
Bond premium deferred	3.8	4.1
Deferred gilt lock proceeds (note (vii) below)	5.2	5.3
Deferred proceeds*	115.0	124.7
Total loans and other borrowings from SWSF	3,563.4	3,526.9
Term Facility Agreement 2013 £150m – 6-month Libor plus 3% 2017	-	150.0
Term Facility Agreement 2014 £150m – 6-month Libor plus 1.95% 2021	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	1.8	1.6
Total loans and other borrowings	3,857.8	3,821.1

*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 2015

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 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 the Licence to own and operate water assets. 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 2015, 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. SWSF has entered into mirror swaps (as well as loans) with SWS. SWS is not required under applicable accounting standards to include the fair value of these intercompany instruments within the financial statements.

The table below analyses the total value of swaps entered into by SWSF as at 31 March 2015 and the fair value of these instruments held off-balance sheet in SWS.

Nominal value of debt	Original Fixed interest rate	Swapped Index Linked interest rate	Nominal value of debt plus capitalised RPI	Fair value of related off-balance sheet swap instrument liability at SWS*
£349.3m	6.192%	3.335%	£402.0m	£215.4m
£141.9m	6.640%	3.699%	£162.0m	£86.5m
£177.0m	5.000%	2.060%	£202.6m	£153.3m
£150.0m	5.000%	0.500%	£204.4m	£159.8m
£200.0m	4.500%	0.060%	£266.3m	£269.6m
£300.0m	5.125%	1.132%	£363.3m	£304.1m
£1,318.2m			£1,600.6m	£1,188.7m

* includes capitalised RPI already included in book value of £282.4 million

- (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 five per cent. This swapped rate has been reflected in the rate charged to SWS plus 0.01 per cent. The fair value of the swap instrument held off-balance sheet at SWS equates to an asset of £13.8 million.
- (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. The balance on the Senior Mezzanine loan was repaid on 14 November 2014. The fair value of the related swap instrument held off-balance sheet at SWS equates to a liability of £16.2 million.
- (v) The preference shares issued have been classified as loans in the financial statements. 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, any time earlier. Class A1 and B shares were issued at £1,000 per share and the

Notes to the financial statements (continued)

For the year ended 31 March 2015

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

amounts received totalled £142.6 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 £326. Class A2 shares, which do not carry voting rights, are also redeemable at nominal value. Shareholders are entitled to receive dividends annually as follows:

Class A1 – £40 per share

Class A2 – the base value dividend plus an amount for company out-performance and any savings arising from any refinancing of the Mezzanine debt. The base value is £nil per share increasing by £15 every five years from 31 March 2011. From 1 April 2007, out-performance is defined as 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 2015 for out-performance in the year ended 31 March 2015.

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 2015 debt issue costs amounted to £33.1 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 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 and is 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 2015

17 Provision for liabilities

(a) Environmental obligations	2015	2014
	£m	£m
At 1 April	0.5	0.8
Utilised in year	-	(0.3)
At 31 March	0.5	0.5

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.

(b) Deferred taxation	2015	2014
	£m	£m
Accelerated capital allowances	347.2	333.0
Other timing differences	(10.4)	(18.8)
Deferred taxation	336.8	314.2

Movement in deferred tax provision	2015	2014
	£m	£m
Deferred tax provided at 1 April	314.2	356.8
Prior year adjustment	(1.4)	(11.7)
Deferred tax charge in profit and loss account	24.0	16.2
Effect of corporation tax rate change	-	(47.1)
Deferred tax provided at 31 March	336.8	314.2

Deferred tax asset relating to pension deficit	2015	2014
	£m	£m
At 1 April	18.1	21.6
Deferred tax charge in profit and loss account	(1.3)	(0.1)
Deferred tax credited/(charged) to the statement of total recognised gains and losses	8.6	(0.7)
Impact of rate change		
Charge in profit and loss account	-	(1.2)
Charged to the statement of total recognised gains and losses	-	(1.5)
At 31 March	25.4	18.1

The total deferred tax asset of £25.4 million (2013–14: £18.1 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 2015

18 Grants and contributions

	£m
At 1 April 2014	43.8
Receivable in year	0.5
Released to profit and loss account	(2.9)
At 31 March 2015	<u>41.4</u>

These grants and contributions relate to non-infrastructure assets

19 Called up share capital

	2015 £m	2014 £m
Equity shares		
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		
Preference shares		
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 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 2015

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	914.3
Profit after tax	-	-	169.8	169.8
Dividends paid	-	-	(43.8)	(43.8)
Actuarial gain on pension scheme	-	-	3.1	3.1
Movement on deferred tax relating to pension deficit	-	-	(2.2)	(2.2)
At 1 April 2014	0.1	46.3	994.8	1,041.2
Profit after tax	-	-	167.2	167.2
Dividends paid	-	-	(44.9)	(44.9)
Actuarial loss on pension scheme	-	-	(42.9)	(42.9)
Movement on deferred tax relating to pension deficit	-	-	8.6	8.6
At 31 March 2015	0.1	46.3	1,082.8	1,129.2

The profit and loss reserve includes recognised losses of £115.3 million (2013–14 £90.4 million) less deferred taxation of £25.4 million (2013–14 £18.1 million) in respect of pension scheme liabilities of the company pension fund

21 (a) Cash flow from operating activities

	2015 £m	2014 £m
Continuing operations		
Operating profit	328.3	306.2
Depreciation charge	260.3	237.8
Difference between pension charge and cash contributions	(18.6)	(2.7)
Amortisation of grants and contributions	(2.9)	(2.9)
Decrease in environmental provision	-	(0.3)
Increase in stocks	(0.2)	(0.4)
Increase in debtors	(16.5)	(15.8)
(Decrease)/increase in creditors	(6.0)	21.4
Total net cash inflow from operating activities	544.4	543.3

Notes to the financial statements (continued)

For the year ended 31 March 2015

21 (b) Analysis of net debt

	At 1 April 2014 £m	Cash Flow £m	Other non- cash changes £m	At 31 March 2015 £m
Cash deposits	135.5	38.0	-	173.5
Debt issue costs	36.3	-	(3.1)	33.2
Gilt lock proceeds (see note 16)	(5.4)	-	0.1	(5.3)
Loans due within one year	(40.3)	-	-	(40.3)
Loans due after one year	(3,847.4)	5.0	(38.4)	(3,880.8)
Finance leases	(1.6)	0.1	(0.3)	(1.8)
	<u>(3,722.9)</u>	<u>43.1</u>	<u>(41.7)</u>	<u>(3,721.5)</u>

The non-cash movement of £41.7 million relates to an increase in debt as a result of indexation, 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 deficit after deferred tax of £89.9 million (2013–14 deficit £72.3 million) has arisen mainly as a result of lower expected future returns on investments primarily due to low interest rates. The deficit (before deferred tax) of £115.3 million (2013–14 deficit £90.4 million) has increased due to a decrease in the yields on AA-rated corporate bonds, partially offset by a reduction in the RPI inflation assumption used (this decreases the value placed on the pension scheme liabilities, decreasing the shortfall in the pension scheme), and asset returns in excess of the expected return over the year (this has resulted in a higher value in the year end assets, decreasing the shortfall in the pension scheme). The deferred tax asset related to the plan deficit increased by £8.6 million leading to a corresponding credit in the statement of total recognised gains and losses (note 17)

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 manage assets for the Southern Water Pension Scheme within pooled investment funds, and appoint custodians for these assets 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 2015 amounted to £2.0 million (2013–14 £1.4 million). No contributions were outstanding at either year end in relation to the defined contribution scheme

Notes to the financial statements (continued)

For the year ended 31 March 2015

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

	2010 SWPS % per annum (pa)
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 2015-16 are £15.2 million and £0.3 million respectively under the current Schedule of Contributions. An actuarial valuation as at 31 March 2013 is currently under way 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 2015

22 Pensions (continued)**Assumptions, asset, liability and reserves**

The formal actuarial funding valuation was carried out as at 31 March 2010 and updated to 31 March 2015 by a qualified independent actuary. The major assumptions used by the actuary are set out in the table below.

	2015	2014	2013
	% pa	% pa	% pa
Price inflation (RPI)	3.0	3.2	3.2
Price inflation (CPI)	2.0	2.3	2.3
Rate of increase in salaries (plus an age-related promotional scale)	2.5	2.5	2.5
Rate of increase of pensions in payment (MIS* members only)***	2.0	2.3	2.3
Rate of increase of pensions in payment (Old section** members only)***	3.0	3.2	3.2
Rate of increase of pensions in payment (all other members)***	2.9	3.1	3.1
Rate of increase for deferred pensions (MIS* members only)***	2.0	2.3	2.3
Rate of increase for deferred pensions (all other members)***	2.9	3.1	3.1
Discount rate	3.4	4.5	4.4
Expected return on assets	4.0	5.1	4.7

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

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

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

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. For 2014–15, the company has used the post-retirement mortality assumptions based on the standard SAPS mortality tables together with future improvements in line with CMI 2014 improvements with a long-term improvement rate of 1.25 per cent per annum.

	2015	2014
	Years	Years
Longevity at age 65 for current pensioners		
Male	23.0	22.9
Female	25.1	25.0
Longevity at age 65 for future pensioners		
Male	24.7	24.7
Female	27.0	26.9

Notes to the financial statements (continued)

For the year ended 31 March 2015

22 Pensions (continued)

The assets and liabilities in the schemes and the expected rates of return at 31 March 2015 and 31 March 2014 were

	Rate of return 2015	Rate of return 2014	Value at 2015 £m	Value at 2014 £m
Equities	5.9%	7.1%	282.2	256.6
Government bonds	1.9%	3.1%	159.1	132.3
Non-Government bonds	2.8%	4.0%	208.8	183.9
Cash	2.7%	2.9%	23.9	8.7
Total market value of plan assets			674.0	581.5
Total value of plan liabilities			(789.3)	(671.9)
Accrued deficit in the plan			(115.3)	(90.4)
Related deferred tax asset			25.4	18.1
Net pension liability			(89.9)	(72.3)

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

Reconciliation of the present value of the scheme liabilities

	2015 £m	2014 £m
At 1 April	671.9	669.7
Current service cost	4.8	5.0
Interest cost	29.8	29.1
Member contributions	0.2	0.3
Actuarial loss/(gain) on liabilities	108.1	(7.5)
Benefits paid	(25.5)	(24.7)
Scheme liabilities at 31 March	789.3	671.9

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%	-/+ 15	-/+ 117
Rate of inflation*	+/- 1%	+/- 13	+/- 101
Rate of increase in pensions in payment	+/- 1%	+/- 11	+/- 90
Mortality	+/- 1yr	+/- 3	+/- 23

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

Notes to the financial statements (continued)

For the year ended 31 March 2015

22 Pensions (continued)

Reconciliation of the fair value of the scheme assets	2015 £m	2014 £m
At 1 April	581.5	576.0
Expected return on assets	29.2	26.7
Gain/(loss) on assets	65.2	(4.4)
Employer contributions	23.4	7.6
Member contributions	0.2	0.3
Benefits paid	(25.5)	(24.7)
Bid value of scheme assets at 31 March	674.0	581.5

The actual gain on scheme assets was £94.4 million (2013–14 £22.2 million)

Analysis of amounts charged to operating profit	2015 £m	2014 £m
Employer's current service cost	4.8	5.0
Expected return on pension scheme assets	(29.2)	(26.7)
Interest on pension scheme liabilities	29.8	29.1
Total P&L expense before deduction for tax	5.4	7.4

Analysis of the amounts recognised in STRGL	2015 £m	2014 £m
Actuarial return less expected return on pension scheme assets	65.2	(4.4)
(Loss)/gain on change of assumptions (financial and demographic)	(108.1)	7.5
Total (loss)/gain recognised in STRGL before adjustment for tax	(42.9)	3.1

The cumulative amount of actuarial losses recognised in the statement of total recognised gains and losses is £179.5 million (2013–14 £136.6 million)

Analysis of the movement in the schemes' deficit during the year	2015 £m	2014 £m
Deficit in the scheme at 1 April	(90.4)	(93.7)
Employer's contributions	23.4	7.6
Employer's current service cost	(4.8)	(5.0)
Other finance expense	(0.6)	(2.4)
Actuarial (loss)/gain	(42.9)	3.1
Deficit in the scheme at end of year	(115.3)	(90.4)
Deferred tax relating to scheme deficit	25.4	18.1
Net deficit at end of year	(89.9)	(72.3)

Notes to the financial statements (continued)

For the year ended 31 March 2015

22 Pensions (continued)

History of gains and losses for the year to 31 March 2015	2015	2014	2013	2012	2011
a Experience (gain)/loss on scheme assets					
Amount (£m)	<u>(65.2)</u>	<u>4.5</u>	<u>(43.0)</u>	<u>0.5</u>	<u>(1.1)</u>
b. Experience (gain)/loss on scheme liabilities					
Amount (£m)	<u>-</u>	<u>-</u>	<u>1.1</u>	<u>4.9</u>	<u>(6.0)</u>
c. Total amount recognised in the STRGL					
Fair value of assets at year-end (£m)	674.0	581.5	576.0	519.8	500.6
Actuarial value of liabilities at year-end (£m)	(789.3)	(671.9)	(669.7)	(616.1)	(560.7)
Deficit in scheme at year-end (£m)	<u>(115.3)</u>	<u>(90.4)</u>	<u>(93.7)</u>	<u>(96.3)</u>	<u>(60.1)</u>

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 (2013–14: £nil).

24 Financial commitments

As at 31 March 2015 and 2014, 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:

	Land and Buildings		Other	
	2015	2014	2015	2014
	£m	£m	£m	£m
Expiring between two and five years	-	0.1	0.2	0.1
Expiring after more than five years	<u>1.6</u>	<u>1.4</u>	<u>-</u>	<u>-</u>
	<u>1.6</u>	<u>1.5</u>	<u>0.2</u>	<u>0.1</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 2015 are IIF International SW UK Investments Limited (managed by J.P. Morgan Investments Inc.) and The Northern Trust Company.

Notes to the financial statements (continued)

For the year ended 31 March 2015

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 2015 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 2015 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

25 June 2015