

Annual Report and Financial Statements

For the year ended 31 March 2021



from
**Southern
Water** 



from
**Southern
Water.** 

Our purpose is to provide water for life. We are committed to making a positive impact for the good of our customers and communities.

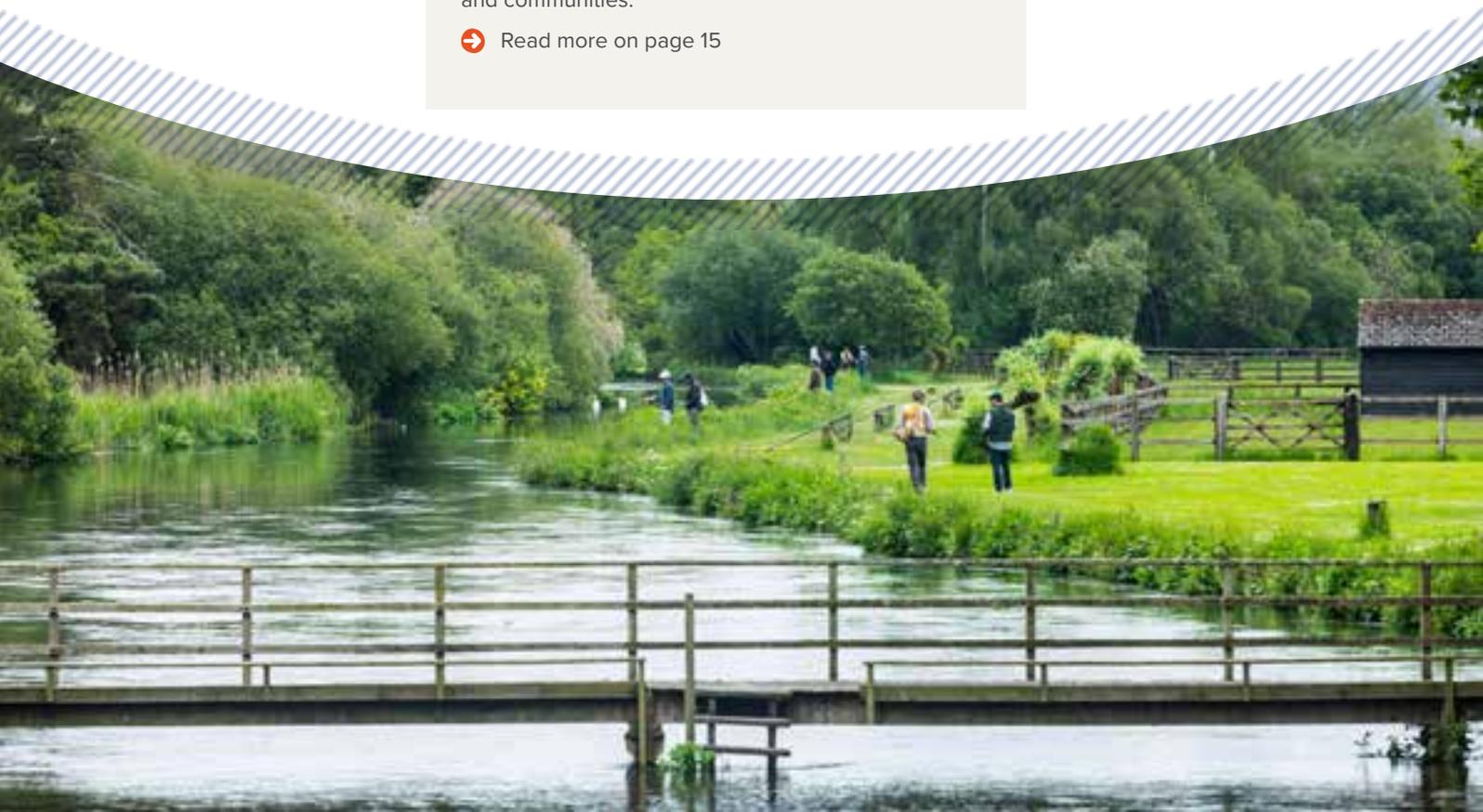
We provide essential services to 2.6 million water customers and 4.7 million wastewater customers across Sussex, Kent, Hampshire and the Isle of Wight.

[➔ Read more about our purpose on pages 2 and 3](#)

Our response to COVID-19

As a provider of water and wastewater services, many of our employees are key workers whose tasks are critical to the health and wellbeing of our customers and communities.

[➔ Read more on page 15](#)



Delivering value to our customers and key stakeholders

The water cycle touches every part of life and so our stakeholder base is diverse. Understanding what matters most to our stakeholders is fundamental to being a purpose-driven organisation. We consider these priorities alongside potential impacts on our company and value created when developing our strategy.



Customers



Communities



Regional stakeholders



Retailers



Employees



Suppliers



Environment



Regulators



Investors

➔ Read more about our s172(1) Statement on pages 66 to 69

In this report

Overview

How we are delivering our purpose	02
Our leadership	06
What we do and where we do it	08
Highlights and challenges	10
Chairman's statement	16

Strategic Report

Chief Executive's summary	22
Our progress	26
Our external environment	28
Our business model	38
Sustainability	63
s172(1) Statement	66
Environmental disclosures	70
Our operational performance	74
– Deliver great service	80
– Use water wisely	86
– Protect and improve the environment	88
– Fit for the future	96

Financial performance

Financial performance	102
Capital structure	112
Risks	118
Principal risks and uncertainties	125
Viability statement	140

Governance

Chairman's overview	146
Board of directors	148
Our approach to governance	154
Corporate governance report	157
Directors' remuneration report	194
Directors' report	212

Financial statements

Income statement	222
Statement of other comprehensive income	223
Statement of financial position	224
Statement of changes in equity	225
Statement of cash flows	226
Notes to the financial statements	227
Independent Auditor's report	266

Registered office

Southern Water
Southern House, Yeoman Road
Worthing, West Sussex BN13 3NX

Registered no: 02366670

How we are delivering our purpose

We are providing **water for life**

Creating value for our customers and stakeholders

In order to create a resilient water future for the South East, we continue to develop our plans with our customers and key stakeholders; finding shared solutions to the challenges facing our region.

[➔ Read more on pages 41 to 43](#)



Enhancing health and wellbeing

Supporting our customers, employees and communities in the South East

It is our priority to ensure everyone has access to clean, safe and affordable water and effective and efficient wastewater services. We also want to ensure that our employees reflect the diverse communities we serve and that we are always improving.



Protecting and improving the environment

Ensuring a sustainable and resilient water future

It is our responsibility to help protect the water environment for future generations. This means not only looking after the environment but finding ways to leave it in a better state than we found it using nature-based solutions where possible, adapting to climate change and ensuring we manage our operations in a sustainable way.



Sustaining the economy

Promoting innovation and a holistic approach to planning

We take an integrated, systems-thinking approach to creating long-term value for our customers and key stakeholders. Our decisions are shaped by their material issues, risk and value assessments and an underlying commitment to environmental, social and governance (ESG) matters.



Our purpose, vision, strategy and values

Our strategy defines how we operate. Our purpose, vision and core values provide the cultural framework that informs our decision-making.

Our governance

Our Board draws on both the principles of leadership, transparency and governance published by Ofwat, as well as those of the UK Corporate Governance Code.

➔ Read more on pages 154 to 156

Risk management

Our approach to risk management is designed to provide a clear and consistent framework for managing and reporting risks associated with our operations to executive management and to the Southern Water Board. The framework seeks to promote better decision-making, avoid incidents and encourage the best outcome for the company and our customers.

➔ Read more on page 118

Our purpose

Why we exist

We provide **water for life** to:

enhance health and wellbeing



protect and improve the environment



sustain the economy



➔ Read about Our commitment to sustainability on pages 63 to 73

Our vision

Our ambition

To create a resilient water future for our customers in the South East



“ A key pillar of our purpose, protecting and improving the environment, is something that sits at the very heart of our business ”

Ian McAulay
Chief Executive Officer

Our strategy

How we achieve our purpose

Our strategy for the next five-year planning period 2020–25:

-  Deliver great service
-  Use water wisely
-  Protect and improve the environment
-  Fit for the future

 Read more on pages 74 to 99

Our values

Fundamental beliefs that underpin everything we do

Our three values sit at the core of our ethical decision-making framework.



Our culture

Ethical foundation enabling better decisions every day

Ethical decision-making and modern compliance frameworks, alongside our vision, purpose and values, help our leadership team, employees and partners make better decisions every day so that we can achieve our ambition in the long term.

 Read more on pages 168 to 175



Our leadership

A core principle of corporate governance is the need for transparency in terms of performance, and to ensure that the Board is accountable for the company’s actions. The day-to-day running of Southern Water is led by its Executive Leadership Team.



Keith Lough
Chairman

Keith was appointed Chairman of Southern Water in August 2019. He has extensive experience in the natural resources and energy sectors in both finance and leadership roles. This includes as a former finance director of British Energy plc, as a non-executive member and chairman of the Audit and Risk Assurance Committee at Ofgem.

→ Read the Board biographies on pages 148 to 153



Independent non-executive directors



Paul Sheffield

Paul joined the Board in 2014 and has served as Southern Water’s senior independent non-executive director since July 2015. Paul has extensive experience of the construction industry, including major capital projects in the rail, energy and water sectors. Paul is currently also Chair of the Remuneration Committee.



Rosemary Boot

Rosemary joined the Board in 2015. She is on a number of other listed and unlisted boards. Rosemary has substantial experience from the finance sector, initially investment banking and more recently as CFO. She has been involved in the low carbon agenda for 20 years.



Mike Putnam

Mike joined the Board in 2017 and currently acts as Chair of the Risk Committee. Mike has over 25 years’ experience leading and managing businesses across development and construction. Mike previously served as president and CEO of Skanska UK between 2009 and 2017.



Malcolm Cooper

Malcolm joined the Board in 2019 and acts as Chair of the Audit Committee. Malcolm has extensive experience of the regulated utility sector, including having worked at National Grid plc for around 30 years. He is also a past president of the Association of Corporate Treasurers.



Gillian Guy DBE

Gillian joined the Board in 2018 and serves on the Risk and Remuneration Committees. Gillian is a lawyer and spent 11 years as chief executive officer of the London Borough of Ealing. Gillian is currently the Independent Assessor of the Financial Ombudsman Service and was previously CEO of Citizens Advice.



Kevin McCullough

Kevin joined the Board in 2019 and since 2020 has acted as the non-executive director with the remit of communicating the views of the workforce to the Board. Kevin has extensive experience of the utility sector, having held significant executive positions at a number of energy companies.

Non-executive directors



Sara Sulaiman

Sara joined the Board in 2017 as a shareholder-nominated director. Sara is a managing director at JP Morgan Asset Management. Sara is a director of a number of energy and distribution companies and has a background in investment.



Marykay Fuller

Marykay joined the Board in 2020 as a shareholder-nominated director for Greensands Holdings Limited. Marykay is currently a director of a number of other bodies, including the UK Civil Aviation Authority and has a background in finance and consulting.

Executive directors and company secretary



Ian McAulay

Ian joined Southern Water as CEO in January 2017 and was appointed to the Board from 1 February. He is a member of the Executive Committee and the Executive Leadership Team. Ian has more than 30 years of global water and environmental experience, operating in both publicly quoted FTSE100/250 companies and privately held enterprises.



Sebastiaan Boelen

Sebastiaan joined the Southern Water Board in December 2018. He is a member of the Executive Committee and the Executive Leadership Team. Following a career in the Royal Navy, he took on management consulting and senior finance roles in telecoms (infrastructure), consumer goods, business services and financial services for listed and private equity portfolio companies.



Richard Manning
Company Secretary

Richard joined Southern Water in July 2018 as General Counsel and Company Secretary and now has overall responsibility for leading the Risk and Compliance directorate alongside his legal and governance roles. He is a member of the Executive Committee and the Executive Leadership Team. He has held similar roles in a number of listed and private companies.

Our governance

Ensuring transparency and accountability

The Board's leadership and approach to transparency and governance engenders trust in Southern Water and ensures accountability for the company's actions. Our Audit and Risk Committees play a key role in overseeing the quality and accuracy of the information we publish, supported by both internal and external auditors who can give independent assurance of the information presented by management.

➔ Read more on pages 186 to 193

Developing and embedding our purpose

The Board defines our purpose, strategy and values. In order to do this, it regularly consults with and takes into account the interests of customers and stakeholders to ensure that the decisions made support the company's purpose.

Engaging with stakeholders and monitoring culture

The Board is responsible for embedding consideration of s172(1) factors in decision-making, including improvements in its engagement with customers and key stakeholders. The Board monitors the culture of Southern Water and can take corrective action if the values and behaviours exhibited do not align with our purpose and values.

➔ Read how the Board considered stakeholders' views in the s172(1) Statement on page 66.

Our approach to risk management

Embedding risk management at every level of the organisation

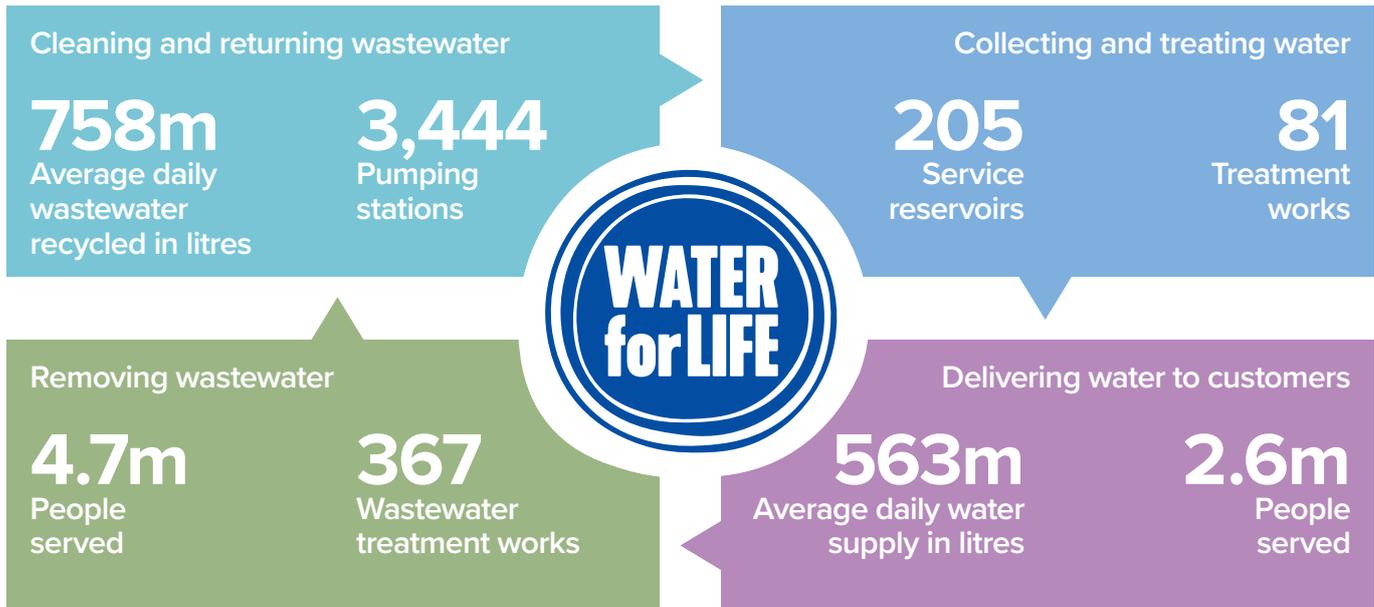
We need to be transparent in terms of the market and environment in which we operate, including the risks that we face. As a result, we need a clear picture of the risk landscape, as well as agreement on what level and type of risk the Board is willing to accept.

➔ Read more on pages 118 to 139

Southern Water at a Glance

What we do

Key facts about our operations



Engaging with our stakeholders

To create a resilient water future, we must work with our customers and key stakeholders to co-imagine and co-create solutions in all aspects of our process.

➔ Read more about our approach to materiality on pages 64 to 65

42,000

regional stakeholders were engaged through a series of surveys and workshops to determine the future of our water and wastewater programmes for 2020–25

Driving innovation and fostering partnerships

Over this five-year business plan period 2020–25, we are investing £3.7 billion across the region. Working with our partners in the community this will create jobs, benefit the local environment and ensure the resilience of our water and wastewater networks.

➔ Read more about our strategy on pages 74 to 99

£12m

in efficiencies have been delivered by our bluewave innovation hub in 2020–21

Where we do it

Creating a resilient water future for our customers in the South East

Comprising over 700 miles of coastline, two National Parks and five Areas of Outstanding Natural Beauty, chalk rivers, ancient woodland, wetlands and downland, our region is as diverse as the populations we serve.

Understanding the key matters affecting the South East

Social

Making sure our services are affordable for all and that those in the most vulnerable circumstances have access to them is a priority for us.

- 382,000 of our customers are facing situations of long-term vulnerability.
- 122,244 customers have received either a discount on their bill or a capped bill from Southern Water since April 2020.
- The number of our customers on our Priority Services Register has increased 80% since March 2020.

Environmental

We cover a large area of coastline, protected rural areas and large urban areas, all of which create different demands on our services.

- Two National Parks, five Areas of Outstanding Natural Beauty, a heritage coast and two UNESCO world-heritage biosphere reserves.
- 83 designated bathing waters – with 62 currently classified as excellent. (2019 assessment due to suspension of sampling during COVID-19 pandemic.)
- 350+ Sites of Specific Scientific Interest; 38 Special Areas of Conservation; 17 Special Protection

Areas and 13 Ramsar sites – these are wetland areas of international importance under the UNESCO Ramsar Convention, 1971.

Economic

Resilience is a focus as we continue to serve our growing population and support jobs and the tourism industry.

- Population of the South East is expected to grow by 15% by 2030.
- 2,000+ direct employees and many more jobs supported through our supply chain.
- Tourism relied on by key coastal communities across the South East.



[➔ Read more on sustainability on pages 63 to 73](#)

Our approach to sustainability

By creating shared solutions to the challenges of climate change and population growth, we can create a resilient water future for our customers in the South East.

To deliver what our customers and stakeholders want and expect from us, we need to go beyond regulatory compliance to demonstrate long-term stewardship of the environment, deliver public impact and ensure we are responding to our customers' and stakeholders' needs as we plan for the future.

Our approach to sustainability is driven by our core pillars of purpose.

We provide water for life to:

- enhance health and wellbeing
- protect and improve the environment
- sustain the economy

Highlights and challenges

Value delivered to our communities, employees and the environment

→ Read more about our communities on page 60

→ Read more about our employees on pages 56 to 59



Communities

Overview

- We contributed to a combined donation, with other water companies and UK Power Networks, of £500,000 to regional Community Foundations. In addition, 700 care packs were sent out via our foodbank partners and we provided remote volunteering support through our 'befriender' caller network.
- We offered virtual job interviews and mentoring opportunities to secondary school pupils and hosted the 'Big Virtual Water Quiz' with National Geographic Kids and four other water companies.

Future plans

- Our refreshed community funding scheme will offer grants to our regional charities as well as local non-registered charities, e.g. community groups/'Friends of' groups. We will also look to support our communities with access to training, storage and meeting room space.
- Our new community steering group – including employees and customers – will ensure we foster connections with our communities so we can better support and understand their individual needs.



Employees

Overview

- During the year, as a result of the impact of COVID-19, we changed a number of our policies to support our employees and their families, offering extended dependency leave and enabling remote working where possible.
- The Learning Zone was launched in early 2020–21 for all employees, offering online access to mandatory and people skills training via a series of short courses. Since its launch, the number of our employees undertaking training has increased by 5%.
- A new Southern Water STARS platform offers colleagues the opportunity to send each other messages of thanks, and managers the opportunity to reward exceptional employees with small monetary awards. More than 3,000 STARS have been awarded since the platform went live in April 2020.

Future plans

- We will be taking on up to 23 apprentices in different functions such as wastewater, water and engineering and construction, as well as rolling out new internal apprentice programmes in leadership, management and project management with space for up to 34 colleagues in the year to March 2022.
- We have partnered with the Chichester College Group to offer a range of business skills training, such as project management, lean management, business writing and change management.



Environment

Overview

- During 2020–21, we have refocused our baseline operations to further reduce pollution incidents and increase compliance through investment in capital maintenance, digitisation and incident response. We also published our Pollution Incident Reduction Plan.
- Our Catchment First programme is investigating potential pollutants that could compromise the sustainability of our drinking water supplies, and is working in partnership with farmers and landowners to manage those risks. The programme is also investigating the impact of the removal of water from the local environment and the use of more sustainable methods, be that from rivers/streams, Sites of Special Scientific Interest (SSSI), Special Areas of Conservation (SAC) or wetlands.
- We are working with partners across the South East to improve bathing waters as part of our Bathing Water Enhancement Programme and have launched our updated Beachbuoy service, offering watersports enthusiasts access to real-time data about our Combined Sewer Overflow (CSO) discharges.

Future plans

- We are already industry leading in terms of driving down personal daily water usage through our metering and Target 100 water efficiency programmes. We will demonstrate further how we can focus and lead on this issue, which is vital in the water-stressed South East.
- We will create a cross-sector plan to protect the globally important chalk rivers of Hampshire.
- Over the next four years, we will invest £5 million on targeted environmental projects that will deliver additional benefits such as increased carbon storage, improved water quality, reduced flood risk and increased health and wellbeing. These projects will be run in partnership with recognised bodies such as the Wildlife Trusts and the Rivers Trusts.
- We will publish our Net Zero Plan by July 2021 and our updated Climate Change Adaptation Plan by December 2021.
- We are purchasing 100% green energy as part of our Net Zero Plan – delivering on our Water UK-agreed Public Interest Commitment.

➔ Read more on our environmental ambitions on page 17



Highlights and challenges continued

Our operational highlights

→ Read more about our operational performance on pages 74 to 99



Deliver great service

Our performance in 2020–21

- We forecast that our water compliance risk index (CRI) score will be 4.53 (2020: 7.7). Although this is a further year-on-year improvement, we expect it will still be worse than the industry average once results are published by the Drinking Water Inspectorate (DWI). 78% of the 2020 score was due to failures at works (eight coliforms and one turbidity). We are continuing to deliver against our established compliance improvement plan, agreed with the DWI.
- We have reported 4,409 external flooding incidents during the year (2019–20: 5,968), which represents an improvement on last year, and falls within our regulator's target of 4,412. Fluctuations in the weather always put pressure on our network, however, we are confident that our performance demonstrates our improved resilience.

Future plans

- Water supply interruption – continue to reduce the average time customers are without water, with a reduction of 23% by 2025.
- Internal and external sewer flooding – a 20% reduction in the number of internal and external sewer flooding incidents affecting customers' homes and outside areas by 2025.



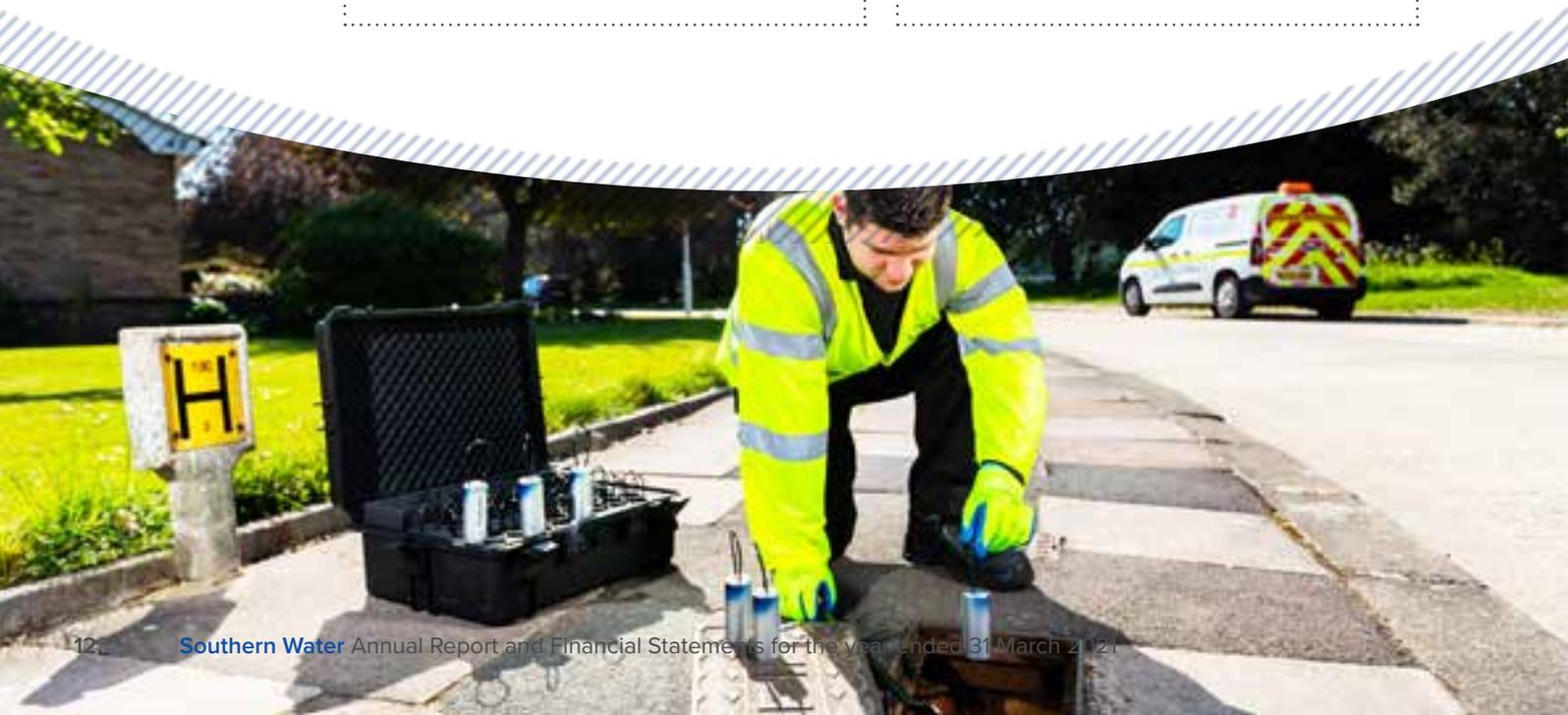
Use water wisely

Our performance in 2020–21

- Although we had to stop all water-saving home visits during the national lockdowns this year, we have still carried out more than 1,000, installing water-saving products for those customers using more water than average, saving a total of 105 cubic metres per day. We have also continued to supply customers with water-saving advice through our digital, social media and radio awareness campaigns.
- Our leakage performance for 2020–21 was 98.5 MI/d (2020: 94 MI/d), which means we did not meet our target. We expect an improvement in our leakage performance as we deliver our advanced pressure management roll-out over the coming year.
- Changes in water usage as a result of COVID-19 have increased customers' individual daily water consumption by around 7% to 137.6 litres per person, per day (2019–20: 126.5 litres).

Future plans

- Individual daily water consumption – reduce personal water use to 118.8 litres per person, per day by 2025.
- Leakage – reduce leakage to 84.9 megalitres per day (MI/d) by 2025.





Protect and improve the environment

Our performance in 2020–21

- We are pleased to report that once again 100% of the bio-solids from our wastewater treatment process were recycled in 2020–21, with none going to landfill.
- Our total number of reportable pollution incidents for the year was 400, which was higher than our target of 98 due to an extended period of wet weather in February. As a result, we received the maximum penalty of £7.7 million. We forecast that we will remain in the penalty space for the remainder of this five-year period while we continue to drive improvements through our Pollution Incident Reduction Plan.
- Our Wastewater Treatment Compliance deteriorated in 2020, with 10 failed works. A new Compliance Process Assessment and Control process for taking plant in and out of service, and extreme weather plans have been introduced. In addition, our new ‘Go-to-Green’ management process is reducing the number of sites at risk.
- A number of our projects in our National Environment Programme did not achieve completion by their regulatory dates due to a combination of planning, design or construction challenges. We recognise this is an area to improve and remains a key focus.

Future plans

- Pollution incidents – reduce annual incidents to less than 80 by 2025, aiming for zero by 2040.
- Treatment works compliance – maintain and improve our wastewater treatment works, aiming for 100% compliance by 2025.
- Deliver environmental benefit by embedding a natural capital approach, investing in initiatives delivering environmental net gain and nature-based solutions. One project already identified is focusing on Chichester and Langstone Harbours.
- Deliver the Water Industry National Environment Programme – 739 investigations and schemes to 2025.



Fit for the future

Our performance in 2020-21

- We have undertaken extensive work to better understand and improve the resilience of our water asset health. As a result, we have more than halved unplanned outage to 9.21%, from 18.59% in 2019–20 and below our regulatory target of 9.45%. Unplanned outages occur when emergency works at our treatment plants cause us to lose water in the system.
- Sewer collapses were reduced in 2020–21 to 7.2 (2020: 7.8) per 1,000km of sewers. This is above Ofwat’s target but is an improvement on last year’s performance.

Future plans

- Long-term supply and demand schemes – ensure future customers have access to sufficient water supplies by making progress toward delivering an additional 182.5 Ml/d of new water resource capacity.
- Risk of severe restrictions in a drought – maintain our performance of no customers being at risk of severe water restrictions in a drought.

Highlights and challenges continued

→ Read more about our financial performance on pages 102 to 111

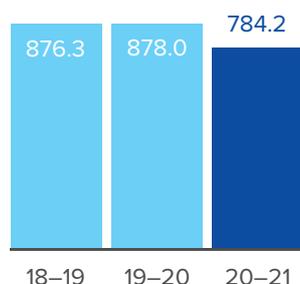
Profit before interest and tax fell to **£139.6m**

largely as a result of the reduction in our revenues, as agreed as part of our Business Plan for 2020–25

Financial highlights

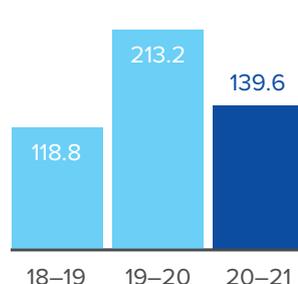
Revenue¹ (before regulatory settlement) £m

£784.2m



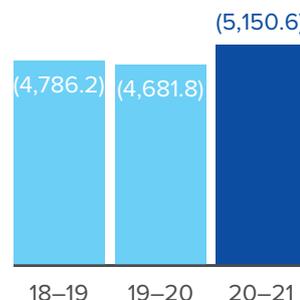
Profit before interest and tax¹ £m

£139.6m



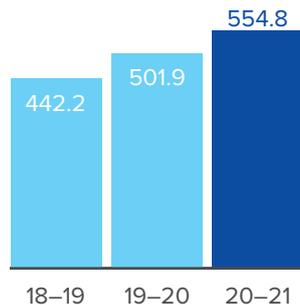
Net Debt² £m

(£5,150.6m)



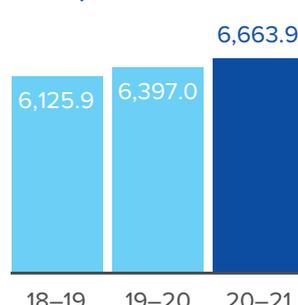
Capital investment² £m

£554.8m



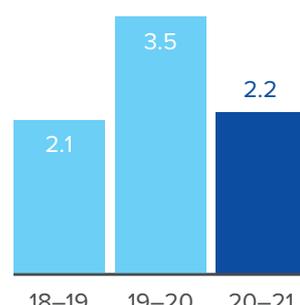
Non-current assets (excluding debt) £m

£6,663.9m



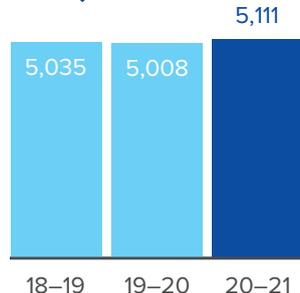
Return on capital employed (ROCE)³ %

2.2%



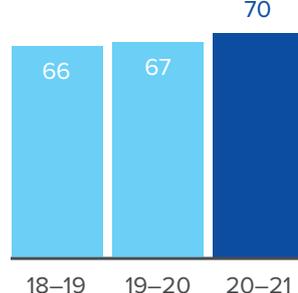
Regulatory Capital Value (RCV)⁴ £m

£5,111m



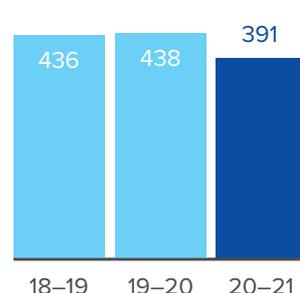
Net debt/RCV⁵ %

70%



Average water and wastewater customer bill £

£391



1. Following its investigation into our wastewater treatment works compliance reporting Ofwat imposed a penalty under Section 22A of the Water Industry Act. We provided in full for this proposed regulatory settlement in the financial statements for 2018-19 reducing profit in that year. We are now making rebates to customers, through revenue, over the period from 2020 to 2025 and these are offset in the income statement by the amortisation of the provision made in 2018-19.

2. Capital investment for 2020-21 includes an intangible asset of £124.6 million recognised for the future payments to Portsmouth Water in relation to the right to water from the construction of the Havant Thicket reservoir. This is a non-cash valuation in the year and payments will be made to Portsmouth over the period to 2100.

3. ROCE is presented as the ratio of profit before interest and tax (£139.6 million) to non-current assets excluding debt (£6,663.9 million) less current liabilities excluding borrowings and lease liabilities (£317.6 million) from the Statement of Financial Position.

4. Regulatory Capital Value (RCV) a measure of the value of our regulatory capital asset base as published by Ofwat. The RCV for March 20 has been restated to reflect the adjustments made by Ofwat at the end of the last regulatory period.

5. 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).

Our response to COVID-19

Our response at a glance

When the COVID-19 pandemic began in March 2020, like every other business in the UK, we needed to adapt quickly. As a provider of essential public services, with many of our employees classified as key workers, we quickly identified those with tasks that were critical to keeping water and wastewater services operating for our customers. We moved in just one week from business as usual to a revised Business Continuity Plan running against four simple priorities, outlined in more detail opposite.

Board's oversight

Our budgets and plans to 2025 have been used as the baseline, and all decisions and changes implemented as a result of COVID-19 have been managed through existing governance processes. A regular situation report has been shared with the Board since the start of the pandemic. In addition, Board member Dame Gillian Guy, until recently Chief Executive Officer of the independent charity Citizens Advice, has brought particular expertise in advocating the interests of those in vulnerable circumstances during the COVID-19 crisis. Kevin McCullough, Board member with responsibility for engagement with Southern Water colleagues, co-hosted a Company Conversation in February. These fortnightly open-invite webinars have been hosted by Ian McAulay since March 2020.

➔ Read more about the **Board's response to COVID-19** on page 146.

Future priorities

As well as contributing towards regulatory conversations that can more dynamically reflect the priorities for economy, society and the environment that emerge in a post-COVID-19 world, we will continue to refine and improve our plans to deliver the services our customers and stakeholders expect.

Maintaining provision of essential services at all times

To maintain customer supplies and protect the environment, our priority has been ensuring the smooth running of our frontline water and wastewater services. The lockdowns have meant more of our customers and their families are at home and, as a result, we have seen changes in water usage, demand for water and impacts to our wastewater network.

Protecting the health, safety and wellbeing of our employees, including our supply chain, and our customers

The health, safety and wellbeing of our teams, supply chain and our customers has been a priority as all have adapted to new ways of working. We have ensured that all our workplaces are COVID-19 secure, as we continue to stringently follow government guidance. To date we have widened our sourcing approaches and worked collaboratively with the sector, our supply chain and regulators to prepare for any issues.

Providing the maximum practicable level of assistance to our vulnerable customers

We are fully aware that some of our customers' circumstances have changed drastically and unexpectedly as a result of COVID-19. Therefore, from the very start of the pandemic, we made our processes easier for people who need to discuss or apply for help with their bills and we widened the criteria for eligibility for help. We also made it possible for third parties to apply for priority services on behalf of vulnerable friends and family.

Protecting the financial stability of our business

Following a challenging settlement from our regulator Ofwat in relation to our business plan 2020–25, and the unprecedented impact of the COVID-19 pandemic, we will not be paying a dividend this financial year and will maintain a gearing target of 70% net debt/RCV for the period to 2025. In addition, a waiver from the Security Trustee was approved in February 2021, which forms part of our contingency planning in case of a prolonged adverse impact from COVID-19 or a Trigger Event a result of a breach of a financial ratio or a credit rating downgrade. Two successful sustainable bond issuances were made in May 2020 and March 2021. We are confident that we have sufficient liquidity in the short to medium-term and have access to different sources of liquidity.

Our response in numbers

14

Contracts offered across nine different suppliers delivering extra support as a result of the pandemic

0

Colleagues furloughed during the COVID-19 pandemic

1,700+

Employees provided with remote working access in just a few weeks at the start of the pandemic

£21k

The new income threshold for access to our social tariff, increased from £16,105 during the November 2020 lockdown

80%

Increased number of customers on our Priority Services Register since March 2020

Chairman's statement



Keith Lough
Chairman

→ Read more on the impact of COVID-19 on page 15

A warm welcome to our Annual Report and Financial Statements for 2020–21.

At the close of a year that has presented Southern Water, and the communities we serve, with unprecedented challenges, I would first like to thank each of our colleagues, and our many suppliers, for their dedication and commitment to ensuring the continuity of essential services for our customers and their care of one another.

The impact of COVID-19, alongside the weather extremes we have experienced this year, have tested our teams, but despite these challenges our core values – succeeding together, doing the right thing and always improving – and our purpose, to provide water for life, have continued to inform and drive the transformation and cultural shift needed to extend and embed the improvements across our business. Supported by strong leadership and clear planning, these improvements have helped us continue to forge stronger relationships with our regulators and to build confidence and credibility among our stakeholders, making amends for past behaviours and poor performance record, and demonstrating the tangible changes we are making as a business every day.

“ We have maintained the financial stability of the company, ensuring at the same time that we have the appropriate financing in place to deliver on our Business Plan 2020–25 ”

Maintaining essential services

In spite of the challenging conditions created by the COVID-19 pandemic, we have maintained services to our customers, and we have done this throughout a period of sustained increase in demand over the summer and beyond, as more of our customers were forced to work from home.

We have also started to deliver improved performance in incident response, particularly during water supply interruption events. This has been driven by a number of changes to people, processes and systems within our Incident Management team, including better forecasting, new supplier agreements and a more collaborative approach with local resilience forums.

Like businesses up and down the country, we have had to adapt to new ways of working in the wake of the COVID-19 pandemic. Early on, we adapted our Business Continuity Plan, which continues to deliver against four simple priorities:

- Maintaining provision of essential services at all times.
- Protecting the health, safety and wellbeing of our employees, including our supply chain, and our customers.
- Providing the maximum practicable level of assistance to our vulnerable customers.
- Protecting the financial stability of our business.

We have maintained services throughout a period of sustained increase in demand.

As a result of this planning and a continuous review of these priorities, we have maintained the financial stability of the company, ensuring at the same time that we have the appropriate financing in place to deliver on our business plan 2020–25. The plan set out a number of challenging targets requiring a significant level of investment, and we have continued to refine and implement our execution plans over the year, as we have dealt with the current situation.

In May 2020 we successfully secured £825 million in sustainable bonds in one of the biggest public market financing issues for the water sector in recent years. This established an environmental, social and governance (ESG) sustainable

financing framework to support our plan, which aligns our long-term strategy with our social and environmental commitments. In March 2021 we issued a further £300 million bond under the same sustainable financing framework.

We know that we still have a lot to do to improve our performance in areas such as customer experience, pollutions, water quality and wastewater compliance and leakage, but I am confident that the plans we have in place, and the continued transformation of the business, which our Chief Executive Ian McAulay will discuss in more detail in his statement, are delivering tangible improvements as we move into the second year of this five-year investment period.

Our environmental ambitions

Our vision is clear; we want to create a resilient water future for our customers in the South East. The challenges which face us in delivering it are to transform our operational performance while in parallel demonstrating to our customers, regulators and other stakeholders that they can have confidence in our ability to deliver.

The environment, and our role in protecting and enhancing it, are at the core of these challenges and we must go further to realise our ambitions. The underpinning context is the very challenging Final Determination made by our regulator Ofwat, the realities of climate change and the expectations of our customers, regulators, and partners.

Our executive and the Board have discussed how we focus on critical environmental issues so that we maximise the opportunities, learn efficiently from the experience of others, and identify where we are already in a position to lead the agenda. The steps we have agreed to take to realise our ambition focus around three core themes:

Simplicity – implementing practical plans and measurable activity to improve pollutions performance and compliance, focusing on the development of a natural capital approach to planning, developing our plans to achieve net zero by 2030, putting our catchments first, shifting our focus from traditional engineering solutions to working collaboratively with partners to create long-term sustainable improvements and a focus on building our flagship Target 100 water efficiency programme.

Transformation – delivering a small and carefully chosen number of bold, ambitious programmes which differentiate Southern Water as an environmental custodian, such as our Water for Life Hampshire plans to tackle a significant potential water supply shortage and our Catchment First programmes; and

Capability – building, from Board level down, a cadre of skilled and committed leaders and expert practitioners.

This framework will take Southern Water a step further towards achieving its vision of a resilient water future. In fact, we are investing nearly £1 billion to deliver environmental benefits to 2025, which will not only improve compliance and the capacity and efficiency of our networks across the region, but also deliver nature-based solutions and environmental net gain.

This work will be led by Southern Water's new Director of Environment and Corporate Affairs, Dr Toby Willison, who joined us following a significant tenure at the Environment Agency. We are very excited to add his considerable knowledge and skills to our Executive Leadership Team, and he has the Board's full support to drive this strategy forward.

➔ Read more about our environmental disclosures on pages 70 to 73

Chairman's statement continued

➔ Read more on the Ofwat and EA investigations on pages 30 to 31

Making amends for past failings

We continue to be the subject of intense regulatory scrutiny, and this was reflected in Ofwat's 2019 report of its investigations into our historic reporting and operation of our wastewater treatment works, and the associated Section 19 undertakings and customer rebates that we have committed to carry out over five years starting in 2020–21. These undertakings encompass a wide range of other activity, including technical reviews of our wastewater treatment works, compliance process improvements, improvements to our culture, new work to provide more transparency on our environmental performance and improvements to our board governance processes.

Our Audit Committee is responsible for monitoring and reviewing the controls and assurance put in place by management in respect of these undertakings and receives regular reports about the progress against the agreed action plans from both internal teams and external assurers working with our Risk and Compliance directorate.

We have also been working to strengthen our approach to risk management. This has been led by the Board and its Risk Committee. The Board is deeply committed to its role of embedding risk management at every level of the organisation and, as part of our transformation, it has recognised the need to improve our approach to risk and resilience management. Work in this area has helped to support risk-based insight to inform strategic prioritisation and decision-making across the company.

To embed risk management successfully across Southern Water, the process is supported by a governance structure that defines roles and responsibilities at each level of the company, with the Board having overall responsibility.

This year we also established a Culture Change Group of employees, which meets monthly to provide programme oversight and to share ideas and best practice on positively influencing culture change. This includes reviewing outputs from our annual employee engagement survey to inform future delivery of culture change initiatives. The survey results from 2021 indicate a meaningful and wholly heart-warming improvement in employee engagement, key values and ethics measures, which evidences the positive progress made on culture change in the year. To inform this group, we have developed and rolled out a new culture dashboard to allow our Board to measure and track progress. The development of metrics to provide indicative measures of the

company's culture have been cited by Ofwat in its Board governance review as an example of good practice.

In 2017, we had four outstanding Final Enforcement Orders from the Drinking Water Inspectorate (DWI): three were associated with new asset improvement schemes, and one with improvements in water quality sampling and information management. Four years on, we have successfully closed all of these orders, with the most recent being revoked earlier this year. However, the DWI has recently confirmed its plans to prosecute for an event in May 2018 at High Park reservoir. The DWI closed its investigation into a further operational event from 2014–15 and issued Southern Water with a formal warning.

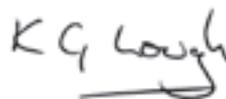
We are being prosecuted by the Environment Agency (EA) for wastewater permit breaches in the period 2010 to 2015, and we pleaded guilty to charges in court. In addition, we continue to assist the EA with its investigations into legacy issues relating to wastewater sampling compliance. The Board, supported by legal advice, has concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from these investigations but will keep the situation under review. Further detail can be found on pages 30 to 31 and in our Annual Performance Report.

Monitoring the market

The Competition and Markets Authority (CMA) concluded its review of the Final Determination for the four water companies that appealed. As a result of that appeal, Anglian Water, Bristol Water, Northumbrian Water and Yorkshire Water will all benefit from an increased rate of return, some increases in allowed costs and a more symmetrical cost sharing rate.

In conclusion

Finally, I would like to say thank you again to our colleagues and partners for their hard work and dedication throughout this extraordinary year. I am grateful to each and every one of them for their contribution, which has made such a positive difference to the communities we serve, and for their collective commitment to our values.



Keith Lough
Chairman
30 June 2021

Highlights:

- Continuity of services to our customers, protection and support of our employees and suppliers, support for those in vulnerable circumstances and financial stability of business secured as a result of a focus on four key themes throughout the COVID-19 crisis.
- Over £1 billion secured in sustainable bonds in 2020–21.
- Three core themes developed to guide our environmental ambition – simplicity, capability and transformation.
- Four DWI enforcement orders successfully closed.
- The development of metrics to provide indicative measures of improvements in our culture was recognised by Ofwat in its Board governance review as good practice.

“ We work continuously to improve our business and have both served our customers and engaged our employees with care throughout this extraordinary year ”



Strategic Report



Contents

Chief Executive's summary	22
Our progress	26
Our external environment	28
Our business model	35
Sustainability	63
s172 Statement	66
Environmental disclosures	70
Our operational performance	74
– Deliver great service	80
– Use water wisely	86
– Protect and improve the environment	88
– Fit for the future	96

Chief Executive's summary



Ian McAulay
Chief Executive Officer

➔ Read more on our operational performance on pages 74 to 99

As a supplier of essential public services, our priorities throughout this year have been to keep water flowing and our wastewater services operating safely and smoothly for our customers, while also protecting and supporting our employees and supply chain and offering help and advice to customers who found themselves in vulnerable circumstances.

At the same time, we have needed to make rapid and complex decisions to ensure the financial stability of the business, making sure that delays to capital projects, increases in delayed payments (and bad debt) and workforce and supply chain constraints were managed and accounted for.

As we entered this financial year, the primary impacts of the COVID-19 crisis relating to people and logistics were already being felt. Ensuring safe working practices for colleagues and customers and adequate supplies of chemicals and personal protective equipment were a priority. As we came to the height of the summer months, we also experienced a significant shift in demand for water as domestic customers used more water at home while commercial customers used far less. We have increased our provision for bad debt to reflect the fact that customers have faced financial hardship as a result of the impact of the pandemic.

“ Our culture is underpinned by our values of succeeding together, doing the right thing and always improving ”

Throughout these difficult times, I am extremely proud of all those involved in keeping those essential services running for our customers, both direct employees of Southern Water and those working for us through our supply chain, and I can only thank them for their dedication and for, on many occasions, putting themselves on the front line.

Ensuring the resilience of the business

Despite redirecting our operational efforts to ensure the smooth running of our front line services throughout the year, we have continued the transformation of our business. As Keith Lough, our Chairman, already highlighted, we need to continue to deliver tangible improvements in historic areas of concern such as customer experience, pollutions and water quality, through better planning and the introduction of more efficient processes.

Although we are in 16th place out of 17 water companies in terms of our customer overall satisfaction (C-MeX) score, our customer service improvement programme has delivered some positive progress. Billing calls have reduced by 21% year on year as a result of proactive work with high usage customers and a focus on collections activity. Digital transactions have increased 47% compared to the same period last year as a result of improvements made to our 'Your Account' self-serve portal and new self-serve journeys. We know we have more to do to improve our satisfaction (C-MeX) ranking, but we believe the work undertaken this year has improved our underlying trajectory and

We have delivered tangible improvements in historic areas of concern such as customer experience, pollutions and water quality.

is focused on the right drivers to improve our performance over the remaining four years of this business plan period.

Our Business Channels team, serving our commercial and developer customers, meanwhile, ended the year in 15th place, driven by our levels of service for water and wastewater design and improved communications. This year, we launched a new workflow solution, web pages and cleared project delays caused by the impact of COVID-19.

Although our pollution performance is still not where we would like it to be, the first few months of 2021 have delivered some significant improvements. For the last quarter of 2020 incident numbers were over 40% of their 2019 equivalent, and we were able to finish the year with under 400 category 3 incidents, four category 2 and no category 1 incidents on the Environment Agency's (EA) tracker. This improvement has been driven through our Pollution Incident Reduction Plan, published in September 2020 (southernwater.co.uk/our-performance/reports/pollution-reduction-programme).

From a water quality point of view, our provisional score for the end of the first regulatory year of the Drinking Water Inspectorate's new Compliance Risk Index (CRI) measure is 4.53 (2019: 7.7). Although this represents a significant improvement, it is still not as good as we would like it to be.

Our leakage for 2020–21 was 98.5 Ml/d (2020: 94 Ml/d) largely due to extreme seasonal fluctuations in the weather, alongside the demand associated with increased customer usage due to COVID-19. We are continuing to invest in improvements in the teams and technology used to detect leaks and our plans are to reduce leakage by 15% by 2025, 40% by 2040 and 50% by 2050.

Our financial performance

We accepted Ofwat's funding settlement for our business plan of our price controls for 2020–25 in February 2020, despite the significant challenge it presents in delivering what our customers want within the financial envelope Ofwat has set. It led to a 13% reduction in average customer bills and that, in turn, is the principal reason for the reduction in our operating profit of £73.5 million to £138.8 million.

As I have already mentioned, COVID-19 had a significant impact on the demand for water from our customers. We experienced an increase to our revenues from the additional household demand, however, this was offset by the reduction in our income from our non-household customers and new housing developments.

COVID-19 also increased our operating costs by £2.7 million, with additional expenditure to ensure the health and safety of staff, facilitate remote working, support suppliers and maintain services to meet the significant increase in water demand.

In order to support our customers in vulnerable circumstances, we introduced a number of support schemes to assist them in paying their bills.

This included pausing our normal debt recovery activities and introducing payment breaks for those in financial difficulty. As a result, we incurred lower debt recovery costs in the year although they were in part offset by an increase in our provision for bad debt, reflecting the impact of the pandemic on our likelihood of recovering some of our charges. The net impact of these items was a reduction in our operating costs of £4.0 million.

Over the past two years, we have undertaken a number of transformation and re-organisation activities in order to improve our performance and efficiency. These resulted in an overall reduction in operating costs from the prior year of £14.6 million, reflecting both the one-off costs incurred last year to make the transformation and the ongoing savings resulting from the changes made.

Our capital programme for the new investment period commenced with over £380 million spent on improvements to our assets. This included initial payments towards the construction of a new reservoir at Havant Thicket and a number of schemes in Hampshire aimed at tackling the impacts of climate change and population growth.

Our credit ratings are an indicator of financial health used by our lenders when we borrow money to finance our capital investment programme; our licence of appointment also contains minimum credit rating provisions. Our ratings have continued to be under pressure in 2020–21 as a result of operational performance challenges against key regulatory indicators such as pollutions, wastewater treatment works compliance and customer performance, plus a challenging financial position with reduced turnover and increased costs, and financial uncertainty regarding the outstanding prosecution by the Environment Agency relating to wastewater permit breaches from 2010 to 2015.

Action taken to support our credit ratings include a commitment by the Board to not pay dividends, if to do so will undermine the company's financial resilience and our transformation programmes to improve both operational and financial performance. During the year, we have also mitigated a risk from credit rating downgrade by securing consent from our lenders to continue to be able to finance the business in the event either our credit ratings or financial ratios fall below prescribed levels set out in our borrowing covenants.

20k
leak repairs
completed to
April 2021

Chief Executive's summary continued

7,000
acoustic loggers
were installed
on our network
this year

£2.7m
increase in our
operating costs
as a result of
COVID-19

In order to support the delivery of our business plan, we have continued to benefit from the support of our lenders in the successful issuance of £825 million bonds in May 2020 plus a further issuance of £300 million of bonds in March 2021. These bonds were issued under our newly established sustainable financing framework which includes a set of environmental, social and governance (ESG) standards for our operations that socially-conscious investors use to screen potential investments.

Other areas of significant progress

A number of key strategic projects were approved by the Board in December 2020, which will see us focus on improving digital, logistics and asset maintenance capability across our network, allowing us to take a more proactive approach to the management of risk, in turn protecting our environment and improving our performance and services for customers. You can read more about them in 'Our progress' on pages 26 to 27.

These projects, which will drive £150 million of efficiency improvements to 2025, represent the final phase of our transformation programme. Started in 2017, it has focused on improving people, processes and systems, in support of our business plan 2020–25 targets; providing Southern Water with a new baseline to start allowing for outperformance in the next asset management period to 2030.

A key pillar of our purpose, protecting and improving the environment is something that sits at the very heart of our business, which is why I would like to join Keith in welcoming Dr Toby Willison to our Executive Leadership Team. Toby brings with him a wealth of experience from the Environment Agency, and over the past few months has helped us to redefine our environmental ambitions.

Over the next four years, we will invest nearly £1 billion in programmes that will deliver environmental benefits as a result of improvements to our network, and we have committed an extra £5 million to an environmental improvement fund, which will be focused on initiatives that deliver nature-based solutions and environmental net-gain, in partnership with local Wildlife Trusts and the Rivers Trusts. One project already identified is focusing on the important natural habitats in Chichester and Langstone Harbours working in partnership with the Chichester Harbour Protection & Recovery of Nature (CHAPRoN) project.

I am excited about the year ahead; as we publish our net zero plans, we take further steps to embed natural capital approaches in our planning processes and we refocus our efforts on helping customers reduce their water usage as part of our flagship Target 100 water efficiency programme.

As I have already mentioned, we saw an enormous increase in demand for water as a result of changes to people's lifestyle due to COVID-19, which has seen individual daily water usage increase significantly. With life slowly returning to something like normal, we still expect demand to remain high over the summer as people continue to work from home and holiday closer to home. We are prepared for this, and have adjusted our plans. We continue to work with Ofwat and our peers to understand the longer-term effects on usage. The increase we have seen is not unique to our region. However, as an area of water scarcity we need to work with our customers to try and drive down consumption in order to meet our target of 118.8 litres per person, per day by 2025 (this is a three-year rolling average).

Water is a precious, and increasingly scarce, resource for people and wildlife. It is essential that we strike the right balance between protecting the environment and maintaining supplies for customers. In Hampshire, that means taking less water from the sensitive chalk stream habitats of the Rivers Test and Itchen and more from sustainable sources instead. As part of our Water for Life Hampshire plans, which launched its first consultation in February of this year, we are planning to create a new network of water mains across this region and we are investigating new treatment techniques such as desalination and water recycling. You can read more at southernwater.co.uk/water-for-life-hampshire.

Challenges we are still facing as a business

Climate change and population growth in the South East present very real challenges that initiatives like Water for Life Hampshire are looking to address. Plans like these, and bulk supply collaborations with neighbouring water companies, are needed to secure reliable water supplies for the future, alongside reducing the amount of water lost through leaks and encouraging people to use less water.

This will help the country tackle extremes in weather such as droughts, which are likely to happen more often, and be more serious, as our climate changes. It will also help provide water supplies to more customers in the future and enable us to leave more water in the environment to support habitats and wildlife.

In February, we signed an 80-year bulk supply agreement with Portsmouth Water, under which it will supply us with 21 million litres of water a day. Together, we are developing Havant Thicket Reservoir in Portsmouth Water's supply area; the first new reservoir to be developed in the UK since the 1990s, which will play a key role in reducing the amount of water taken from the Rivers Test and Itchen. It will be the first time a large water supply asset has been developed in this collaborative way.

Reflections on a difficult year and our future priorities

At the end of the first year of delivery of this new five-year period, I would like to reflect on how far we have come in what has been a year of unprecedented challenge for all of us. We started in a tough place, with a challenging Final Determination from our regulator and increased regulatory scrutiny as a result of a number of legacy issues with our culture and performance. We also received the lowest score in the industry in our annual Environmental Performance Assessment from the Environment Agency.

I am pleased to report that, as a result of our transformation programme, we have continued to drive the changes in people, processes and systems that our Board and regulators have been asking for. A great example is the development of our People Strategy and focus on diversity and inclusion, our commitment to which earned us a ranking in the Inclusive Companies list of Top 50 UK Employers.

The Consumer Council for Water (CCW) mentioned us in its annual 'Water for All' report, published in November, citing our partnership working approach to vulnerability and our proactive contact methods to build our Priority Services Register as best practice.

A great example of collaboration in action is the development of our catchment-based Drainage and Wastewater Management Plans (DWMPs), engagement for which has been ongoing throughout the year via a series of online stakeholder workshops. These plans set out how we intend to extend, improve and maintain a robust and resilient drainage and wastewater system in the future, providing greater transparency, robustness and clarity towards investment decisions. Working with our regional stakeholders is vital if we are to manage future risks to the people, businesses and the environment of the South East.

As our Chairman already mentioned, our new culture dashboard is allowing us to measure and track the development of our company culture. The development of such metrics to track our progress in this area has been highlighted by Ofwat in its Board governance review as good practice.

Our culture is underpinned by our values of succeeding together, doing the right thing and always improving and this year, more than ever, we have embedded them at the heart of how we deliver our services to our stakeholders. A clear focus on our core priorities during the pandemic has ensured that our customers have had priority services and financial support when they have needed it most, and that our employees and

supply chain have been able to work safely, prioritising our essential services and keeping our customers in supply and avoiding significant spikes in flooding incidents despite the challenges of extreme demand and fluctuations in our weather.

As we move into a new financial year, we are focused on continuing to drive the changes needed in our business to improve performance and our services for our many stakeholders.

I would like to take this opportunity to say thank you again for the hard work, commitment and sacrifice demonstrated by all our employees – whether Southern Water or supply chain – during the year. We have all had to adjust to new ways of working, meeting significant challenges along the way and that is not easy when you are juggling huge changes in your personal circumstances and home lives at the same time. We have achieved a lot despite this and, although we know we have challenges going forward to build on the confidence and trust we have now established with our stakeholders, there is positive change happening and we need to keep that momentum.



Ian McAulay
Chief Executive Officer

30 June 2021

Highlights:

- A number of key strategic projects were approved by the Board in December 2020, which will see us focus on the digitalisation of our network and logistics and asset maintenance capability.
- In February, we signed an 80-year bulk supply agreement with Portsmouth Water, under which it will supply 21 million litres of water a day to Southern Water.
- A clear focus on our core priorities during the pandemic has ensured our customers have had priority services and financial support when they have needed it most, and that our employees and supply chain have been able to work safely.

c.£1bn
investment in
environmental
benefits to 2025

Our progress

Our journey of delivering better outcomes for our customers and becoming a more resilient organisation.

Resilience is at the centre of our strategy to become brilliant at the basics while transforming key areas of our business. We believe there is a substantial opportunity to adopt a more integrated approach to the way that we deliver our services over the 2020–25 period; using systems thinking to look at the bigger picture, and how we might collaborate with our peers and other industries to deliver joint solutions to some of our bigger challenges.

➔ Read more about our **operational performance** on pages 74 to 99

Improving our operational performance

A number of key Strategic Projects delivering improvements in network digitalisation, logistics and asset maintenance were agreed by the Southern Water Board in 2020, and programmes to deliver them are now being driven by a new Head of Strategic Projects.

Asset maintenance

Now, more than ever before, we need to make sure that the assets we build and the infrastructure we install is sustainable, in terms of the source of the materials used, their longevity and ultimate impact on the environment. It is not just our capital construction schemes that need this attention; we also need to make sure that we are carrying out routine maintenance in the most sustainable and efficient way.

Logistics

Our area of operation stretches across Kent, Sussex, Hampshire and the Isle of Wight so efficient logistics, ensuring our field teams have access to the right kit, when they need it, is critical. We are looking at a number of initiatives in this area, including a repair call line for teams.

Digitalisation

This programme will specifically look to improve our proactive control capability, situational awareness and technology across our wastewater network to ensure that asset failures can be better predicted, reducing the impact of potential pollution incidents. We have more than 3,400 pumping stations across our network, many of them unmanned due to their size or remoteness of location, so making sure our alarms and control systems are working as they should is a priority.

Working together to co-create an industry-leading system

To prevent homes and businesses flooding, during very heavy rainfall we sometimes have to release screened stormwater – domestic wastewater heavily diluted by rainwater – into the environment. In May 2021 we launched an updated version of our Beachbuoy service; an online map that shows when and where this has happened so people can make an informed decision before entering the water.

Unlike anything in our industry, the map shows all 83 of our region's designated bathing waters and two non-designated recreation harbours, along with more detail about each release.

We originally piloted the service in 2018 for a handful of bathing waters; however, as part of our commitment to improve how we report on our environmental performance, we agreed to develop the system further. The trial received lots of interest from watersports enthusiasts and other local groups who shared ideas for improvements. We used this feedback to prioritise which features to develop and allocated people full-time to oversee this work.

The first change we made was to automate updates. Previously, data was input by hand and could cause delays. We have now linked Beachbuoy directly to our new spill reporting system, Aspire, so updates would show on the map in near real-time.

To ensure we were getting it right, we formed a Beachbuoy stakeholder group, which met for the first time in October 2020. The session was joined by around 20 people from groups such as Surfers Against Sewage, local authorities, public bodies and our regulators. The group has met every six to eight weeks since and has grown to include representatives from our entire region.

➔ Read more at southernwater.co.uk/water-for-life/our-bathing-waters/beachbuoy

Reducing pollution incidents

In September 2020 we published our Pollution Incident Reduction Plan (PIRP) which set an ambitious target to reduce pollution incidents to zero by 2040. To work towards this, we have developed a detailed programme of activities to deliver a step-change in how we work and prioritise and remedy issues on our sites.

The PIRP forms part of a wider initiative called Environment+, which is focused on harnessing our people, processes and systems to deliver a resilient water future for Southern Water's customers, by protecting our natural environment as well as our customers' properties.

The in-depth analysis, which we used to create the PIRP, is helping our dedicated Pollutions team to understand where and how our sites are most likely to impact the environment. The team has weekly internal conference calls and meets fortnightly to review progress and address issues. By understanding what can go wrong, and why, the team can focus investment on areas which will deliver the biggest reduction in pollution incidents. It is also learning from past pollution incidents and industry best practice to drive effective interventions to reduce pollution incidents in future.

So far, activities to resolve specific issues include:

- awareness and training available to all employees
- enhancing site resilience to power failure and electrical faults
- improving pump reliability
- customer behaviour programmes to reduce blockages caused by sewer misuse
- alarm transformation and enhanced rotas for our regional control centre.

➔ Read more at southernwater.co.uk/our-performance/reports/pollution-reduction-programme.

Taking steps to change our culture

To address the cultural issues experienced in our past, we know it is essential to do the right thing. We also know that to continue to improve our performance we must behave correctly and compliantly. In order to have a better view of these 'measures of culture' we created a dashboard of key metrics during the year, under four key themes: collaboration; driving results; customer focus; and ethical working.

These measures are collated and reported each quarter to give us, and our regulators a holistic view of the changes taking place across the organisation, at every level.

Collaboration measures include overall employee engagement, which we are thrilled to see has improved this year despite the impact of COVID-19 on colleagues, gender metrics, employee sickness levels and the number of internal STAR Award nominations made by colleagues, to colleagues.

Environmental and public health concerns drive those measures sitting under the driving results theme, and these include pollution incidents and self-reported pollutions, in addition to permit compliance at our water and wastewater treatment works. These are key areas for us where we know we need to show tangible improvements, both to our customers and our regulators.

We care about what our customers think about us, which is why we included a number of customer measures including complaints, guaranteed standards of service payments to customers we have let down, overall satisfaction with our services and net-promoter score (which captures how likely our customers are to recommend us as an organisation).

Of equal importance are our measures related to ethical working, which track a number of survey scores related to confidence in the company, integrity of colleagues, understanding of our values and Code of Ethics. This is also where the number and nature of the reports to our Speak Up service are captured – this is our anonymous reporting system, accessible by all employees.

➔ Read more about how we measure our culture on pages 168 to 175

Transparency and accountability

As a supplier of essential services, we have a duty of care to the communities we serve and, as such, our performance is independently scrutinised by a number of regulators including Ofwat, the Environment Agency and the Drinking Water Inspectorate.

➔ Read more on page 30

Our external environment

The way we operate as a business is impacted by a number of external factors that we must consider and manage the impact of.

25 years from now we predict that we will have lost a third of our water sources in the South East due to climate change

The water sector

Access to clean water and sanitation is vital to public health. Water piped to customers' homes has only been available for the majority of England and Wales since the 18th century, with the first sewers developed later to provide people with access to adequate sanitation. By the early 20th century areas of the country organised their own water supply services, and by 1945 there were more than 1,000 bodies involved, with another 1,400 delivering wastewater services.

This role has shifted over the past 60 years and now water and wastewater services are provided by several privately owned companies, serving more than 50 million households and commercial customers in England and Wales. There are currently 11 licensed water and wastewater companies, with a handful of smaller licensed companies providing water-only services to customers.

Since the industry was privatised in 1989, a regulatory framework has been in place to ensure that customers receive a good standard of service at a fair price, managed by the industry economic regulator Ofwat. This framework has seen these water and wastewater companies invest billions of pounds maintaining and improving assets and services, and, in turn, enhancing the environment.

The challenges of population growth and climate change mean that the water industry must significantly change the way it operates over the coming years. In 25 years from now within Southern Water's region, we are anticipating to have lost a third of our water sources as a result of climate change. We will also see a reduction in the amount of water we are allowed to take from rivers and underground sources, and our population will have grown by 15%. Without action, we predict a supply and demand deficit by 2030, equivalent to around 50% of our current supply.

Social environment

As a provider of essential services, we have a direct impact on the communities we serve and the many, and varied, stakeholders within them. We also own or help to manage areas of land in areas of natural beauty or environmental significance that are valued and enjoyed by both residents and visitors to our region. As a result, we must consider what matters to all of these stakeholders as we deliver our services today and plan for the future. This means continuously building relationships and ensuring we consult with them in developing and executing our plans.

Our affected capital(s):



Link to our risk(s):

Customer; Resources; COVID-19

Political environment

Decisions made by politicians have the potential to significantly impact the way we operate. We must ensure that we follow any directions set by government, and that we adapt quickly to political and policy developments. As a result, we work closely with regional and national policymakers to understand the development of any policies that will have an effect on our business, while ensuring they understand the economic, environmental and social value we deliver for the communities we serve in the South East.

Our affected capital(s):



Link to our risk(s):

Compliance; Regulatory and Corporate Affairs

➔ Read more about the **six capitals** on pages 44 to 45

Key to our capitals

In order to create an integrated view of the value we create, we are starting to use the following stocks of value or 'capitals' that can be affected or transformed by our activities and outputs.



Financials



Culture



Social



Manufactured



People



Natural

Regulatory environment

In order to ensure a resilient water future for our customers in the South East, we must operate as a sustainable business. This means working with our regulators to understand and prepare for future market reforms while ensuring we fulfil current regulatory requirements. Our relationships with our various regulators – economic, drinking water quality and environmental – are vital to ensure the resilience of our business and we work closely with them, sharing our progress and our plans for the future, as well as influencing market reform where we see opportunities.

Our affected capital(s):



Link to our risk(s):

Compliance; Regulatory and Corporate Affairs

Economic environment

Like all other UK businesses, we are impacted by changes in interest rates, inflation and other market rate movements, and we must manage these to reduce risks to our financial stability. We must also pay attention to the general economic climate as it will have a direct impact on our customers and their ability to pay their bills. We are aware that there are a number of areas across the South East that experience high levels of deprivation so we make it a priority to offer support and advice to any of our customers who find themselves in vulnerable circumstances.

Our affected capital(s):



Link to our risk(s):

COVID-19; Financial

Innovation and technology

In order to always improve our services and the ways in which deliver them, we need to take advantage of new technologies and innovative ideas, which we recognise could come from anywhere – from our customers, across different industries and different countries, as well as ideas from colleagues within our business. Innovation is very important to us, as one of our three core values is always improving and this is reflected in the development of our own bluewave innovation hub. Of course, we also understand that new technology brings with it a number of risks, which is why we are focused on continuously improving our cyber security.

Our affected capital(s):



Link to our risk(s):

Information Technology; Water; Wastewater; Customer; Resources

Environmental factors

Our natural environment is under pressure, and we must ensure that we are adapting to and preparing for future impacts such as climate change and population growth. This includes taking action to plan for and mitigate climate change by reducing our own emissions and the environmental impact of our operations. The water cycle is continuous so we must ensure that we are removing water from and returning it to the environment safely and responsibly. We must also make sure that we are engaging with all stakeholders within our catchments to reduce their collective impact on the water environment.

Our affected capital(s):



Link to our risk(s):

Resources; Customer; Water; Wastewater; Climate Change

11 licensed water and wastewater companies, with a handful of smaller licensed companies, provide water-only services to customers; 50 million households in England and Wales

➔ Read more about our risks on pages 118 to 139

Our external environment continued

Ofwat investigations

As previously announced, and as explained in our Annual Reports 2018–19 and 2019–20, Southern Water's wastewater treatment compliance was under investigation by Ofwat due to breaches of statutory obligations between 2010 and 2017. A Final Notice setting out the plans for Southern Water to make rebates to current customers and payments to former customers, and a commitment to greater transparency on environmental performance, was published by Ofwat in October 2019. The rebates to current customers began with the April 2020 bills. The scheme to compensate those eligible former customers was open until 30 September 2020. The Notice confirmed that the reduction in wastewater charges for current customers, and the payments to former customers, will total £123 million (in 2017–18 prices), together with a £3 million fine.

The regulatory environment



The *Department for Environment, Food and Rural Affairs (Defra)* determines the overall water and sewerage policy framework in England, setting standards, drafting legislation and creating special permits, e.g. drought orders.

defra.org.uk



Ofwat is the economic regulator of the water and sewerage sectors. It protects the interests of consumers by promoting appropriate competition, making sure water companies properly carry out their functions and ensure they have the adequate finance in place.

ofwat.gov.uk



The *Environment Agency* is the environmental regulator of the water and wastewater sector in England. It is the principal adviser to the government on the environment, and the leading public body improving and protecting the environment of England. They work with a range of organisations to reduce flood risk, promote sustainable development, and secure environmental and social benefits.

gov.uk/government/organisations/environment-agency



The *Drinking Water Inspectorate* is the drinking water quality regulator and enforces the Water Quality Regulations set by the Government. To do this, they check the tests carried out on drinking water by water companies, along with carrying out company inspections.

dwi.gov.uk



The *Consumer Council for Water* represents water and wastewater consumers. It also investigates consumer complaints that have not been satisfactorily resolved by water companies.

ccwater.org.uk



Natural England advises the government by providing practical guidance, grounded in science, on how to best safeguard England's natural wealth. Its purpose is to protect and improve England's natural environment and encourage people to enjoy and get involved with their surroundings.

gov.uk/government/organisations/natural-england

Since Chief Executive Ian McAulay joined in 2017, he has been driving thorough internal reviews of our wastewater business and is leading a major transformation programme.

Environment Agency Investigations

Like other wastewater operators, in the normal course of operations we occasionally face Environment Agency investigations. The company has been subject to a detailed investigation regarding permit breaches at some of our wastewater treatment works in two locations during the period 2010–15. In February 2020 the agency presented 51 charges before the court and we entered guilty pleas to these charges. We will continue to be open and transparent and are committed to working with the agency to ensure a swift conclusion to the case. Since Chief Executive Ian McAulay joined in 2017, he has been driving thorough internal reviews of our wastewater business and is leading a major transformation programme, which has already delivered a number of improvements to processes, people and systems.

For the reasons also set out in note 26 to the financial statements (see page 260), supported by legal advice, the Board has concluded that it is not yet possible to make a reliable overall estimate of the financial obligation that will arise from this prosecution, notwithstanding the guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, the Board does recognise that there will be a minimum liability associated with these charges and having reviewed the latest information, has maintained the provision of £1 million, recognised in 2019–20, reflecting a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs.

The court has a very broad discretion to assess the level of the fine and the provision is not intended to indicate or predict any particular level. When considering the above it is noted that there are disputed levels of culpability and environmental harm. The sentencing guidelines are very wide and there is a requirement for the court to examine the financial circumstances of the organisation in the round. The next court hearing may take place in July 2021. The Board will continue to review the level of provision made as more information becomes available.

We are also committed to assisting the Environment Agency with its separate investigation into sampling compliance and reporting issues between 2010 and 2017 (inclusive). The Board, supported by legal advice, has again, and for similar reasons, concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from this separate investigation, but will also keep this under review.

➔ Read more in our **financial statements** on page 260



Our external environment continued

Our plans focus on what is important to our customers

Our Water for Life Business Plan 2020–25 was developed following extensive consultation with our customers and stakeholders over a three-year period. Our customers told us that as well as thinking about the challenges of the future, they have an expectation that we will continue to deliver on the basics – clean, high-quality drinking water and effective wastewater systems.

Engaging customers

As a result of the impact of COVID-19 on everyone’s lives, customers have become more engaged in the provision of essential services and their importance to overall health and wellbeing. Customers have been using more water at home, and we have seen a greater desire for them to actively participate in the protection of future water resources through our water efficiency behaviour change campaigns.

Link to our risk(s):

Customer; Resources; Regulatory and Corporate Affairs

How we are responding now:

This shared responsibility sits at the heart of our values, purpose and long-term vision, as it is only by succeeding together that we can provide water for life and ensure a resilient water future. Over the past year, we have adjusted our approach to engaging with customers, using digital engagement platforms and online forums to gather insight, which continues to drive our transformation and performance improvement in areas such as incident management.

How we are responding in the long-term:

In 2020–21 we launched Water Futures 2050 (our young person’s group) and Water Futures 2030 (our household customer panel), which provide a central hub for members to challenge our strategic plans. We continue to work collaboratively with other water companies and our regulators across the South East on future resource options and behaviour change. For example, in February 2020 we brought customers from our action group on the Water for Life Hampshire programme together with technical leads, regulators and members of our executive to collaboratively work through proposed solutions.

Links to our purpose:



Delivering value to:



Affordability and vulnerability

Many of our customers have been put under financial pressure as a result of the COVID-19 pandemic. As a supplier of essential services, we have a duty of care to offer support where we can. While we have committed to reduce our bills over the next five years by 18%, our customers’ needs are unique and so we take a pragmatic approach, and have offered additional payment breaks. We have also delayed debt collection when appropriate and increased access to our Priority Services Register. We regularly engage with customers and other agencies to identify how and when to support those that need it most.

Link to our risk(s):

Customer; Financial; COVID-19

How we are responding now:

A range of COVID-19 support measures were introduced in the first few weeks of the pandemic, including payment holidays, automated renewals for those already on our support tariffs, and an increase in the threshold for our social tariff, as well as a change to the requirements to join our Priority Services Register allowing family members to add names of loved ones or trusted third parties. We also joined a UK Power Networks-led consortium to provide funding to Community Foundations in our area. We continue to work collaboratively in the community through our Customer Inclusion Panel – a cross-regional group of experts in vulnerability. We have also looked wider, working closely with local councils to understand the impact water efficiency can have on households struggling with their bills.

How we are responding in the long-term:

We have signed up to a Public Interest Commitment to end water poverty by 2030. By 2025 we are committed to significantly increasing the number of people we support and continually assessing the effectiveness of that support. We will also continue to work across the sector to ensure there is consistency and fairness in identifying customers in vulnerable circumstances, making it easier for everyone to get access to the right support.

Links to our purpose:



Delivering value to:



Key:

We provide water for life to:

- enhance health and wellbeing
- protect and improve the environment
- sustain the economy

Our stakeholders:

- Employees
- Communities
- Regulators
- Customers
- Environment
- Suppliers
- Regional stakeholders
- Retailers
- Investors

Increasing customer expectations

As a result of the impact of the COVID-19 pandemic customers are more aware of the essential services we provide and their cost, the communities and neighbourhoods in which they live, as well as those who might need access to additional support. Yes, they still want the basics of good levels of service and affordable bills, but they have also become more focused on ensuring the sustainability of those services and the impact of them on their communities and environment. Many customers have become far more confident in their use of digital technology and have increased expectations for new digital channels, so the definition of 'great' service continues to change.

Link to our risk(s):

Customer; COVID-19; Financial

How we are responding now:

Our customer service improvement programme is leading the digitalisation of our customer service channels. As we continue to transform our business, we have focused on not only improving access to our customer service channels but also ensuring we improve our operational management, incident response and support services for customers, our suppliers and local businesses in turn. The core pillars of our purpose: health and wellbeing, the environment and economy, drive our planning, strategy and delivery so that we are taking a more holistic and long-term approach to meeting our customers' expectations and measuring our impact.

How we are responding in the long-term:

Customer expectations around the reliability of services, the quality of water we supply and the impact our assets have on the environment are a constant. We need to make sure that we are staying ahead of any advances in technology, always improving to ensure the efficiency and resilience of our services while mitigating the impact of any ageing assets. Ensuring a quick response to issues raised by our stakeholders is also key, whether this is through traditional or digital platforms.

Links to our purpose:

- Enhance
- Protect
- Sustain

Delivering value to:



Securing long-term resilience

Our customers expect us to maintain essential services so we need to plan to mitigate potential risks, both internal and external. This means developing a rich understanding of the connection between our processes and the wider community around us. To maintain continuity of service, we have made plans to reduce our carbon footprint and are looking at ways to adapt our business to mitigate the risks of climate change and population growth in the South East.

Link to our risk(s):

Resources; Climate change; Compliance

How we are responding now:

We are building partnerships across sectors to ensure we have the expertise to secure long-term resilience. Our Water for Life Hampshire programme is a prime example, as we work with regional partners to develop options for new water sources in our most water-stressed area. We are working with our environmental stakeholders to ensure impacts and opportunities for nature are built into our plans. As a key member of the Greater Brighton Infrastructure Panel, we have developed collaborative initiatives combining our water, energy and transportation expertise. Our Catchment Risk Management team has brought together farmers and catchment partners to develop more sustainable land management practices and investigate further sustainable approaches to the removal of water from the natural environment. In addition, we have continued to enhance our data and IT systems to allow teams to develop a proactive view of network and resource management.

How we are responding in the long-term:

Our Resilience Action Plan shows how we will be taking steps to enhance how we reduce risk, making corporate risk reporting more transparent and comprehensive. Our incident management capabilities have been improved through the introduction of new monitoring indicators and a new system, root cause analysis and regular scenario testing. We will continue to collaborate with our peers to bring processes and systems together, taking a regional approach to water resources planning.

Links to our purpose:

- Enhance
- Protect
- Sustain

Delivering value to:



Our external environment continued

➔ Read about our **approach to sustainability** on pages 63 to 73

Transparency and accountability

As a supplier of essential services, our performance is rightly scrutinised by a number of independent regulators including Ofwat, the Environment Agency and the Drinking Water Inspectorate. Our stakeholders are increasingly looking for us to offer support during these times of unprecedented uncertainty. They want us to demonstrate we are having a positive impact on our communities and that we are providing stability. As such, we need to engage in a transparent and open way, providing information and explanation around the decisions we make and taking accountability for our responsibilities.

Link to our risk(s):

Customers; Regulatory and corporate affairs; Compliance

How we are responding now:

We have continued to embed insight gathered from customers and stakeholders via our customer action groups in our decision-making. We have developed our environmental reporting at southernwater.co.uk/our-performance/environmentalperformance and have clarified our environmental ambition. We have launched our updated Beachbuoy service, which allows customers to monitor releases from our combined sewer overflows in real time. We also continue to provide our various regulators with regular reports about progress against our performance commitments.

How we are responding in the long-term:

Being open, honest and transparent is key to building and maintaining trust and legitimacy. As well as reporting openly, this means setting out commitments to our stakeholders and delivering on them. One example is the launch of our Water Futures 2030 and 2050 consumer groups which will work together to ensure we are building the right future for our customers. We will continue to build on our engagement with these groups as we develop our plans for the next asset management period from 2025–30.

Links to our purpose:

Enhance **Protect**

Delivering value to:



Delivering public value

We fully support efforts to explore how the water sector can deliver even more public value. We are working to develop a clear understanding on expectations so that we can development measurable objectives and reflect these in our company targets, making these as simple for our customers and stakeholders to understand as possible. We also need to ensure that we use consistent definitions, frameworks and reporting tools to clearly communicate our progress.

Link to our risk(s):

Customers; Regulatory and corporate affairs

How we are responding now:

We have already taken significant action to create an enabling culture to support delivery of greater public value. We renewed our company purpose and values in 2019, which now inform decision-making across the business. Our Board and Executive Leadership Team have made a commitment to company transformation and improved ways of working. We are utilising a number of new tools to optimise the value we provide, e.g. risk and values process, six capitals approach (starting with natural capital) and we are tracking progress in terms of our culture change through regular Gallup employee engagement surveys and culture dashboard. These improvements have helped us deliver outcomes across a range of activities including our Water for Life Hampshire, Catchment First, Target 100 water efficiency and Bathing Water Enhancement programmes, and through our support for vulnerable customers.

How we are responding in the long-term:

We are starting to use a six capitals approach, beginning with natural capital. Incorporating natural and social considerations into our decision-making, monitoring and integrated reporting will help ensure we capture, review and track progress on a wide range of outcomes. This will also help to align our plans, where appropriate, with the UN Sustainable Development Goals. We are also working with Water Resources South East to develop criteria and metrics to assess the additional value delivered by different water resources programmes as part of the development of a 'Best Value' regional plan.

Links to our purpose:

Enhance **Protect** **Sustain**

Delivering value to:



Key:

We provide water for life to:

- enhance health and wellbeing
- protect and improve the environment
- sustain the economy

Our stakeholders:

- Employees
- Communities
- Regulators
- Customers
- Environment
- Suppliers
- Regional stakeholders
- Retailers
- Investors

Climate change

Climate change, and the extreme weather events and rising sea levels that are a result of it, present a significant challenge to water companies up and down the UK. We are proud of the steps we have taken to reduce carbon emissions, recycle waste from our wastewater treatment sites and use more renewable energy to power our operations.

Link to our risk(s):

Climate change; Water; Wastewater; Financial

How we are responding now:

Reducing our environmental impact, and protecting and improving our environment, sits at the heart of our purpose as an organisation. As such we have committed to the Water UK Public Interest Commitment to achieve net zero carbon emissions by 2030 and our net zero plan details how we will do this. We have set up a climate adaptation steering group within the business, which is overseeing changes to operational processes and systems to plan for and mitigate the impact of climate change.

How we are responding in the long-term:

We plan to increase the proportion of renewable energy we use to 24% by 2025, while at the same time looking for ways to reduce the amount of energy we use. In doing this, we aim to achieve net zero by 2030, in turn delivering financial benefits for our customers and investors. We are also exploring how to maximise the contribution of our extensive land bank to reduce greenhouse gas emissions and will have updated our Climate Change Adaptation plan by 31 December 2021.

Links to our purpose:

- Enhance
- Protect
- Sustain

Delivering value to:



Regulatory expectations

Government and regulators rightly expect water companies to provide customers with high standards of service at a fair price, while protecting and improving the environment. They have challenged companies to go faster and further, particularly on environmental priorities, long-term resilience and looking after vulnerable customers. The policy landscape is also continually evolving. The 25 Year Environment Plan, Environment Bill, review of the Water Industry National Environment Programme and preparation for the next price review for 2025–30 are just some of the key drivers for change in the water sector and beyond.

Link to our risk(s):

Regulatory and corporate affairs

How we are responding now:

We are working proactively with the rest of the sector, regulators and others on workable solutions to some immediate and complex challenges which we simply cannot solve alone. Concerns around storm overflows and chalk streams are examples where a multi-sector approach is essential, and we fully support the Government's efforts to facilitate a collective response. We are also actively representing the interests of our customers and region in national discussions to ensure the unique challenges faced by the South East are fully considered.

How we are responding in the long-term:

We are contributing to the national debate on a long-term vision for the sector and our ambition is to go beyond what our regulators expect. Developing collective, systems-based approaches will be essential. We have a really great opportunity to help deliver many of the objectives included in the government's ambitious 25 Year Environment Plan. We are actively exploring new ways of working including through nature-based solutions and natural capital approaches as part of our long-term planning. We are also part of a sector-wide commitment to deliver a net zero water supply by 2030.

Links to our purpose:

- Enhance
- Protect
- Sustain

Delivering value to:



Case Study

Giving our customers a say in how we address water scarcity

Customer engagement is a central part of our Water for Life Hampshire programme, which is looking to secure a resilient water future for the area.

Initially, we set up a Customer Action Group (CAG) and asked this panel of 35 customers for views about the water resources challenges in the area and our potential solutions.

Building on the informed, qualitative insight shared by the CAG, we have reached out to broader audiences to explore some of the key areas identified in these two-way conversations.

As our solutions could impact the cost of our services, we engaged customers who were struggling to pay their bills or whose circumstances have been affected by COVID-19 to explore how our proposals could impact them. We also worked with diverse cultures to understand the different ways they interact with water so these could be taken into consideration.

To understand what tomorrow's customers want the future of the water industry to look like, we set up a youth panel made up of school pupils, students, apprentices and young people.

Consumers are not the only ones who rely on water. Businesses such as breweries and food manufacturers do too. We spoke to them about how changes to local water sources could affect their end products.

We also worked with Water Resources South East (WRSE) – an alliance of the six water companies in our region – to share data and gain a more complete picture of the situation in the South East. Meanwhile, we have researched how customers reacted to solutions by water companies further afield.

Ultimately, local residents will be affected most directly by our proposals, so we gave them a chance to share their thoughts on our plans through a public consultation.

In February, members of the programme and our Executive Leadership Team met with our regulators and other stakeholders to discuss our proposals. Our ongoing customer engagement is making sure our customers' voices are at the forefront of these conversations as we work to address water scarcity in the South East.

Nick Eves
Head of Customer Insight



→ Read more on sustainability on pages 63 to 73

→ Read more on our work to protect and improve the environment on pages 88 to 93

Case Study

Collaborating across our region to develop long-term plans

Long-term planning for drainage and wastewater management is needed to address ongoing challenges such as climate change and the development of new homes in the South East.

100+
stakeholders
attended our
initial webinars

Water UK published guidance on preparing new Drainage and Wastewater Management Plans (DWMPs) in November 2018. Along with other water companies, we made a commitment to Ofwat to produce the first version of these by March 2023.

The DWMPs will become statutory plans under the Environment Bill currently progressing through Parliament.

Responsibility for drainage and flooding is shared among several organisations including the Environment Agency, local councils and internal drainage boards, so preparation of DWMPs requires a new collaborative approach. We recognised this as one of our critical success factors, so we set about working with these partners, as well as organisations with responsibilities for protecting the water environment, to co-create these plans.

In August 2020, we organised an initial round of webinars to introduce the DWMPs and share our timetable and approach. Over 100 stakeholders from around 30 organisations joined. We followed this with a series of workshops – one for each of our region's 11 river basin catchments – to assess the risks in each and define our objectives.

Working with these stakeholders, we have been able to explore and set objectives that cover the issues that are important to us and our partners, such as flooding, pollution and impacts on designated sites. We have been developing a new risk assessment for each of these objectives so we can understand the current and future risks.

In December 2020, we reported to Water UK on the results for the risk assessments for the six national planning objectives, and completed risk assessments for our eight additional planning objectives in March 2021. We held further webinars with our partners in December 2020 and March 2021 to share and discuss the results of these assessments.

During another round of workshops in spring 2021, we will use the results of the risk assessments and our understanding of the root causes to set out our investment strategy for each wastewater catchment, the generic options and the priorities for more detailed assessment and investment.

The final document will be a critical publication to accompany our Business Plan to be submitted for the 2024 Price Review and will set the direction of investment in wastewater into the future.

Andy Adams
DWMP Programme Sponsor



➔ Read more on **our operational performance** on pages 74 to 99

➔ Read more on **long-term ambition** on pages 54 to 55

Our business model

Our business model describes the essence of what we do; how we create value for all our stakeholders from the resources and relationships we use to operate the business.

Our purpose is to provide water for life to:

- enhance health and wellbeing
- protect and improve the environment
- sustain the economy

Our purpose is why we exist. It drives our long and short-term decision-making and is centred around the value we provide to our customers and stakeholders. Living our purpose ensures that we are able to deliver water for life and a resilient water future for our customers in the South East.

Our external environment

The way we operate as a business is impacted by a number of external factors that we must consider and manage, whether they be political, economic, regulatory, social, technological or environmental.

➔ Read more on pages 28 to 35

1. Our key inputs

To really understand if a business is acting responsibly and with integrity it needs to consider its impacts and dependencies. This means expanding beyond financial, manufactured and intellectual capital to bring in people, social and relationships and natural capital, as all can affect the ability of an organisation to create value over time.

Natural

the environmental resources that we rely on as a business, in particular water.

Financial

our financial health, including equity, debt and pensions.

Manufactured

our sites and assets, equipment, networks and IT.

Intellectual

knowledge, systems, processes, procedures and the data we hold.

People

the skills, capabilities and wellbeing of our people.

Social and Relationship

open and transparent engagement, our brand, reputation and value we create for our communities.

2. Our key relationships

Understanding what matters most to our stakeholders is fundamental to being a purpose-driven organisation. We consider these priorities alongside potential impact on our company and value created.

Customers

Our customers sit at the heart of our business. They expect us to be always improving and to deliver services sustainably, at affordable prices while supporting those in vulnerable circumstances.

Communities

Water for life is a shared responsibility so we constantly work to build partnerships in our communities with schools and future customers as well as interest groups and local charities. Our employee volunteering programme helps to connect our employees with the communities we serve.

Regional stakeholders

Our work, and the land we manage, impacts a wide variety of regional stakeholders, from county and parish councils to farmers and developers, and we consult them to help develop and execute our plans.

Retailers

Our retailers provide customer and billing services to non-household consumers across our region. We work closely with them, providing wholesale and emergency services to those customers.

Employees

We are focused on attracting, developing and retaining a diverse and inclusive workforce, while ensuring we always look after their health, safety, security and wellbeing.

Suppliers

We generate jobs, skills and income through our capital programme, supporting our supply chain and our local economy. We rely on our suppliers to deliver our services so these relationships are critical.

Environment

We maintain and enhance our natural environment, be that reservoirs, catchments, rivers or bathing waters. Each provide space for wildlife, recreation, and create value in terms of tourism. We aim to protect and improve our environment at all times.

Regulators

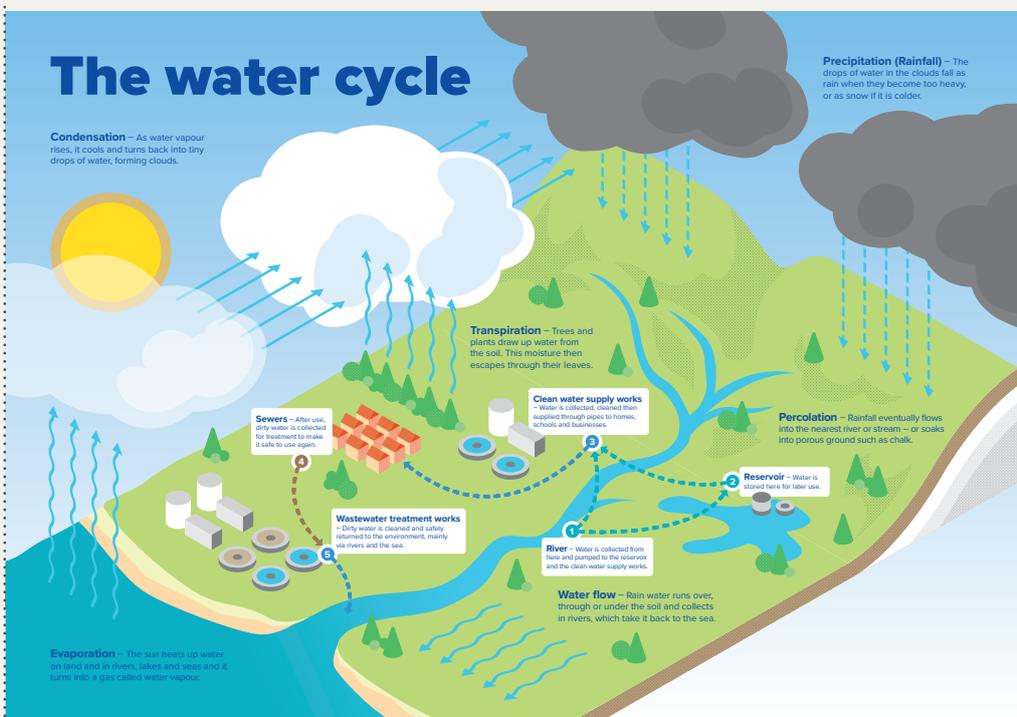
Regulators' priorities help define our five-year commitments so we must actively engage to influence and prepare for any future market reform.

Investors

To ensure we add value for our investors, we manage risk prudently and provide an appropriate return, when we are able to. We also invest their money in our assets to provide growth and resilience. Regulatory price controls help to align shareholder value with customer and environmental priorities.

3. What we do

We provide essential water services to 2.6 million customers, and wastewater services to more than 4.7 million customers across Sussex, Kent, Hampshire and the Isle of Wight. We do this while working hard to enhance the health and wellbeing of our communities, protect and improve our environment and sustain our economy.



▶ 4. How we do it

Our Water for Life Business Plan 2020–25 will take us closer to our ambition of creating a resilient water future for customers in the South East. Developed following extensive consultation with our customers and stakeholders, it will deliver significant performance improvements, including a 15% reduction in leakage, improvements to 537 kilometres of rivers and a further 155,000 customers supported through financial assistance schemes, with bills reducing by 18% in real terms.

Our five year strategy



Use water wisely



Fit for the future



Deliver great service



Protect and improve the Environment

Our materiality assessment

Understanding what matters most to our customers and stakeholders is fundamental if we are truly going to be a purpose-driven organisation. We consider their priorities alongside our own assessment of what has the biggest impact on our company and its ability to create value.

➔ Read more about our materiality assessment on pages 64 and 65

Embedding risk and value processes into operations

Our risk and value (R&V) process underpins our way of working. It is improving our decisions about how to invest, build and run our assets, and allows us to collaborate more effectively with suppliers across our business.

Underpinned by our values

Our values are at the centre of everything we do. They govern how we do things and allow us to build a solid decision-making framework.



537km
of rivers
improved

18%
Reduction in bills
in real terms

➔ Read more on operational performance on pages 74 to 99

Our business model continued

▶ 5. Delivering value to our stakeholders

Customers

In the short term: Delivering reliable services to our customers is a priority. If and when they do need to contact us, we provide easy access to our services, we listen to them and meet their expectations. We ensure that our bills offer our customers value for money and that they are affordable to all. We provide Priority Services to support those customers who find themselves in vulnerable circumstances.

In the long term: As a provider of essential services, we make a vital contribution to the long-term health and wellbeing of customers in the South East. To continue to do so, we need to ensure access to long-term financing and meet the statutory obligations set out in our regulatory framework, but we also need to invest in infrastructure to improve the resilience of those services in the future.

How we measure the value delivered

Operational delivery incentives (ODIs); C-MeX; complaints; adoption of digital services; take up of assistance schemes; total on Priority Services Register

➔ Read more on page 46

Regional stakeholders

In the short term: Water for life is a shared responsibility and we can only meet the challenges of climate change and population growth in the South East by working with our regional stakeholders, be that county or parish councils, local landowners and NGOs. In order to ensure their trust and confidence we must deliver on what we promise and support the wider goals of their communities. We can add value by leading on issues of water efficiency, carbon reduction and improving water quality.

In the long term: We plan to deliver on our commitments to customers in an integrated, collaborative way, using systems thinking to deliver solutions to regional challenges. Examples of this would be the work already started on a regional water grid through Water Resources in the South East, or the energy and water strategies created through our work with the Greater Brighton Infrastructure Panel.

How we measure the value delivered

Annual perceptions audit

➔ Read more on page 47

Communities

In the short term: Our volunteering projects connect our employees with our communities, while at the same time addressing local issues and supporting those in need. Working with community interest groups and local charities in this way means we can accomplish more together. We also support tourism in the South East by helping to look after its landscapes and beaches, and by opening a number of sites to the public, supporting our customers' health and wellbeing through access to relaxation and recreation.

In the long term: We work with local schools and community groups to raise awareness about the value of water and protecting the natural environment. By managing our land responsibly and sustainably, we can ensure the South East's environment is left in a better condition for future generations.

How we measure the value delivered

Number of people supported through our volunteering programme; awareness of value of water; reduced individual daily water usage.

➔ Read more on page 47

Retailers

In the short term: Retailers rely on us to deliver wholesale services i.e. meter installations for their customers on time to enable the correct onward billing of water and wastewater services.

In the long term: We collaborate with our retailers to tackle market issues, exploring new ways of working and different uses of technology. The biggest issue in the market currently is the quality of data held in the central market system. To help address this, we have long-term plans in place to rectify the issues together with our retailers and the regulator, MOSL.

How we measure the value delivered

Operational Performance standards – our performance against market service levels on delivering wholesale services; Market Performance standards – our performance against market service levels on updating the central market operating system with quality data following a request for a wholesale service; and Retailer Satisfaction (R-MeX) – a six-monthly retailer satisfaction survey.

➔ Read more on page 48

 **Employees**

In the short term: The health, safety, security and wellbeing of every Southern Water employee, both physical and mental, is a priority for us. Our Learning Zone – our new platform containing mandatory, soft skills, management and operational training modules – enables all of our employees to grow their skills. Our bi-weekly Company Conversations webinars, newly-established Employee Voice panel and Speak Up platform ensure that every employee has a chance to have their say on the issues that matter to them.

In the long term: We aim to foster a diverse, inclusive and engaged workforce, where everyone feels comfortable and motivated to succeed. This means we need to invest in the development of both current and future employees, ensuring that we have access to the right skills for the future. Our plans to broaden our Learning Network to support training in our communities supports this. Our refreshed pension offerings also support our employees in later life.

How we measure the value delivered

Gallup engagement scores; diversity and inclusion survey; gender pay; our culture dashboard, training and development completed; internal progression, training days delivered, percentage of employees supported to study, employee sickness; health and safety (near misses, accidents); pension contributions

 [Read more on page 48](#)

 **Investors**

In the short term: Many of our shareholders are pension funds so the potential income we provide through dividends benefits a large number of people. In order to give these shareholders confidence in the way we do business we have committed to following ESG (environmental, social and governance) practices. This means operating in an environmentally and socially conscious manner and upholding the highest standards of corporate governance. Our core value of doing the right thing means we act with integrity at all times.

In the long term: Our shareholders have put money into our business, and see us as a stable, long-term investment. As such we must work to provide an appropriate return through a combination of short-term dividend income and long-term growth. To ensure this, we plan far into the future, investing in our infrastructure to ensure the long-term resilience of the business and the services we provide, managing risk prudently. Our commitment to always improve drives innovations, enabling us to find new solutions to shared challenges.

How we measure the value delivered

Totex outperformance; financing outperformance; household retail cost to serve

 [Read more on page 50](#)

 **Suppliers**

In the short term: Our suppliers help deliver our maintenance and enhancement projects across our region, supporting thousands of jobs. While our operations and suppliers are mainly UK-based, we do have a number of third-party teams based overseas. We work closely with our suppliers to address human rights issues.

In the long term: The jobs we support through our supply chain help to develop the skills and knowledge base in the South East. Exploring new technologies and working collaboratively on innovative projects with them means we can identify solutions that will make our services better in the future

How we measure the value delivered

Average time taken to pay invoices; number of suppliers paid on time

 [Read more on page 49](#)

 **Regulators**

In the short term: In order to ensure the trust and confidence of our regulators, we need to reassure them that we are working in the right way, meeting our statutory obligations and constantly improving our performance, be that customer experience, water resource management, water quality or protecting and improving our environment.

In the long term: By placing resilience at the heart of our strategy, we are focused on delivery of long-term, sustainable transformation of our business. This means leaving behind the legacy issues of our past and focusing on doing the right thing for our customers, communities and the environment. This will ensure that we, and the rest of the industry, improve our credibility and legitimacy.

How we measure the value delivered

Improvement across our performance commitments and ODIs; public value; regulator feedback and successful completion of our transformation plans.

 [Read more on page 50](#)



Environment

In the short term: We are focused on meeting stringent environmental consent levels to protect and improve the quality of groundwater, rivers and coastal waters, protecting these resources for future generations, supporting tourism in the South East. We are investing in renewable energy to help reduce our carbon footprint as part of a series of measures outlined in our net zero plan. In addition, we are investing in catchment risk management, working with farmers and landowners across our region. We are also exploring the development of new water sources through our Water for Life Hampshire programme, taking pressure off the Rivers Test and Itchen.

In the long term: We are connecting our customers to the value of water through our flagship Target 100 programme to reduce individual daily water usage to 100 litres per day by 2040. We are continuing our work with environmental stakeholders on our Catchment First programme. We are embedding natural capital approaches into our planning and processes, and exploring nature-based solutions to shared challenges through local partnerships. Our long-term ambition is to ensure our activities and investment enhance the resilience of our natural environment by achieving our net zero plan. We are keen to benchmark our performance in this area and will be aligning our measures to the UN Sustainable Development Goals and Science Based Targets initiative, where appropriate.

How we measure the value delivered

Leakage; individual daily water usage and distribution input; the Environment Agency's performance assessment (including pollutions, compliance, etc); carbon footprint; waste recycling; natural capital accounting; annual stakeholder perception audits

➔ Read more on page 49

“ We are investing in renewable energy to help reduce our carbon footprint as part of a series of measures outlined in our net zero plan ”



Key for value delivered:

Short term

Within the current five-year investment period, to 2025

Long term

Beyond 2025, into the next investment period 2025–30

Our business model continued

1. Our key inputs

Managing our value chain

Using six capitals thinking is helping us keep our responsibilities to customers, our communities and the environment at the forefront when making business decisions.



Social

Value resulting from our relationships with customers, communities, our wider society, and stakeholders. Put simply, it is the trust placed in us by these groups, which directly relates to the impact that we have on them. As a privately owned company, providing an essential public service, our social capital represents our social contract, which is just as important as our operational license. Our core value of doing the right thing drives this behaviour and ensures we are considering all our stakeholders in our decision making.

It also means staying in tune with the wider impact of issues affecting society, such as the COVID-19 pandemic, Brexit, etc, and making sure that the services and support we offer are appropriate.

.....
Link to our risk(s):

Customer; COVID-19



Financial

Financial capital is how society measures the value of something and it includes items with a cash value, for example money, stocks and shares. Although traditional, this is not a very broad view of value. To consider our total impact and value, we need to consider salaries, profits and taxes. We also need to look at other indicators of our financial resilience including our credit rating and gearing ratio.

Our services underpin our local economy and, if we include our supply chain, our impact increases. As a privately owned business, transparency and legitimacy remain priorities which is why we have made substantial changes to our reporting and disclosures, as well as making changes to simplify our financial structure. We also introduced a Sustainable Finance Framework which is described on page 73.

.....
Link to our risk(s):

Financial



People

Encompassing both our people's wellbeing, as well as the value they bring to our communities. As such, it is not owned by Southern Water but is delivered in exchange for salaries and other benefits. By understanding the value of our people, we can take prompt action to address any concerns. Our employees are Southern Water, and we are committed to developing a diverse and inclusive workforce that better reflects the communities we serve.

By tracking factors such as an ageing workforce, sickness rates, engagement and diversity and inclusion programmes, we can better manage risk and also seek out opportunities to improve our workplace.

.....
Link to our risk(s):

COVID-19; Resources; Financial



Manufactured

This includes the physical objects that are owned or controlled by us, such as our pipes, pumps and treatment works, as well as our IT systems and fleet. How we maintain those objects is critical to the health and prosperity of the South East. We need to ensure that resources are used efficiently and effectively and that we manage these assets sustainably to ensure future service levels.

This means using systems thinking and 'circular' approaches to create value by reusing resources and avoiding the creation of waste.

.....
Link to our risk(s):

Water; Wastewater; Financial



Intellectual

This encompasses Southern Water’s collective knowledge and information: the data and information we manage and generate, the information we share with society and also our people’s skills and know-how. It includes the intellectual capital we share outside of the organisation through disclosures, partnership working, investments in innovations, and through community education.

One of our values is always improving, and this means looking at new ways of working, finding quicker, cheaper, or better approaches to save money so that we are able to keep bills low for customers while improving the services we offer.

Link to our risk(s):

Resources; Financial



Natural

In simple terms, natural capital is the stock of environmental resources – ‘ecosystem services’ that nature provides – that we manage, use, and depend on.

These services include: the supply of clean water, natural flood risk management, improved air quality and health and wellbeing benefits.

We will develop natural capital accounts alongside our financial accounts as a means of measuring and reporting progress in this area.

Link to our risk(s):

Financial; Climate Change; Resources

➔ Read more on natural capital on page 71



Our business model continued

2. Our key relationships

Customer and stakeholder engagement is key to our decision-making



Customers

Why we engage

We are privileged to be able to provide essential public services to our region and to be taking a lead to create a resilient water future for customers in the South East.

- **Doing the right thing** – Ultimately it is our customers' investment that helps to build and maintain the infrastructure that supports these services. As guardians of this investment, engaging with customers is crucial to ensure we understand and take into account their views.
- **Always improving** – Customers expect a great level of service and by engaging, listening and acting we are able to innovate and improve where it matters most.
- **Succeeding together** – We all play a role in protecting our resources and the environment around us, which we can only do by working collaboratively with our customers and regional partners.

Key interests:

Customer service and operational performance; affordability and vulnerability; leakage and water efficiency; resilience; environmental impacts; community investment; data protection.

How we engage:

In 2018 we developed our Participation Principles. These are our guiding framework for customer engagement, designed with our brand values at their heart.

- **Doing the right thing** – We start by thinking about participation first, so that it is easy and accessible for customers to engage. We are inclusive in our approaches, ensuring that we explore the diversity and different experiences of our communities. We then integrate multiple sources of insight and bring it together defining clear customer voices.
- **Always improving** – We innovate in our approaches and are open to challenge to find new and engaging methods for customers to participate. We design approaches that are iterative so customers can get closer to the detail of our industry and share learning from others.
- **Succeeding together** – We collaborate with others, sharing best practice by partnering and building relationships over time. We share plans to link up different programmes of activity that allow customers to have an ongoing, two-way dialogue on our current performance and future plans.

Outcome of engagement:

Our engagement focuses on our strategic planning, improving the experience to our customers and being efficient in how we operate. Our customers are central to our strategic planning with engagement driving investment and focusing our activity. To improve the experience our customers receive we engage on areas such as how best to support those that need it most through our billing and service, how to manage through a supply interruption and ensuring the right channels are available. In many areas working together with customers is a highly efficient solution, so we engage to ensure we deliver the right impact, such as reducing water consumption or minimising blockages in our sewers.

Where we are going:

For us, the aim of our engagement is to have customers actively participating in the creation of resilient water future for the South East. This means having the customer at the heart of the organisation through engagement on all our key programmes, continuous dialogue and providing leadership through the support we provide. Following our last price review, we launched our participation strategy focused on setting up continuous insight programmes to integrate alongside our decision making. In 2020–21 we focused on increasing the inclusivity and range of continuous programmes – launching Water Futures 2050 (our young persons' group) and Water Futures 2030 (our household customer panel). As we move into the next year our focus will be to share our Water Futures views with our teams, driving real action for our customers.

 **Communities**

Why we engage

Our services enable communities, which is why we work hard to keep improving our services, working with our customers where we can to build trust, respect and an understanding of the impact our work has on their everyday lives. By engaging constantly with our communities we can be sure that we understand what matters most to them so we can develop solutions together.

Key interests:

Trust, transparency and legitimacy; community investment; environmental impacts

How we engage:

We do this in person, particularly where our capital infrastructure schemes might have a direct impact on customers' daily lives or where we want to work collaboratively to find shared solutions to a particular problem. We also engage with groups on social media and provide 'what's happening in your area' information on our website. We also run regular workshops (online at the moment due to COVID-19) and develop community partnerships, through our charitable, volunteering and grant schemes.

Outcome of engagement:

By talking to and working with our communities, we are starting to build mutual trust. Where we have difficult issues, such as ageing infrastructure or a large development scheme, we know that involving our customers in working towards a solution is critical. These relationships are helping us to better plan for the future.

Where we are going:

We are refreshing our community funding scheme to offer grants to our regional charities, as well as local non-registered charities, e.g. community groups/'Friends of groups, for the first time. We are exploring opportunities to offer our communities training, meeting room space and storage. Our new customer and employee steering group will ensure we build stronger relationships with our communities.

 **Regional stakeholders**

Why we engage

It is vital that we ensure that the views of county and parish councils and interested landowners and developers are captured in our planning and decision-making. Building relationships with these groups is vital to protecting and enhancing our reputation. We need to deliver on what we promise, responding to key people in the community on regional, local and political issues.

Key interests:

Resilience; customer service and operational performance; environmental impacts; trust, transparency and legitimacy; land management and access; community investment

How we engage:

Liaising with key individuals and organisations such as MPs, local authorities (CEOs, leaders, senior councillors), environmental groups and more. This can be from weekly calls, to briefing and presenting to key authorities, and the stakeholder workshops that we organise each year. In terms of engagement with developers, we attend industry events, conduct market research and surveys, and we also hold account meetings and customer forums.

Outcome of engagement:

Effective and timely engagement ensures plans and priorities are understood by key partners. Maintaining regular and transparent contact with key developers in our region also improves our developer satisfactions (D-MeX) score over time.

Where we are going:

Our Stakeholder Engagement Management team has been set up to engage with key stakeholders, helping to inform them about our current business plan and how we can work together. For our developers, we have launched a new application portal, Get Connected, which will enable customers to track their application from end to end.

 Read more on pages 42 to 43

Our business model continued

2. Our key relationships continued



Retailers

Why we engage

Our retailers offer customer services to commercial and industrial (non-household) customers, while we supply wholesale services. We welcome feedback from our retailer customers – good and bad – to identify opportunities to improve our services. Our engagement principles allow us to review our plans effectively to ensure they are meeting the needs of our customers. Responding and acting on feedback we receive is key.

Key interests:

Improved meter, property and customer data

How we engage:

We have eight engagement mechanisms which include industry events, market research, social media, customer account meetings, website, customer forums, surveys and action groups.

Outcome of engagement:

For our retailers, improving in the quality of data we provide will help with more accurate onward billing to non-household consumers. This combined with maintaining good levels of service will help deliver strong operational performance and an improved industry Retailer Satisfaction (R-MeX) position.

Where we are going:

We have continued to work on driving down the number of meters that have not been read for a long time, the highest priority data issue in the non-household market. We have collaborated with our largest retailer Business Stream on a 12-month project, which will see the improvement of data. Additionally we are working with our field teams to help resolve further meter data issues for our other retailers.



Employees

Why we engage

We want our employees to be proud to work for Southern Water. There is also a clear business case for engagement, as higher engagement leads to an increase in productivity. Gallup states that this increase could be as much as 21%, while at the same time the cost of disengagement is 34% of a disengaged employee’s annual salary. It also suggests organisations with high employee engagement have fewer health and safety incidents, they are around 48% safer.

Key interests:

Health, safety, security and wellbeing; fair and equal pay; diversity and inclusion; career progression

How we engage:

We run an annual employee engagement survey using Gallup’s Q12, which is supported internally by Workplace campaigns. A series of bi-weekly webinars – Company Conversations – are hosted by our CEO and we supplement these with virtual roadshows (whole company or individual teams). Our digital Learning Zone enables employees to register themselves for a range of mandatory training, and people skills and self-development training. Our managers, meanwhile, receive regular updates and toolkits from our People team.

Outcome of engagement:

Our Gallup engagement scores are increasing year-on-year; our overall engagement score has increased from 3.75 to 3.89. A move of 0.1 or more in organisations with more than 1,000 employees is considered a ‘meaningful’ improvement by Gallup. We have launched our digital Learning Zone to help employees to progress their careers. Around 10% (217 people) have or are undertaking studies as of March 2021; this represents a 5% increase from 2019–20. We also now offer ‘upskilling’ apprenticeships for our internal employees to progress their careers. Regular updates from managers have increased wellbeing and satisfaction within teams.

Where we are going:

We have established a new Employee Voice Group, which includes members of our Board and Executive and this is supported by employee ‘listening’ groups throughout the year. The group will ensure employees, many of whom are also our customers, contribute to our strategic decision-making.



Suppliers

Why we engage

We value the role our partners play in helping us to deliver a quality service to our customers. Working collaboratively with them is key to the success of our business. We have processes in place to ensure that all suppliers of significant spend, or in high risk areas, have a full qualification assessment. This is either as part of the requirement of the Utilities Contract Regulations 2016 or separately. This assessment includes, but is not limited to: corporate and social responsibility, environmental impacts, health and safety, modern slavery, information governance and data protection.

Key interests:

South East economy; responsible supply chain; human rights; resilience

How we engage:

During the year we created a supplier portal, linking from our website, to signpost impacts and guidance for our supply chain, and an internal contract manager helpdesk for our employees, to enable inter-department collaboration and overcome remote working constraints. We also issued guidance to our employees and supplier partners on how to access support and where to directly intervene. Our suppliers were offered access to an online forum to provide leadership and drive collaboration, developing future resilience.

Outcome of engagement:

We have successfully mitigated the potential impact of both COVID-19 and Brexit, ensuring no significant impacts in our supply chain as a result. Furthermore we have established robust working practices as a platform for ongoing collaboration.

Where we are going:

We continuously strive for improvement with our suppliers, looking a new innovation and efficiency gains in processes to meet the needs of our customers and stakeholders.



Environment

Why we engage

To deliver water for life, we must protect and improve our environment. We engage with interest groups, as well as environmental regulators, non-governmental organisations, campaigners and local communities to find shared solutions to environmental issues. We are all facing the same challenges, such as climate change and population growth. Our partnerships with other regional water companies and local councils mean together we can deliver more impact.

Key interests:

Resilience; climate change; environmental impacts

How we engage:

We regularly host workshops with environmental stakeholders, including via our Strategic Environment Panel, to understand their priorities and how we can work together to add value. Our Insight team also works with a number of customer groups to conduct research projects throughout the year, including our Water Futures 2030 youth panel.

Outcome of engagement:

These stakeholders tell us that working together is the best way to ensure resilience of our natural environment so we are always looking to identify new ways to deliver improvements, and engage with them to deliver shared environmental outcomes. For example, we are working with both the Wildlife Trusts and the Rivers Trusts in the South East on a number of exciting projects, including the restoration of the Sussex kelp forest.

Where we are going:

We are establishing an Environment, Customer and Climate Change advisory to advise our CEO and Board as they establish the long-term ambitions of the company. Our Board has also agreed to additional investment over the next four years on targeted projects, run in partnership with bodies such as the Wildlife Trusts and the Rivers Trusts, which will deliver increased carbon storage, improved water quality, reduced flood risk and increased health and wellbeing.

➔ Read more on pages 42 to 43

Our business model continued

2. Our key relationships continued



Regulators

Why we engage

Our price and service quality is controlled by economic, quality and environmental regulators, who exist to help protect the interests of our customers and the environment. Meeting the expectations of each regulator and our stakeholders requires open and continuous dialogue to ensure any regulatory changes align with their priorities. As such, maintaining good relationships enables us to influence future reform.

Key interests:

Political and regulatory environment; resilience; trust, transparency and legitimacy

How we engage:

We hold regular meetings with all our regulators to ensure two-way dialogue, and that they have an accurate view of our performance and compliance with our statutory obligations, with particular focus on improving via our transformation programme.

Outcome of engagement:

Our regulators assess our comparative operating performance against the other water and wastewater companies in England and Wales, with the Drinking Water Inspectorate (DWI) assessing performance in drinking water quality, the Environment Agency (EA) assessing performance in water resources and wastewater, and Ofwat assessing customer satisfaction and economic outcomes.

Where we are going:

Our vision is to create a resilient future for our customers in the South East which means we need to deliver a step change in our operational performance while investing in our infrastructure, new technologies and innovations to ensure future supplies. We need the support and guidance of our regulators in order to achieve this.



Investors

Why we engage

Investors are integral to the ongoing financing of the business. Revenues from customers are not large enough to fund the level of investment that we are making, and it makes sense that these long-term investments are financed on a long-term basis. Therefore we are regularly looking for financing/ refinancing from the financial markets in order to fund our long-term investment. Engaging with investors on a regular basis improves our access to these financial markets and ultimately ensures we can obtain funds as and when they are required.

Key interests:

Stability and predictability; Environmental, Social and Governance (ESG) credentials; resilience

How we engage:

We regularly update investors with our bi-annual investor reporting that is published on our website, as well as conducting investor calls. When measuring ESG performance investors are looking at operational performance, cost of financing and our ESG strategy and are looking for improvements on these areas relative to our peers.

Outcome of engagement:

We put in place a sustainable financing framework in May 2020 and this links investment to qualifying capital projects. We have raised two sustainable bonds during 2020–21.

Where we are going:

We have ongoing financing requirements throughout this investment period so we will continue to engage with our investors on a regular basis. We will further develop our ESG strategy and reporting in the coming year.

Our approach to materiality

Our materiality assessment informs decisions about what we report in documents such as this Strategic Report and ensures we understand key stakeholder priorities and consider their interests, helping us create value in the long term.

➔ Read more on pages 64 to 65

Our s172(1) Statement

Our directors are duty bound to promote the success of Southern Water for the benefit of its stakeholders, paying attention to: the consequences of any decisions, the interests of employees, relationships with suppliers, customers and partners, the impact of the company's operations, standards of business conduct, and the need to act fairly at all times.

➔ Read more on pages 66 to 69

How the Board is kept informed of stakeholder views

The Board is kept informed of the views and opinions of the company's stakeholders, including its regulators, suppliers, investors and government. The company's Chairman and Chief Executive Officer regularly attend meetings with government bodies such as Ofwat, the Department for Environment, Food and Rural Affairs, the Environment Agency and Drinking Water Inspectorate.

➔ Read more on pages 66 to 69



Our business model continued

3. What we do

Our vision is to create a resilient water future for our customers in the South East

The water cycle

Our use of water and its return to the environment is a continuous cycle, and managing our impact at every stage is critical to protecting future resources. Our environment is constantly changing, and it is essential that we can adapt and prepare for the challenges of population growth and climate change.

Water is collected

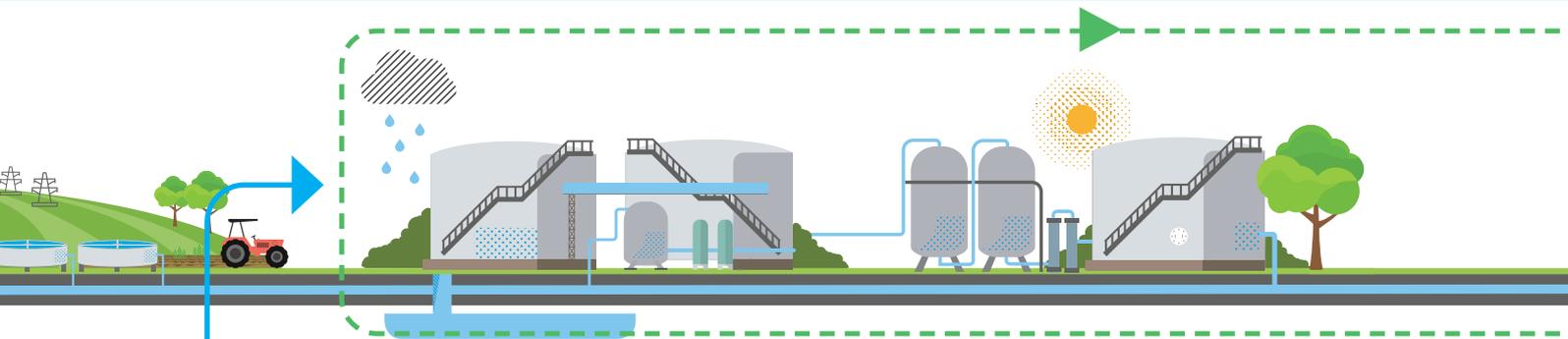
About 70% of the water we supply comes from groundwater (water stored underground in aquifers), 23% is abstracted from rivers and 7% comes from our reservoirs.

Water is cleaned

Our 81 water supply works treat raw water to the highest standards, making it safe to drink.

Clean water is put into the supply

Our 13,972-kilometre network, 205 service reservoirs and 28,169 pumping stations deliver a continuous supply of clean water to our customers at an acceptable pressure level.



Associated risk

In our densely-populated and water-stressed region, we must balance the need to supply high-quality water to our customers with the need to preserve our natural resources.

Associated risk

Failure of key infrastructure could result in a risk to public health due to reduced water quality and/or disruptions to supply. We use several chemicals in the treatment of water which, if not handled correctly, could result in injuries to employees and/or customers. Catchment risk assessments inform our raw water monitoring programme, ensuring we are sampling for relevant substances to inform the treatment requirements.

Associated risk

If we fail to meet required standards, public health could be put at risk, our customers could experience supply disruption or a reduced water quality. We may also experience increased leakage from our network.

Maintenance and development

We constantly monitor our water and wastewater sites and networks, conducting maintenance and developing new infrastructure to make sure they are meeting the standards set by our regulators. Failure to monitor, maintain and, where required, increase capacity of our water and wastewater sites and networks could pose risks to public health, and result in disruptions to supply, injury to our employees or customers, and damage to property.

Customers enjoy our water

Customers across the South East go about their daily lives enabled by a supply of safe, clean drinking water and the removal of wastewater from their homes and businesses. In 2020–21, we put 563 million litres per day into supply.

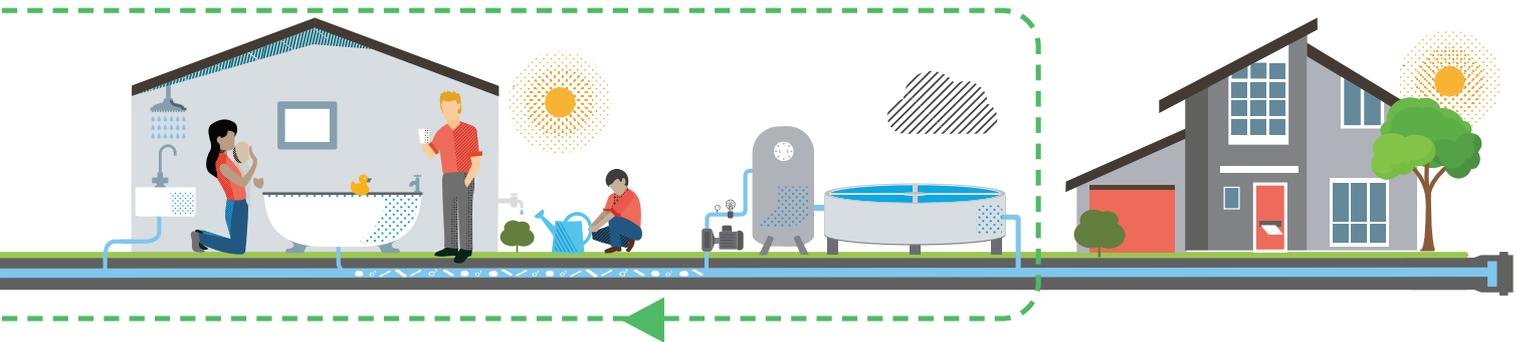
Wastewater is collected and treated

Our 39,835 kilometres of sewers and 3,444 pumping stations collect wastewater from our customers’ homes and businesses, and from the drains outside.

Each day, 758 million litres of wastewater are carefully screened, filtered and treated at our 81 treatment works, meeting strict environmental standards before being returned to the environment.

Customers are billed

Our Customer Service teams calculate and distribute customers’ bills, handle payments and manage any related queries.



Associated risk

If we do not constantly look to improve and maintain high levels of service and quality, we run the risk of not fulfilling our obligations to customers, to provide high-quality drinking water and protect rivers and bathing waters.

Associated risk

If we do not remove wastewater effectively and manage our network, we may cause sewer flooding, environmental pollution and unnecessary distress to our customers.

Potentially hazardous substances and processes are used that could cause injury. Varying rainfall patterns, extreme weather events and rising sea levels all contribute to an increased risk of flooding if our infrastructure is overwhelmed. This could also lead to contamination of water supplies and infiltration/inundation of our sewers.

Associated risk

Errors in our billing calculations or customer information could lead to poor levels of customer satisfaction, and a rise in contact and complaints, which could damage the company’s reputation and increase our operating costs. Failure to properly protect customer data could also lead to significant fines under Data Protection (GDPR) and Networks and Information Systems (NIS) directives.

Ensuring future supply

We continually look for new ways to make our services better, safer, faster and cheaper, working with our partners and communities to find shared solutions. We are always improving to ensure a resilient water future.

Associated risks

At each stage of the cycle there are several opportunities and risks, including penalties and rewards applied by Ofwat where we meet or exceed performance targets. We always seek to maximise opportunities, while also identifying, managing and mitigating any risks.

Our business model continued

4. How we do it.

Our long-term environmental, social and governance ambitions inform our five-year strategy

Our purpose is to provide water for life to:

enhance health and wellbeing

protect and improve the environment

sustain the economy

Our long-term strategic ambitions

Improved and affordable services

Ensure easy access to high-quality customer services, clean safe drinking water without interruption, and the treatment and safe return of wastewater to the environment. At the same time, we are working collaboratively with our peers to end water poverty by supporting customers in financial hardship, providing support through our Priority Services to those who need it most.

Engaged communities

Encourage and inspire our employees to embed themselves in community projects through volunteering and local partnerships, building long-term relationships and mutual trust.

Efficient use of resources

Generate value from wastewater: recycling of wastewater, recovering valuable minerals and bio-solids for agriculture and gas for energy, reducing leakage and increasing customer use of grey water and rainwater.

Enhanced value from our environment

Adopt a natural capital approach to manage and measure our progress, ensuring we take account of the wider environmental value, for example, delivering nature-based solutions instead or alongside more traditional end-of-pipe engineering solutions.

Systems thinking for a resilient future

Analyse our entire system and all its linkages, enabling us to find the best all-round solutions. Mitigate challenges, namely the impacts of climate change and population growth by working with infrastructure partners across the South East to ensure the future planning of 'connected systems' of water, energy, communications and transportation. Water is utilised as part of an economic growth strategy.

Risk and value at the heart of our plans

Ensure planning is a collaborative process, with decisions about how to invest, build and run our assets based on shared insight and risk assessments from our teams and supply chain, delivering cost-effective data-based solutions to business issues.

Underpinned by our values

Ethical decision-making and modern compliance frameworks, alongside our vision, purpose and values, help our leadership team, employees and partners make better decisions every day.

Succeeding together

Doing the right thing

Always improving

In our Water for Life Business Plan 2020–25 we outlined a number of long-term outcomes that demonstrated a step change in collaborative action with customers and stakeholders to co-create a preferred, shared future for water in the region. These outcomes emerged from customer insights, regulatory expectations, and operational imperatives and included a focus on: recycling; clean rivers, lakes, reservoirs and coasts; collaborating to ensure a resilient economy for the South East; innovating to create sustainable communities and helping our customers recognise the value of water in their daily lives. The long-term environmental, social and governance ambitions discussed below will help us achieve these long-term outcomes and our vision of a resilient water future.

➔ Read more about our approach to sustainability on pages 63 to 73

An employer of choice

Build a workforce that is reflective of the communities we serve, fostering a culture where everyone can be themselves, driving better decision-making and improving performance.

A learning organisation

Create a community-focused Learning Network, working in partnership with our supply chain, local councils and regional centres of learning to create the skills we need for a resilient future.

Resilience and climate change

Focus on climate change adaptation and risk management, alongside a reinvigoration of Water Resources South East (WRSE), looking 80 years into the future to deliver infrastructure which safeguards water supplies in drought. Similarly, our Drainage and Wastewater Management Plans (DWMPs) and Pollution Incident Reduction Plan (PIRP) set out how we intend to extend, improve and maintain a resilient drainage and wastewater system.

A sustainable water cycle

Sustainable water sources for the future, enabled through our transformational programmes – Catchment First, Networks 2030, Sustainable Drainage 2030 and our demand reduction Target 100 initiative – ensuring our services for future generations.

New solutions to shared challenges

Look within and outside our sector to find those innovators who can help us develop concepts into solutions we can use. Our innovation hub, bluewave, combines lean start-up and design-thinking approaches and involves active collaboration and co-creation with customers and other stakeholders.

Partnerships protecting our economy

Work with our environmental and community partners to maintain and enhance our reservoirs, catchment land, rivers and bathing waters providing a home for wildlife, areas for recreation, creating a resilient water future. Ensure that we articulate the income generated from water tourism to our stakeholders.

Our five-year strategy

 **Deliver great service**

We are focused on delivering clean, safe water, through a reliable, future-proof network, at a price that everyone can afford, and with great customer service at every step. Our improvements to the water network include hundreds of kilometres of new water mains, and refurbished treatment works. This will cut supply disruptions, while maintaining the same clean, safe water we all need.

➔ Read more on pages 80 to 85

 **Use water wisely**

We are reducing the amount of water lost to leakage with large investments to upgrade and replace our mains. We are investing in more automation on our network and we are working with local authorities and developers to encourage the building of new homes that use the latest water-efficient technology. Our Target 100 water efficiency programme will help partners across the region work together to reduce our water use.

➔ Read more on pages 86 to 87

 **Protect and improve the environment**

We are working with a range of partners to protect the environment. This means going beyond just doing no harm to enhancing our natural world. Over the next four years we plan to invest close to £1 billion in improvements that will deliver environmental benefits, improving the region’s rivers and many of our bathing waters, reducing flood risks, cutting our carbon footprint, and supporting schemes that improve the precious biodiversity of the South East. We will completely transform our sewer network, using smart technologies to predict and prevent sewer blockages and burst pipes.

➔ Read more on pages 88 to 93

 **Fit for the future**

We are looking far ahead, to ensure future generations enjoy the same access to water in the decades to come as we all do today. The South East is already a drier region than most in the UK, and climate change is going to make it increasingly difficult to supply the water we all need. That’s why we are already working in partnership with other organisations and experts – through programmes like Networks 2030 – to start building an innovative, automated network and a more reliable future for water. We are also generating biogas and green energy at our wastewater treatment sites.

➔ Read more on pages 96 to 99

Our business model continued

5. Delivering value to our stakeholders

Delivering a positive impact for our employees, communities and suppliers



Employees

We directly employ more than 2,200 people in Kent, Sussex, Hampshire and the Isle of Wight, as of 31 March 2021, not including those employed by our partners.

Collaborating effectively with our partners is key to the success of every aspect of our business. Whether solving IT issues, supporting major construction projects, maintaining the buildings we work in or the systems we use, our partners, working with our employees, enable us to meet our customers' priorities.

Promoting equality and diversity

We are committed to creating a diverse and inclusive workforce that represents the communities we serve. As an equal opportunities employer, we do not discriminate on the grounds of age, disability, nationality, ethnicity, sex, race, religious or cultural belief, sexual orientation or gender identity. We embrace diversity of all backgrounds, cultures and perspectives, and offer career opportunities based solely on each employee's ability to undertake their duties and responsibilities.

This is a key pillar in our People Strategy, and we are proud of the progress we have made to increase diversity and inclusion (D&I) this year. Our commitment to D&I has been recognised by our placement in the Inclusive Companies list of Top 50 UK Employers.

We have hired an Inclusion and Engagement Partner and worked together to complete our first inclusion survey to benchmark us against our peers and identify how we can improve as part of our D&I strategy. A total of 58% of our employees responded to the survey and we have acted on areas for improvement identified in the results, such as introducing mandatory equality, diversity and inclusion training to help colleagues understand what they can do to build an inclusive culture. We also hosted a series of confidential interviews to understand more about employees' individual experiences. Meanwhile,

20 employees, including members of our Executive Leadership Team, are participating in diversity-themed mentoring schemes.

We have carried out a series of cross-company 'sprint' exercises and focus groups to develop our D&I strategy and ensure this topic remains a high priority in all initiatives within the organisation. We also appointed a recruitment specialist to develop an inclusive talent attraction and retention plan. This builds on our interview training for managers to ensure they can recruit effectively within our competency framework and are aware of the impact of unconscious bias.

One of our ongoing challenges is attracting female employees to our operational and engineering roles, in what has historically been a male-dominated industry. Overall, only 24% (2019: 27%) of our employees are female across the entire company. To address this, we are working to ensure our recruitment processes attract all genders and are free from bias.

We marked International Women's Day, as we do every year, by sharing interviews about women's experiences of working in our industry. We also asked colleagues to show their support and share their own experiences and advice through our Women's Network.

In line with gender pay gap legislation, we report on data relating to salary, bonus and distribution of pay within Southern Water. Though the Government extended the deadline for publishing data for 2020 to October 2021, we prepared our report for April as usual. Our report revealed that – based on the median of all our employees' salaries – our gender pay gap in 2020 was -2% (2019: 2.4%) in favour of women. We are pleased that we have reduced our pay gap by 4.4% since last year; the national average is close to 5%.

Despite this progress in eliminating our hourly gender pay gap, we are disappointed to observe only a small reduction of our bonus gender pay gap. Based on the median of bonuses awarded to employees, our bonus gap was 35.03% (2019: 38.9%). As bonuses are proportionate to salary, people in higher paid roles receive higher bonuses. In the reporting period, more male employees held senior roles than female employees and this contributed to the gap. Although we have had some success attracting more women into management roles, we have more work to do and are keen to create an increasingly inclusive organisation through our ongoing D&I strategy.

Our report on gender pay is available at: southernwater.co.uk/gender-pay-gap.

Health, safety, security and wellbeing

The health, safety, security and wellbeing (HSSW) of our employees, supply chain and the communities where we operate continues to be a priority and has been central to our response to COVID-19.

Throughout 2020–21, our performance remained strong in relation to our peers. We achieved 0.27 (2019: 0.32) reportable injuries per 100 full-time employees, improving on our target of 0.29. We saw a reduction in serious accidents and the amount of lost time. Conversely, the number of non-lost time, low-impact accidents has increased. These trends are broadly due to interventions implemented in the previous year, a better reporting culture and the fact that our main offices were largely empty due to 1,700 employees working remotely, in line with the Government's guidance.

Major supply partners included in this incident rate are: Siemens, MTS Cleansing Services, Cappagh Browne, GSF, MGJV, Galliford Try Southern Water Partnership, PN Daly, Trant Engineering, 4D Woolston, Costain MWH Delivery Partner and Clancy.

Our key focus for this year has been our response to the pandemic. Our activities included:

- implementing controls to ensure our operational activities can continue in a COVID-19 safe way by removing staff from potential virus transmission risk and implementing 'hard' controls in areas where employees had to continue to work to ensure provision of service
- providing guidance and support to employees working from home
- maintaining compliance with our policies, despite the additional complexity of the pandemic
- developing joint industry practice with both our supply chain and the wider water industry, supporting government initiatives and policy (for example, by restricting our societal impact).

All teams, both office and field-based, have adapted to new ways of working and all our workplaces are now COVID-19 secure. We continue to stringently follow the Government's guidance, monitor the situation and adapt our plans accordingly.

We are now preparing to deploy the second part of our HSSW Transformation Strategy, which is supported by a 10-year plan that focuses on key areas such as: removing people from risk, improving culture, risk-based assurance, improving insight and 'unpacking' our data sets.

Promoting employee wellbeing

While the impact of getting safety wrong can be severe, we recognise health must be taken just as seriously.

As part of our response to COVID-19, we have provided support for employees whose wellbeing was affected by the pandemic. We extended dependency leave and offered self-isolation support to around 450 colleagues.

0.27
reportable
injuries per
100 full-time
employees

1,700
employees
worked remotely

Our business model continued

5. Delivering value to our stakeholders continued



Employees continued

In addition, we reviewed our HR policies and updated them to reflect some of the challenges and risks of employees spending more time at home, including supporting employees at greater risk from domestic violence. We also launched a HSSW newsletter with updates about wellbeing-related developments, advice and signposts to our Employee Assistance Programme and other support.

Our wellbeing programme continues to be enhanced. In December, we gave all employees access to the digital mental health platform Unmind. This reinforces our commitment to the Time to Change pledge – signed by our Chief Executive in 2017 – which aims to end the stigma around mental health. The app provides resources and support in areas such as relationships, sleep, stress and more. A ‘plus one’ feature also allows employees to offer the app to a friend or family member.

As part of our HSSW Transformation Strategy, we are developing a wellbeing programme that is inclusive and based on input from colleagues. We recognise physical and mental health are only two aspects of wellbeing and we are developing our programme to address additional areas, such as financial, career and social aspects. We are also exploring ways to benchmark employee wellbeing so we can evaluate our offerings in future.

Developing talent

We are committed to developing our employees. Our emphasis in 2020–21 has been on making sure learning can continue in a COVID-19 safe way and giving our employees the skills they need to navigate new ways of working.

Overall, we supported 10% of employees with focused training through a comprehensive range of formal learning such as apprenticeships and qualifications, as well as offering informal learning such as day courses and certifications to the rest of the business.

We recognise managers play a key role in helping us drive business performance and improvement. At the start of the pandemic, we ran a manager readiness survey to identify how we could best support them and their teams. Based on the responses, we created a training session focused on the manager’s role in performance management and engagement. More than 100 managers attended the

programme from October to December 2020 and over 80% rated it either good or excellent. The readiness survey also identified that managers wanted to become more confident with virtual recruitment, on-boarding and communication. So we provided a range of online guides and virtual skills sessions to enable the business to adapt to remote working.

To allow learning to continue during the pandemic, we transitioned much of our learning online. We introduced LinkedIn Learning for relevant teams and gave all employees access to this training portal’s catalogue of over 15,000 courses spanning business, creative and technical skills. Meanwhile, our technical training team has produced 46 eLearning modules to date and is about to release a new suite of Environmental Toolbox modules. We have also switched many of our Business Essentials courses to virtual events and introduced new courses such as Managing Remote Teams and Resilience training to support colleagues during the pandemic.

We are particularly proud to have offered more apprenticeships this year. We increased our use of our apprenticeship levy to 81% by the end of 2020 and the number of apprenticeships across our business has grown from 19 to 100. We have taken on new apprentices in Commercial and Procurement Services and created a number of apprenticeships for existing employees at all levels. Some of these programmes are accredited, allowing apprentices to gain a professional certificate following successful completion of the programme.

We have continued the roll-out of our EU Skills recognised Water First Operator training, which focuses on ensuring all our water operators are at a consistent Level 3 standard. 56 employees from the 2019 cohorts have completed the programme and another 15 employees started this year.

Following the launch of our Operator/Maintainer programme for wastewater employees last year, completion of the eLearning is currently at 82% after learning moved online and practical training was paused during lockdown. Building on the success of these two training programmes, we are bringing first aid training in-house and preparing to start delivering our Network Inspector programme.

To bring all of our learning and development initiatives together and increase employees' awareness of development opportunities, we have launched a unified learning offering called The Learning Network. Through a single online system, employees are able to browse our entire catalogue of learning, complete video-based modules and book onto virtual sessions, hands-on training and face-to-face events.

A great place to work

While our transformation continues, engagement from our workforce is crucial to delivering and maintaining the necessary changes. During 2020–21, employee engagement has been a continued area of focus as we strive to achieve our ambition to be a great company to work for.

In early 2021, we completed wave four of our Gallup engagement survey. We saw positive progress against every question, our overall satisfaction improved markedly and our engagement ratio (actively engaged: actively disengaged) was our best yet. Those who joined the company in the last year reported the highest engagement, despite joining during the pandemic. We believe this reflects the work we have done to support COVID-19 secure ways of working on-site and in the field, as well as successful remote working practices.

For the second year in a row, our scores around business ethics showed meaningful improvement, indicating more employees believe we will do the right thing – a core pillar of our transformation. Based on insights from the survey, our line managers are working with their teams to address areas for improvement, with support from our team of trained engagement coaches.

Our engagement survey is just one way in which the views of our workforce are considered. We encourage two-way conversations between employees and our leadership team, as this enables our employees' interests to be factored into our decision-making. To continue these open and honest conversations while the majority of our employees are working remotely, we launched Company Conversations. During these fortnightly virtual events, which are open to all employees, members of our Executive Leadership Team talk and answer questions on themes voted for by employees.

To foster engagement and acknowledge the efforts of our employees, we have also launched STARS ('say thanks and recognise success'). Employees can share recognition for each other through an online platform. The initiative is linked to our rewards scheme, allowing recipients to claim perks such as vouchers or charity donations. In early 2021, we also invited employees to nominate teams and colleagues for our first STARS Awards. Prizes were available in a host of categories linked to our values and transformation. The winners were announced at a virtual awards ceremony in April.

Another way we are recognising the contributions of our people is by telling their stories both internally and externally. During the pandemic, we launched a series of internal podcasts called On the Frontline which focused on how our ways of working had changed during the pandemic. In October, we launched Water Stories on our website and social media to share short testimonials from employees about how they help to deliver water for life.

In February, our third 'Values Week' focused on doing the right thing. The week highlighted some of the ways we demonstrate this value across our organisation. As well as sharing examples from across our business, we asked employees to nominate colleagues who do the right thing for our customers, our colleagues and our environment for a STARS Award.

We continue to use our internal social media platform, Workplace, to give employees a forum to share news and events throughout the business. Over 75% of our employees have registered and the platform is regularly used to circulate updates and success stories, organise polls and arrange company and social events.

We have also begun redefining and reinvigorating our Employee Value Proposition to challenge perceptions of what it is like to work in our industry. This will extend beyond the tangible elements such as benefits, development and management style and attempt to capture the essence of what it is like to work for us in this key industry, focusing on our values and impacts within the community.

75%+
of our
employees are
registered on
Workplace – our
internal social
media platform

Our business model continued

5. Delivering value to our stakeholders continued



Communities

As many of our employees live in our region, we are passionate about enriching the communities we share with our customers.

We encourage our people to support charity and community projects and offer every employee two paid community volunteer days each year. Due to the pandemic, no face-to-face volunteer days were able to take place during 2020–21 (2019: 2,943 hours). However, we have continued to support our local community partners through remote volunteering. 47 of our employees supported nine charities in this way, volunteering a total of 384 hours. For example, some worked with Sussex charity Lifelines to make weekly telephone calls to vulnerable adults to provide a friendly voice, listening ear and support welfare checks. We also worked with local schools and colleges to offer mentoring and interviews to students looking to improve their skills.

Our employees voted Alzheimer's Society as our charity partner for 2019–20. We extended this partnership for a further six months up to December 2020 to provide additional fundraising support during this difficult time when many people living with dementia were cut off from their usual support networks and have felt more isolated than ever. During our 18-month partnership, we raised £65,000 to support people living with dementia and fund research towards finding a cure. Southern Water matched donations raised by sponsored employee activities including a sky-dive, step challenges and 10k runs.

As well as fundraising, we aimed to raise our own understanding of the impact of a dementia diagnosis on our colleagues, family and communities and reduce the stigma for those living with a dementia diagnosis. We adapted the charity's Dementia Friends training workshops to be delivered online during the pandemic. Through Alzheimer's Society's befriender programme, our employees also worked as Companion Callers to someone with dementia or a carer during lockdown.

We continued to support WaterAid as part of our five-year partnership. In 2020–21, we raised £92,374 to fund projects in some of the world's poorest communities.

Providing the maximum assistance to our vulnerable customers has been a priority during the pandemic. We have sought ways to support those who have been affected by the situation through our charity and community activity.

Our Affordability Team donated £20,000 to The Trussell Trust Food Bank. In December, our company e-card featured artwork by the children from Pan Together, an Isle of Wight charity which has provided hot meals for young people affected by the pandemic. We donated £1,000 for the festive artwork. We also gave items to Brighton-based charity CHOMP, which provides hot meals for children of low-income families during school holidays. We donated activity books, games and colouring pencils for 60 hampers a week.

We also brought forward part of our regular programme of regional community funding support and supported the regional foundations with £50,000 in donations to support their work to ensure funding makes the most impact in boosting local resilience.

Following a callout from the Sussex Local Resilience Forum (LRF), we also donated wipe-clean tables, coat racks and barriers, along with a fridge, to the coronavirus vaccination site at Brighton Racecourse.

We received a Bronze Award from the Charities Aid Foundation in recognition of the percentage of employees donating through our payroll giving scheme. In 2020, our employees donated £8,000 direct to 44 different charities, schools and community groups through the scheme.

Overall, we donated and fundraised a total of £173,408 during 2020–21.

Working with our communities

Due to social distancing guidance during the pandemic, our planned calendar of community events was cancelled abruptly in March 2020 and has been unable to resume during 2020–21. Where possible, we have honoured our financial commitment to these events or helped to facilitate online alternatives, such as Brighton Festival Children’s Parade, for which we were the main sponsor.

Our work with communities includes helping people to use water wisely, keep their drains clear to prevent blockages and pollutions, and, where possible, save money on their bills. As we were unable to meet our communities face to face, we collated community care packs for our most vulnerable customers. These contained information about our affordability schemes and Priority Services Register, along with giveaways to help customers save money by saving water, such as LeakyLoo strips to detect faulty toilets, and items to prevent blockages, such as GunkPots to collect used fat, oil and grease. We also included stickers and quiz books for children.

Although we usually share water-saving and blockage prevention messages via Waterwise and Sewerwise talks for schools and groups, no talks took place this year (2019–20: 51). However, in collaboration with Thames Water, South East Water and Affinity Water, we delivered a fun and interactive online event called the Big Virtual Water Quiz. As well as encouraging children to value water, the quiz provided an engaging home-schooling tool for seven to 11 year olds and their families during lockdown. The live event had 940 viewers and the video has been watched over 11,000 times since 15 July.

Our employees have also helped young people prepare for the world of work by conducting mock interviews through EBP South and Basingstoke Consortium. This gave young people an opportunity to practise interacting with professionals remotely, which has become a key part of working life during the pandemic.

940

viewers joined us live when we co-hosted the Big Virtual Water Quiz



Our business model continued

5. Delivering value to our stakeholders continued



Suppliers

Working collaboratively with our partners is key to the success of our business. From customer support to major construction programmes, our partners are integral to the delivery of our water and wastewater services. We therefore have an ambition to become the ‘Customer of Choice’ for our supply chain.

In response to the ongoing impact of COVID-19, we have worked closely with our critical supply chain partners to safeguard our essential services to customers and protect the health of our employees, customers and partners. We also collaborated with our supply chain to ensure readiness for the UK’s transition out of the EU. As part of these activities we have:

- **Extended the scope of supplier assessment** – we increased the depth and breadth of our assessment to include a review of each supplier’s business continuity plans and responses to government measures. We have evaluated over 200 Tier 1 and Tier 2 suppliers in this way.
- **Digitalised and formalised risk assessment** – we built a flexible Supplier Analyser Tool to measure and track risks across multiple dimensions and measure risk for different scenarios. We have also created an issue prioritisation tool to triage commercial issues.
- **Developed means for proactive communications at scale and pace** – we established an online portal for our suppliers to explain key changes to our working practices in accordance with national medical and scientific advice. We also set up an internal Contract Manager Helpdesk to facilitate inter-department collaboration while working remotely.
- **Extended and enhanced existing forums with suppliers** – we enhanced forums across our critical partners to provide leadership to the supply chain, drive collaboration and improve relationships with key supply chain partners to develop future resilience.

Outside of our work to mitigate the impacts of COVID-19 and Brexit, we continue to work with our supply chain to foster greater levels of collaboration and consistency as we recognise a common approach to service across our internal and external customer interactions will be essential to upholding high levels of satisfaction, which will impact our C-MeX and D-MeX scores.

Building upon the success of last year’s supplier engagement event, we hosted a virtual event, which was attended by partners and internal employees and reiterated the importance of collaboration and efficiency. As part of our commitment to engage with our supply chain more proactively, we plan to develop our online supplier portal further over the next year.

We are revising our Supplier Code of Conduct which outlines how we expect our suppliers to behave, mirroring our values. This helps us achieve consistent service across our activities and those of our supply chain.



Sustainability

We are committed to providing water for life to make a positive impact for the good of our customers and communities

Overview

Our purpose is to provide water for life and this is a responsibility we take very seriously. We know that the resilience of our business is directly linked to the economy of our region, the communities we serve and our environment. Together, we are facing real challenges with regards to the impacts of climate change and population growth so to ensure that we can create a resilient water future for our customers in the South East, we must go beyond regulatory compliance and manage our business in a sustainable way.

What we've done

In order to operate more sustainably, we need our business to run efficiently. Our transformation programme, which began in 2017 has focused on improving people, processes and systems, in support of our Water for Life Business Plan 2020–25 stakeholder priorities. Since 2017 we have:

- Continued to help customers to reduce their water consumption, with individual daily use getting as low as 126.5 litres by March 2020.
- Invested £437 million in our sewer network since 2015 to maintain and enhance ageing infrastructure.
- Increased the number of bathing waters at excellent status to 62 as part of our regional Bathing Water Enhancement Programme.
- Continued to embed our values, Code of Ethics and Ethical Decision-Making Framework. This and modern compliance frameworks, alongside our vision and purpose, help our leadership team, employees and partners make better decisions every day.
- Made significant investments to improve our wastewater treatment and water quality compliance.
- Published our Pollution Incident Reduction Plan (PIRP), which set an ambitious target to reduce pollution incidents to zero by 2040 and includes £8.2m investment to 2025. It has already delivered a reduction of around 400 category 1-3 incidents in 2020.
- Signed up and put detailed plans in place to deliver against a number of water industry Public Interest Commitments, based on stakeholder feedback, to: keep bills affordable; achieve 100% commitment to the Social Mobility Pledge; triple the rate of leakage reduction; achieve net zero by 2030; and reduce the amount of plastic bottle ending up as waste by 2030.

What we're doing

We have now entered the final phase of our transformation programme, which will see the strategic projects put in place drive £150 million of efficiency improvements to 2025. We have already:

- Launched £1.1 billion in sustainable bonds to support the financing of investments and activities that deliver sustainable outcomes. This is the largest-ever sustainable deal for a UK utility company.
- Defined our plans to achieve our carbon reduction ambitions (net zero by 2030) following a company-wide analysis of options and costs.
- Expanded our Catchment First programme, investigating potential pollutants and sustainable abstraction methods that could compromise our drinking water supplies and the environment, working in partnership with farmers and landowners.
- Reinvigorated Target 100 water efficiency programme, which aims to support and incentivise customers to reduce their personal use to 100 litres a day by 2040. Levers include: behaviour change campaigns; home visits to install water efficient products; engagement with developers to improve the water efficiency of new homes; and smart metering.
- Launched our first Water for Life Hampshire consultation on our plans to explore new sustainable treatment techniques and create a new network of water mains across the region. The programme will be delivered through a combination of infrastructure investment, nature-based solutions, land management and customer behaviour.

£150m
efficiencies
delivered
by strategic
projects to 2025

→ Read more about our Pollution Incident Reduction Plan on page 23

Sustainability continued

➔ Read more about our **Learning Network** on pages 56 to 59

- Signed an 80-year bulk supply agreement with Portsmouth Water, under which it will supply us with 21 million litres of water a day. Together, we are developing Havant Thicket Reservoir in Portsmouth Water's supply area.
- Recycled 100% of the bio-solid waste from our wastewater treatment works during the year, with none of it going to landfill. We continue to explore new ways to extract value from these resources.
- Launched our Learning Network, offering training, coaching and mentoring support to our colleagues and communities.
- Joined the Inclusive Companies list of Top 50 UK Employers.

Where we want to go

Our transformation programme has provided us with an efficient baseline to start allowing for outperformance in the next five-year period to 2030. By 2030 we are aiming to have:

- Achieved significant reductions in our carbon emissions, in line with our peers, reaching our net zero targets.
- Simplified our business strategy, with a focus on annual planning reviews, continuous improvement and our long-term vision.
- Developed our existing stakeholder engagement approach, focusing on regional and local partnerships.
- Connected our customers to the value of water through expansion of our smart metering programme and a focus on behaviour change communications, moving closer to achieving Target 100 – with customers using 100 litres of water per person per day by 2040.
- Driven down the number of pollutions caused by our operations, moving closer to our target of zero pollutions by 2040.
- Taken action to address the most harmful of our sewer overflows, building on our monitoring programme, and our Beachbuoy service; working with our regional partners to maintain more excellent bathing waters in the South East.
- Embedded six capitals thinking into our decision making processes to ensure we are adding value to our many and varied stakeholders.

Focusing on what matters to our stakeholders

Our approach

Understanding what matters most to our stakeholders is vital and we consider their priorities alongside our own assessment of what has impact on the company and its ability to create value. The output of this assessment can be seen in our current materiality assessment opposite.

Having visibility of these issues helps us understand key stakeholders' priorities so we can consider their interests in strategic decision-making, in turn helping us create long-term value.

Determining and prioritising key issues

To define the overall strategic relevance of each issue to Southern Water, we considered its effect on our ability to create value, internally (for the company, our investors and employees) or externally (for customers, communities, our suppliers and the environment). This value could be financial or non-financial.

Stakeholder engagement

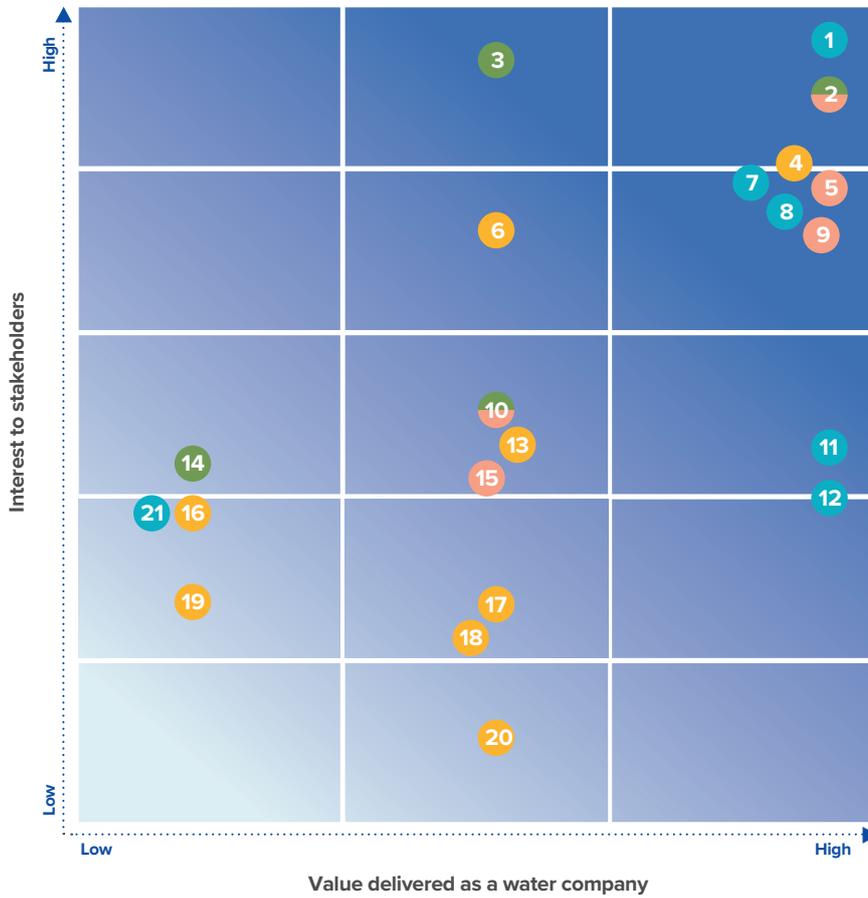
Our assessment of the level of interest to stakeholders is based on views obtained from our stakeholders through continuous engagement. This includes the insight gathered as part of the consultation process for the regulatory price review in 2019.

Key issues and their importance

To compile our first materiality assessment, we consolidated feedback from our various stakeholder groups, as detailed on pages 46 to 50, which resulted in 21 key issues impacted by internal or external factors or sometimes both.

These issues have been plotted on the next page, from low to high in terms of level of interest to stakeholders and how much each issue affects our ability to create value.

Southern Water's materiality assessment



Key issues

Economic dimension

- 2 Resilience
- 3 South East economy
- 10 Responsible supply chain
- 14 Land management and access

Environmental dimension

- 2 Resilience
- 5 Leakage and water efficiency
- 9 Environmental impacts
- 10 Responsible supply chain
- 15 Climate Change

Social dimension

- 4 Customer service and operational performance
- 6 Affordability and vulnerability
- 13 Health, safety, security and wellbeing
- 16 Community investment
- 17 Diversity and inclusion
- 18 Social mobility
- 19 Fair and equal pay
- 20 Improved meter, property and customer data

Governance dimension

- 1 Trust, transparency and legitimacy
- 7 Political and regulatory environment
- 8 Environmental, Social and Governance (ESG) credentials
- 11 Stability and predictability
- 12 Data protection
- 21 Human Rights



Sustainability continued

s172(1) Statement

In order to make effective decisions, the Board needs to take into account the interests of our stakeholders, our impact on the environment and on the communities we serve

Our approach

When making key decisions and considering key areas, the Board takes into account not only the factors listed in section 172(1) of the Companies Act 2006, but also the company’s strategy, purpose, values and risk. Our five-year business plan 2020–25 was built on the basis of extensive customer and stakeholder engagement ensuring our Board is focused on what matters most to them.



Ensuring effective stakeholder engagement

At the core of the directors' duty under section 172 is the need to take into account the interests of the company's key stakeholders as well as the need to take into account the impact on the environment and the outcomes over the long term. The company and its Board engage with a variety of stakeholders through a number of mechanisms, including membership of stakeholder panels, regular meetings with stakeholders, 'town hall'-style events (albeit held remotely in view of COVID-19) as well as simply speaking to people.

Delivery for our customers is one of our key priorities. The Board receives regular reports from management regarding customer performance and attitudes. The introduction of performance metrics that take into account the wider customer experience has also led to increased need for awareness of customer views.

Throughout the COVID-19 pandemic, the Board has paid particular attention to the needs of our customers, who may face significant challenges as a result of the change in circumstances, whether these be financial or physical or mental health-related, and has been supported in this through regular updates from our Affordability and Vulnerability team which has been working directly with third-party support organisations in the community. The presence of Dame Gillian Guy on the Board, the former Chief Executive of Citizens Advice, has further improved awareness of the needs and concerns of customers.

Our Board receive regular updates on environmental matters, including legislative changes, key areas of concern such as climate change, biodiversity and water resources.

The company appointed a Director of Environment and Corporate Affairs during the year to ensure that increasing focus is given to this important area and its challenges.

In 2020, one of the independent non-executive directors, Kevin McCullough, was given the remit of engaging with the company's workforce and ensuring that their views are communicated to the Board. In addition, the CEO has held fortnightly 'Company Conversations' with the company's workforce to explain what is happening at Southern Water and to answer questions on a variety of topics.

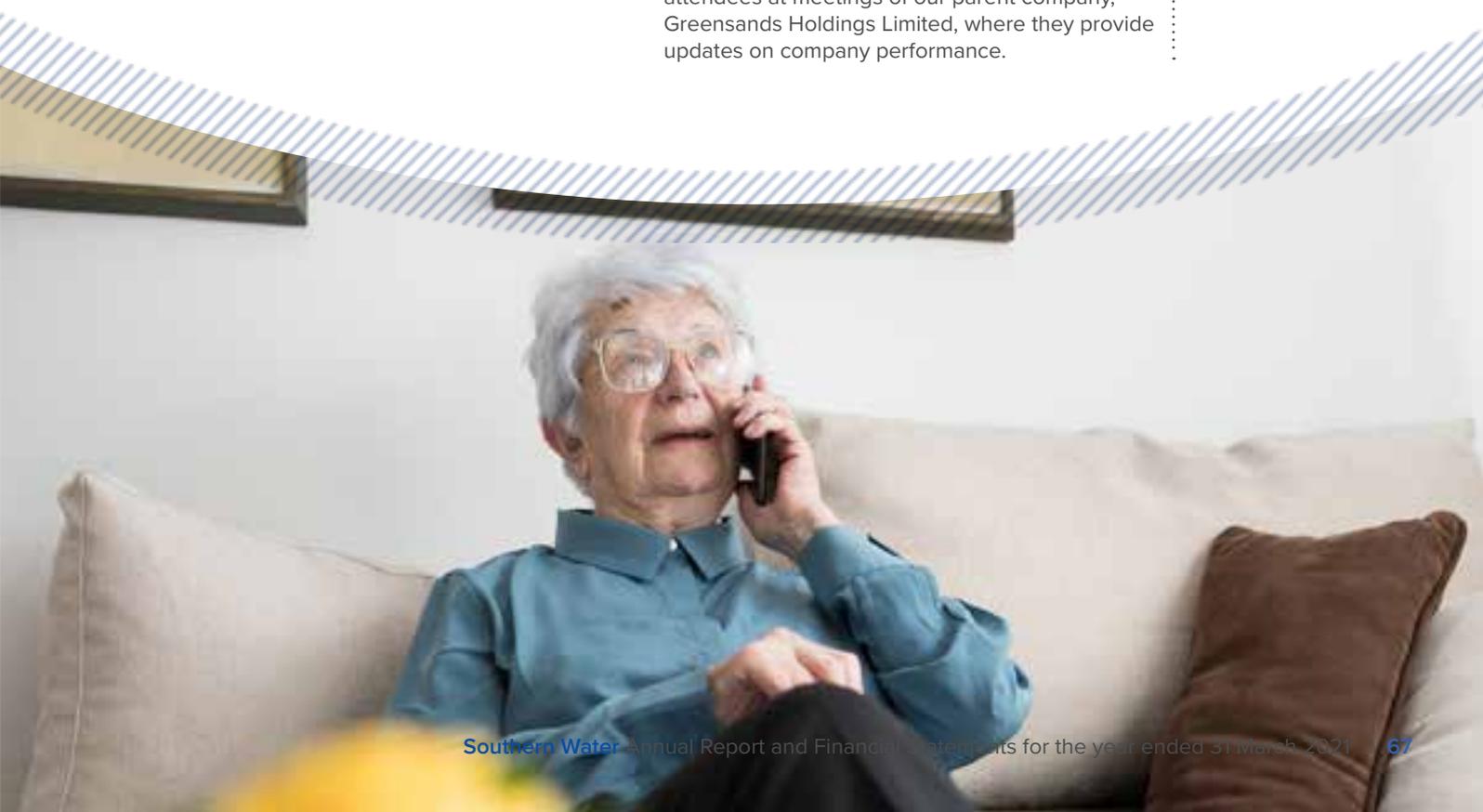
These 'in-person' forms of engagement are supported by regular Gallup all-employee surveys. A key focus for the Board this year has been on employee wellbeing owing to the significantly changed working conditions due to COVID-19.

The CEO, Ian McAulay, is a member of the Greater Brighton Infrastructure Panel, which focuses on the capital infrastructure in the sub-region.

Our senior executives and Chairman hold regular meetings with senior representatives of our key regulators – Ofwat, the EA and the DWI – in order to discuss our performance and compliance with our statutory obligations as well as to communicate our vision for the future of Southern Water.

The Chairman, CEO and CFO are regular attendees at meetings of our parent company, Greensands Holdings Limited, where they provide updates on company performance.

- Read more about our **COVID-19 response** on page 15
- Read more about our **environmental disclosures** on pages 70 to 71
- Read more about **employee engagement** on pages 56 to 59



Sustainability continued

s172(1) Statement continued

Overview

Section 172(1) of the Companies Act 2006 sets out several factors which the Board is expected to take into account in its activities and decisions.

Section 172 considerations key:

Likely consequences of decisions in the long term

 Read more about our long-term ambitions on pages 54 to 55

The interests of the company's workforce

 Read more about our employees on pages 56 to 59

The need to foster relationships with suppliers, customers and others

 Read more about suppliers on page 62

Impact of operations on the community and environment

 Read more about operational performance on pages 74 to 99

Maintaining high standards of business conduct

 Read more about how we measure our culture on pages 168 to 175

The need to act fairly between members of the company

 Read more about capital structure on pages 112 to 117

COVID-19

Link to Section 172 considerations



Customers

Ensure that all of our customers, and in particular those in vulnerable circumstances, have access to our services even under challenging conditions.

Workforce

Ensure that our employees have a safe work environment and the impact of the substantially-altered working and home environment of our workforce on employees' wellbeing is monitored.

Outcomes and actions:

Implementation and continued monitoring of the company's Business Continuity Plan.

Simplification of our processes for customers who need help with their bills. Offering additional payment breaks and delaying debt recovery where appropriate.

Taking proactive steps to ensure that sufficient tankering capacity was available for the summer to ensure a continued supply of water throughout a period of sustained increase in demand.

Monitoring of our culture change and culture dashboard.

Launch of a new employee recognition scheme – Southern Water STARS.

Monitoring of employee physical and mental health through employee surveys.

Regular engagement with employees by a designated non-executive director.

Weekly 'Company Conversations' with CEO.

Link to risks: Customers; Health, Safety, Security and Wellbeing; Finance; COVID-19

Link to strategy: Deliver great service and Use water wisely

 Read more about our COVID-19 response on page 15

Delivering our business plan

Link to Section 172 considerations



Long-term impact

Invest for the long-term to ensure continued supply of essential services.

Ensure that the company remains financially and operationally resilient.

Community and the environment

The need to address climate change and population growth in the South East.

Customers and suppliers

The need to ensure that our teams and contractors continue to deliver essential services for our customers.

Outcomes and actions:

Throughout the year, the company has sought to refine and improve plans to ensure that it can deliver its obligations under the Final Determination from Ofwat, while remaining financially resilient.

In March 2021, the company updated its Execution Plan to deliver its obligations over the 2020–25 period. This includes significant investment in proactive maintenance as well as transformational programmes to improve efficiency.

In May 2020, the company raised £825m via a 'green' bond to support its investment in the environment.

In February 2021, we signed a bulk supply agreement with Portsmouth Water and joint development of the Havant Thicket Reservoir to improve the resilience of supply and reduce reliance on abstraction from rivers.

Link to risks: Water; Wastewater; Finance; Resources; Climate Change; Delivery of Capital Investment

Link to strategy: Deliver great service; Use water wisely; Protect and improve the environment; Fit for the future

➔ Read more about our operational performance on pages 74 to 99

Our environmental ambitions

Link to Section 172 considerations



Long-term impact

Invest in environmental improvements to create a resilient water future for our customers in the South East.

Take steps to mitigate and adapt climate change.

Community and the environment

The need to maintain and improve water quality in rivers and beaches so that they can continue to be enjoyed.

Outcomes and actions:

Publication of the company's Pollution Incident Reduction Plan in September 2020 with a focus on proactive investment in capital maintenance, digitisation and improvements in incident response to deliver zero pollution incidents by 2040.

Commitment to net zero by 2030, including plans to increase the proportion of renewable energy we use to 24% by 2025.

Investment in targeted projects to deliver additional benefits such as increased carbon storage, improved water quality, reduced flood risk and increased health and wellbeing in partnership with bodies such as the Wildlife Trusts and the Rivers Trusts.

Working collaboratively across sectors to address concerns around storm overflows and chalk streams.

Link to risks: Delivery of Capital investment; Resources; Regulatory and Corporate Affairs; Transformation

Link to strategy: Use water wisely; Protect and improve the environment; Fit for the future

➔ Read more about our environmental ambitions on page 17

Sustainability continued

72%

of the energy we consume is in our wastewater treatment processes

Environmental disclosures

Overview

Energy: In 2020–21 Southern Water consumed 548,583 MWh of energy for Water and Wastewater operational purposes. Wastewater is the largest consumer of energy, accounting for 72% of consumption. Most of this energy will be used to power our pumps and blowers.

We also generated 73,656 MWh of energy in Wastewater via our CHP engines, which offsets 24% of our wastewater consumption and prevents the need for this energy to be imported. Water supply accounts for the remainder of the energy needed to power our operations, with solar generation totalling 2,916 MWh, helping to ease the need for imported energy at our supply works. We aim to generate 24% of our electricity from renewable sources by 2025.

Carbon emissions: Our 2020–21 emissions were significantly lower than 2019–20. In 2020–21 we can report that our emissions are 91 kilotonnes of CO₂e, compared with 144 kilotonnes CO₂e in 2019–20. This reduction is due to the renewable backed power that we purchased from our suppliers. Going forward we have contracted our suppliers to provide 100% renewable backed power, and our market based emissions will reduce further in 2022–23. This is part of our broad strategy to reach net zero operational emissions by 2030.

Compliance: We are investing £234 million in transformation programmes and investment at specific sites that will secure improved wastewater compliance – we have called it our ‘Go to Green’ process. This will help us in our efforts to achieve 100% compliance for all our wastewater sites and prevent further deterioration in our performance baseline. The Go to Green process was mobilised in September 2020 to improve our ways of working, focusing more on pollutions and treatment compliance, in turn, improving our environmental and Operational Delivery Incentive (ODI) performance. As part of this initiative, we have:

- Embedded weekly meetings, with a focus on fast mitigation on our risk sites
- Drawn up tactical improvement plans for region-wide improvements, particularly where there are multiple parties involved
- Created stronger links into our normal risk and planning process.

As we rebuild trust and can evidence that compliance is just part of the way we work, we can focus more attention on our environmental performance improvement programmes.

Water quality: The water reaching customers’ taps continues to meet the Drinking Water Inspectorate’s (DWI) stringent water quality tests, with 99.97% of samples meeting all the necessary standards. Our target was to achieve 100% compliance.

We monitor water quality at treatment works, treated water storage facilities and customers’ taps. The Compliance Risk Index (CRI) was introduced by the DWI to apply from 2020 onwards. Both the CRI and the ERI (Event Risk Index) are weighted by population to better highlight risks to customers from treated water that fails to comply with the required standards. Our expected year-end CRI score of 4.53 is better than in 2019, but we know we still have work to do to improve our performance in this area. 78% of the 2020 CRI score was due to failures at works (eight coliforms and one turbidity). Improvements to our water supply works are being carried out as part of the HazRev programme. Two coliform failures at Otterbourne works accounted for 50% of the CRI score. Improvements to the disinfection at Otterbourne are currently being carried out including a new contact tank and the addition of a UV disinfection step.

Pollution: In September 2020 we published our Pollution Incident Reduction Plan (PIRP), which includes a detailed programme of activities to deliver a step-change in how we work, prioritise and remedy issues on our sites. The PIRP forms part of a wider initiative called Environment+, which is focused on harnessing our people, processes and systems to deliver a resilient water future for Southern Water’s customers, by protecting our natural environment as well as our customers’ properties.

Our total number of pollution incidents for the year reached 400 incidents, which is unacceptable. Our target is 24.51 incidents per 1,000 km of sewer which translates into 98 actual incidents. We received the maximum penalty of £7.7 million.

Our aim is to reduce pollution incidents to less than 80 by 2025, aiming for zero pollution by 2040. Read more at southernwater.co.uk/our-performance/reports/pollution-reduction-programme.

Reducing our use of plastics: Reducing single-use plastics is a priority, which is why we were one of the first water companies in the UK to publish a formal policy on managing plastic waste. We are working with colleagues, our supply chain and our peers to reduce our reliance on plastic in our offices and our operations. We have carried out an audit of our use of plastics and are working with our supply chain to encourage them to reduce plastic waste too.

We are also still supporting the national Refill water bottle filling campaign started by City to Sea and we are sponsoring their plastic-free Rethink Periods programme, which aims to reach 500 schools across our region over the next two years.

Although we are not the source of plastics in the marine environment, we recognise that water companies are a link in the chain and have an opportunity to intervene. We are proud to be playing an active role in better understanding the challenge posed by plastics and to be helping our customers and communities protect the environment.

Conservation and biodiversity: It is important to us to enhance the health and wellbeing of our environment, protecting and improving it where we can. During 2020–21 our Environmental Compliance team has introduced a number of new conservation and biodiversity initiatives, which include working with our new facilities service provider to implement ‘no mow zones’ on our sites, allowing wildflowers to grow and encourage biodiversity. The team has also created before-and-after surveys so we can better monitor the types of habitat we are providing and see how they have improved. This work has uncovered a number of activities on our sites across Kent, Sussex, Hampshire and the Isle of Wight, where our operational teams have built bug hotels, kestrel and owl nesting boxes and bee boxes on sites. While those more green-fingered teams have created space for species of protected orchids and installed planters full of pollinating plants. We continued to encourage our teams to explore these opportunities to enhance the biodiversity on our sites.

Natural capital: We have included commitments to adopt a natural capital approach in our Water for Life Business Plan 2020–25. We have a commitment to establish natural capital accounts alongside our traditional financial accounts in 2022–23, to enable us to measure and monitor a wider breadth of ‘value added’ as a result of investment and activity.

Our plans include:

- building capacity and expertise
- applying approaches to strategic programmes such as WRMP, DWMP and Water for Life Hampshire
- embedding in business process, including our Risk and Value processes
- planning for the next five-year regulatory period
- understanding the value and potential of our own estate.

The Sussex Kelp Forest is an example of a project we are already involved with. This innovative approach will restore marine and coastal natural capital assets. The project is looking to stop damaging fishing practices to enable a historic area of kelp to regenerate off the Sussex coast and to create a financial model for attracting investment in natural capital. A partnership is forming and we want to be facilitators and enablers to explore its value in terms of natural water quality improvements and a significant ‘blue’ carbon offsetting opportunity.



Picture courtesy of Dan Smale,
Sussex Wildlife Trust

→ Read more about **our other five capitals** on pages 44 to 45

Sustainability continued

100%
green energy
purchased from
the national grid

Our net zero plan and climate adaptation

In 2019 the UK water industry joined forces to commit to reaching net zero carbon by 2030 for emissions arising from its operations, joining the United Nation's Race to Zero. This target brings the industry in line with the terms of the Paris Agreement, and comprises emissions associated with heat and power, transport and the treatment of water, wastewater and sludge.

We have developed our own plan to reach net zero by 2030 and beyond, which will be published this month (July 2021). In the short term, we will continue to drive energy efficiency and focus on water demand management while we install more renewable power sources. We have also purchased 100% 'green' power from the national grid, and very soon we will begin the update of our fleet, introducing electric vehicles as the technology in this area develops.

At the same time, we will support the sector's efforts to better measure and manage the emissions arising from the treatment of wastewater and sludge. Termed process emissions, these comprise methane and nitrous oxide, which are 25 and 200 times more potent than carbon dioxide, respectively. At the moment these gases are difficult to abate so more work is needed here to find sustainable management solutions.

Longer term we will develop plans to optimise the power of human waste by enhancing our technology to generate green gas (biogas) from wastewater to replace fossil fuels. We will also work with our stakeholders to develop local nature-based solutions to absorb carbon where we are able to.

Climate adaptation

Due to a rise in global temperatures, we have forecast warmer wetter winters and hotter drier summers in the South East. This, of course, has major implications for us in terms of the provision of public water supplies to a growing population and the likelihood of increased flooding of our sites and networks from rising sea levels and intense rainfall.

The impact of climate change is considered in all our long-term infrastructure plans. For example, our Water Resources Management Plan models the impact of a rise in global temperatures, while our Drainage and Wastewater Management Plans assess climate impact.

This year we are preparing an updated risk assessment for Defra to demonstrate our approach to climate adaptation. This plan will take the latest climate forecasts from the Met Office and update our assessment of short, medium and long-term risk for a two degree and four degree rise in global temperatures. We will invite comments from our stakeholders prior to final publication later this year.

Our sustainable bonds

Overview

In May 2020 Southern Water secured £825 million in sustainable bonds to support the financing of investments and activities that deliver sustainable outcomes. This is the largest ever sustainable deal for a UK utility company. A further £300 million bond was secured in March 2021 under the same sustainable financing framework.

Our sustainable framework was put in place in January 2020 in order to attract a wider investor base and socially conscious investors. The framework allows us to issue Green Bonds or Social Bonds or both, which are collectively known as sustainable bonds. A sustainable bond is broader than a Green Bond adding in Social categories such as access to affordable basic infrastructure and essential services (water and wastewater) and also includes areas such as support for our vulnerable customers and social tariffs.

Why have we put this framework in place?

We wanted to demonstrate to investors our environmental, social and governance (ESG) agenda by attaching it to our debt financing. This in turn supports our wider ESG framework that is continually being developed to demonstrate a holistic approach to our strategy alongside the requirements of the regulatory regime.

The general direction of travel in the water industry suggests that this type of sustainable finance in the form of bonds and other sustainability linked products will become the norm in the future.

It is certainly our intention to progress further down this path where market conditions allow, and our framework will naturally evolve as our ESG strategy does.

As part of our reporting requirements under the framework, and in order to demonstrate to investors the impact that our investments have made, we will be issuing our inaugural allocation and impact report later in the year.

Key facts:

- £350 million of the £825 million May 2020 bonds was used for the refinancing of 15 projects within the 2015–20 asset management period (AMP).

- The remaining £475 million of the May 2020 bonds, and all £350 million of the March 2021 bonds, will be used to support the funding of projects within the current five-year AMP period to 2025.
- All bonds are allocated to capital projects.
- All projects meet the strict eligibility criteria under the ICMA Green and Social Bond Principles.
- Our Sustainable Framework and the underlying eligible projects have been assessed by a third party, namely assurance experts DNV GL.
- The bonds give a return to investors of 2.375 and 3.000% for the May 2020 bonds (£375 million and £450 million respectively), and 1.625% for the March 2021 bonds.
- All the sustainable bonds are public issuances and have tenures ranging between six years to 17 years.

➔ Read more about our long-term ambitions on pages 54 to 55



Our operational performance

Our Water for Life Business Plan 2020–25 is broad and ambitious and includes 47 clear customer commitments. We are now at the start of a £3.7 billion investment to ensure we supply water and wastewater services responsibly and sustainably, while protecting the environment.

Our purpose is to provide water for life to:

- enhance health and wellbeing
- protect and improve the environment
- sustain the economy

Deliver great service

- DWI Compliance Risk Index (CRI) – Aim for a score of zero on this new measure of drinking water compliance risk.
- Drinking water appearance, taste and odour – Continue to reduce the number of customers needing to contact us about their water quality, be that appearance or taste and odour.
- Replace lead customer pipes – Provide customers in affected areas with grants towards the cost of replacing lead plumbing, reducing the risk from lead in drinking water.
- Water supply interruption – Continue to reduce the average time customers are without water with a reduction of 23% between 2020–21 and 2024–25.
- C-MeX – Improve both the overall customer experience and our handling of customer contacts.
- Void properties and gap sites – Reduce by more than 10% the number of unbilled, occupied households, reducing the burden of debt on our bill paying customers, as well as identifying any properties missing from our billing system.
- Internal sewer flooding – A 20% reduction in the number of internal sewer flooding incidents affecting customers’ homes between 2020 and 2025.
- External sewer flooding – A 20% reduction in sewer flooding affecting outside areas between 2020 and 2025.
- Customer satisfaction with vulnerability support – Satisfaction with the tailored support offered to customers in vulnerable circumstances, with the aim of a 90% satisfaction rate by 2025.
- Effectiveness of financial assistance – Aiming for 90% effectiveness of our financial assistance for customers, making their bills more affordable and helping them pay their bills.
- Priority services for customers in vulnerable circumstances – Increase the number of customers in vulnerable circumstances on our Priority Services Register.
- Value for money – Increasing, to 75% by 2025, the proportion of customers who believe we deliver services that represent value for money.
- Properties at risk of receiving low pressure – A 25% reduction in the number of households suffering from persistent water pressure problems, reducing the number to just 182 by 2025.

Underpinned by our values
 Our values form the foundation of our Code of Ethics and influence our decision-making.

- Succeeding together
- Doing the right thing
- Always improving



Use water wisely

Leakage – Reduce leakage by 15% over the five years from 2020 to 2025.

- Per capita consumption – Reduce personal water consumption by 7%, to 122.7 litres per person, per day by 2025.
- Target 100 – Reduce personal water consumption to 100 litres per person, per day by 2040, with 55% of households meeting this target by 2025.
- Water saved from water efficiency visits – Reduce household water use by increasing the number of free water efficiency visits conducted in customers' homes, saving 2,500 cubic metres a day by 2025.
- Access to daily water consumption data – Provide customers with easy access to data about how much water they use, helping them to make informed choices and reduce their bills.



Protect and improve the environment

- Pollution incidents – Reduce pollution incidents to less than 80 by 2025, aiming for zero pollution by 2040.
- Thanet sewers – Deliver the third phase of our groundwater protection sewer scheme for Thanet.
- Delivery of Water Industry National Environment Programme (WINEP) of requirements – Deliver more than £500 million of investment to improve the natural environment and ensure that water can be taken from groundwater sources, rivers and reservoirs without any negative impact via investigations and schemes within WINEP.
- River water quality – WINEP programmes to improve the health of 182 kilometres of rivers in our region.
- Maintain bathing waters at 'Excellent' – Maintain the current 'Excellent' water quality status at 57 beaches designated for swimming in our region, supporting the continued development of the leisure and tourism industries.
- Improve the number of bathing waters to at least 'Good' and improve the bathing waters at 'Excellent' quality – Improve bathing water quality, at five sites to 'Good' and at two sites to 'Excellent' water quality status by 2024.
- Treatment works compliance – Maintain and improve our wastewater treatment works, aiming for 100% compliance with Environment Agency standards.
- Combined Sewer Overflows (CSO) monitoring – Ensure we have effective and functioning monitoring equipment in place at all of our CSOs, helping to reduce sewer flooding and pollution incidents.
- Distribution input – Effective management of our water resources, in turn reducing the need to take water from the environment.
- Abstraction incentive mechanism – Reduce, by 15 MI/d, the amount of water we take from the River Itchen at Otterbourne and Twyford in September when river flows or levels are low.
- Effluent re-use – Develop effluent re-use solutions, reducing the demand for potable water and, in the long term, improving the resilience of drinking water supplies.
- Renewable generation – Generate 24% of our electricity from renewable sources by 2025.
- Natural capital – Better understand the current condition of the environment that we own, or can influence, and the impact of our work, producing natural capital accounts for three catchments by 2025.
- Satisfactory bioresources recycling – Ensure correct use and disposal of sludge created from the wastewater treatment process, ensuring that 100% of biosolids we recycle to agricultural land are compliant with guidelines.

Key performance indicators

The key measurements and targets behind each of the Operational Delivery Incentives and Performance Commitments will be discussed in the relevant operational performance section.

➔ Read more on pages 80 to 99

Our operational performance continued

→ Read more about how we are getting Fit for the Future on pages 96 to 99

Underpinned by our values

Our values form the foundation of our Code of Ethics and influence our decision-making.

Succeeding together

Doing the right thing

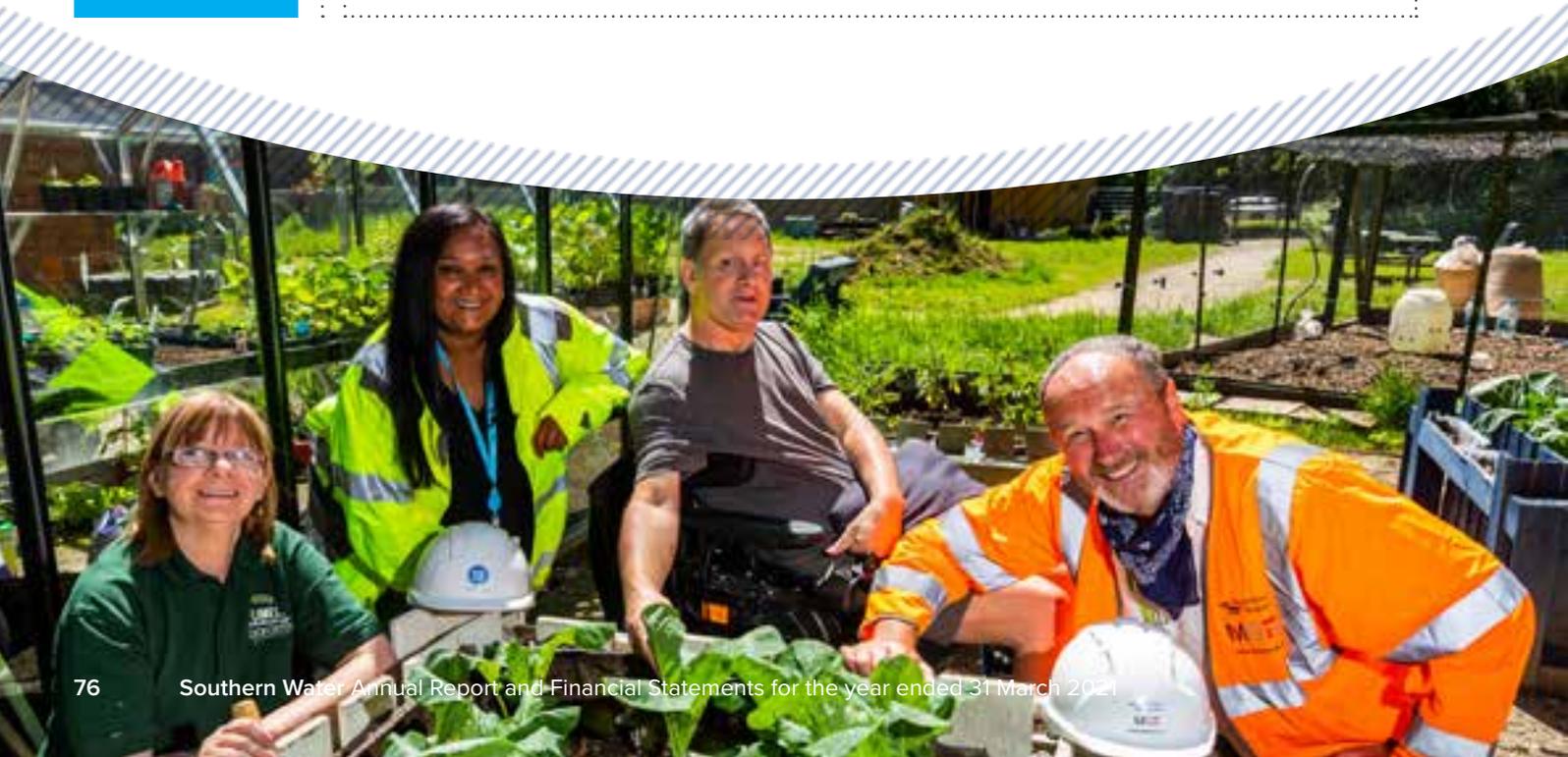
Always improving



Fit for the future

Mains repairs and unplanned outage – Maintain and improve the health of our water treatment sites and network, reducing the number of mains bursts by 30% over five years and the proportion of treatment capacity out of service to 3.25%.

- Risk of sewer flooding in a storm – Improve our understanding of flood risk and ensure the proportion of customers at risk of flooding in a severe storm does not increase.
- Sewer collapses – Maintain and improve the health of our wastewater network, reducing the number of asset failures.
- Water supply resilience – Through our Network 2030 initiative, reduce the risk of customers experiencing loss of supply for more than 48 hours in the Thanet, Brighton and Isle of Wight water supply zones.
- Long-term supply and demand schemes – Ensure future customers have access to sufficient water supplies, by making progress toward delivering an additional 182.5 Ml/d of new water resource capacity.
- Risk of severe restrictions in a drought – Maintain our performance of no customers being at risk of severe water restrictions in a drought.
- Impounding reservoirs – Deliver our agreed reservoir safety schemes, reducing the risk of failures.
- D-MeX – Improve the experience we provide to developers (new connections) customers, including property developers, self-lay providers and those with new appointments and variations (NAVs).
- Surface water management – Use Sustainable Urban Drainage (SUDs) approaches to reduce the amount of surface water in our network, reducing the risk of pollution incidents and sewer flooding.
- Community engagement – Improve our community engagement, as measured by external benchmarks and reflecting an ongoing commitment to working with charities, community groups and partners.
- Schools visited and engagement with children – Increase the amount of good or excellent feedback from schools we visit to raise awareness and improve understanding of the value of water, water efficiency and ‘unflushables’. Targeting 90% positive feedback.



COVID-19 and its impact on our performance

The COVID-19 pandemic has brought with it a great amount of uncertainty. However Southern Water's role as a provider of essential water and wastewater services has not changed. What has become apparent is our need to be responsive and agile in our plans to protect public health as the pandemic has developed.

Ensuring safe working practices for colleagues and customers, and adequate supplies of chemicals and personal protective equipment were a priority as the pandemic surfaced in March 2020. As the months went on, we experienced a significant shift in demand for water, an increase in levels of bad debt and a huge shift in customers' perceptions of us as an essential service provider.

A number of our performance measures have been directly affected by the effects of COVID-19, and they are highlighted in the following operational performance tables and supporting commentary.

➔ Read more on page 15

Remuneration and performance

Our remuneration policy outlines how executive pay is linked to overall and individual performance, and how annual bonuses are based on targets relating to customers, stakeholders and communities. Our Remuneration Committee closely monitors the policy and executive pay. We publish this policy annually, with an explanation of its application at southernwater.co.uk/our-performance/reports/annual-reporting.

➔ Read more on pages 194 to 211

0 Employees furloughed during the COVID-19 pandemic



Case Study

Driving innovation and fostering partnerships

During this five-year period, our organisation is investing £3.7 billion across the region.

c.£12m
cost efficiencies
achieved

2–3
pollutions a
week prevented

Working with our partners in the community, this will create jobs and benefit the local environment. It will ensure the resilience of our water and wastewater networks.

In 2020–21, bluewave, Southern Water's in-house innovation and Research & Development team, worked on a wide range of problems within the business. These covered various stages of maturity from insight to scaling solutions into the wider business, with an emphasis on co-creation and collaborating across directorates. Despite the impacts of COVID-19, bluewave has enabled c.£12 million in efficiencies during this time.

The team has been a positive agent for change and pace in ongoing strategic programmes. These have included impactful trials of sustainable passive solutions for wastewater treatment, enabling lower carbon footprints and better outcomes for the environment. Elsewhere, bluewave has been at the heart of delivering new sewer level monitoring technology trials to help prevent flooding incidents and redesigned our customer bills to make them easier to understand. bluewave has also helped to rapidly develop and test data-led proactive maintenance improvements with an agile team working to deliver real impact visible from the start, to date preventing two to three potential pollutions per week.

Outside of the business, bluewave was central in shaping the Water 2050 sector innovation strategy with 18 other UK water companies. This activity sought to reimagine and reinvent a more sustainable, open, innovative vision for the water industry.

The team has also been an active conduit for the business in accessing the £200 million Ofwat Innovation Fund. It made collaborative bids for funding in the initial competition, supporting innovative programmes to drive improvements across our business for our customers and colleagues in the coming year and beyond.

David Lloyd
Innovation Lead



→ Read more on
innovation and
technology on
page 29

Case Study

Showing customers how their choices affect the environment

Products like wipes, period products and cotton buds often contain single-use plastic.

If customers flush them down the toilet, they can cause blockages that can flood homes, riverbanks and coastlines with pollution.

During the pandemic more people have been buying – and flushing – things like wipes and absorbent tissues, leading to concerns about a rise in blockages. We wanted to raise customers' awareness about how the products they purchase and the way they dispose of them can affect our sewers and the environment. To achieve this, we embarked on two targeted awareness campaigns.

We identified blockage hotspots around Brighton, East Sussex and Chatham, Kent and used insights to develop targeted messages to match the life stage and living situation of local residents. We sent leaflets to over 100,000 homes which included practical tips about what can safely be disposed of down the drain. In areas with lots of young families, we enclosed a free pack of reusable bamboo wipes. The leaflets were reinforced through targeted radio and digital adverts. Overall, the campaign reached over 130,855 customers. In a follow-up survey, 52% said it had encouraged them to think about what they flush.

In November 2020, we launched our partnership with the charity, City to Sea, to support its Rethink Periods campaign. This free teacher training programme equips PSHE teachers and school nurses to deliver up-to-date education about periods, including the negative impact flushing period products can have on our sewers and the environment.

Schools receive lesson plans for key stage two and three, along with a product demonstration box packed with eco- and health-friendly period products to use in class and bring the lessons to life. Over 100 schools signed up in the first four months of our partnership and sessions have been underway since February 2021 – taking place online until COVID-19 restrictions allow them to continue in the classroom.

Together, these campaigns are helping people at different stages of life understand the impact of the products they use and the way they dispose of them.

Elvira Gabos
FOG and Unflushables Manager



130k+

Customers reached in recent unflushables campaign

52%

Now think differently about what they flush

➔ Read more on how we manage pollutions on page 27

➔ Read more on sewer flooding prevention on page 83

Our operational performance continued

Deliver great service

Great service for most customers means minimal interaction with us and a reduced impact from issues or disruptions in everyday life. Where there is engagement, customers want an efficient, tailored and personalised service that provides assistance to those customers who are in genuine need of support.

Link to risks

- Water
- Wastewater
- Customer
- See Principal Risks on pages 125 to 139

Key outcomes	Why it is important	Associated ODI/PC	RAG status	Link to remuneration
Water quality	It is essential to always provide clean safe drinking water. This is seen as a basic service from a water company and the most important of the services we provide. Our customers' preference is for water to be as natural as possible.	DWI Compliance Risk Index (CRI)	—	Indirect
		Drinking water appearance	—	
		Drinking water taste and odour	—	
		Replace lead customer pipes	—	
Supply interruption	Customers want us to be able to deal with problems, such as interruptions, quickly and efficiently. Any interruptions require clear communication, as they can cause inconvenience and distress to customers.	Water supply interruption	⊙	Indirect
Customer experience	Customers want to see us improve our customer service performance. They want us to minimise the impact of issues and disruptions to their daily life. When shown comparative information, they expect us to do better.	C-MeX	—	Direct
		Void properties	—	
		Gap sites	—	
Sewer flooding prevention	It is essential that our network stops homes being flooded with waste from sewers. There is strong support to ensure we continue to improve sewer flooding prevention.	Internal sewer flooding	—	Indirect
		External sewer flooding	✓	
Water pressure	Customers expect a standard of water pressure to be part of the basic service we provide.	Properties at risk of receiving low pressure	⊙	Indirect

Key outcomes	Why it is important	Associated ODI/PC	RAG status	Link to remuneration
Supporting the vulnerable	Customers find the concept of the social tariff acceptable. They want us to protect the most vulnerable in society, and find it acceptable to pay a little extra on their bill to help those in genuine need. They want us to partner and provide support by understanding and acting on customers' individual circumstances.	Customer satisfaction with vulnerability support	—	Indirect
		Effectiveness of financial assistance	—	
		Priority services for customers in vulnerable circumstances	—	
		Value for money	—	

We are focused on delivering great service to our 4.7 million customers, the 5.2 million who visit our region and the 400,000 businesses and their employees that are based in the South East. Customer satisfaction with that service is measured through the Customer Measure of Experience (C-MeX) and the Developer Measure of Experience (D-MeX), collated by our regulator, Ofwat.

Providing our services to customers has presented some challenges during the COVID-19 pandemic, but we have made it a priority to offer every customer, whatever their situation, access to our services when they have needed them most. We increased the number of vulnerable customers on our Priority Services Register (PSR) and provided financial assistance and other support to these customers. We introduced payment breaks as an option for all and have proactively supported these customers to review their changing circumstances. We have also improved how customers were able to access our services digitally. Although the number of customer complaints has reduced within our Billing and Water teams, we have seen an increase in wastewater complaints largely due to blockages and sewer flooding.

We continue to work with our customers to reduce blockages in pipes which can affect the flow of wastewater through our sewers. We know that sewer flooding incidents can be very upsetting, so we try to minimise blockages caused by fat, oil and grease (FOG) or flushing the wrong items away, by running campaigns.

We want our customers to feel that they receive value for money when they access our water services. The water quality Compliance Risk Index monitors water quality, helping us to make sure that our drinking water stays clean and safe. Moving forwards, we want all our customers to find us easy to deal with. We want them to be able to contact us using a channel of their choice, while experiencing a consistent, supportive and inclusive service.

Key:

-  Ofwat target met or exceeded
-  Ofwat target missed but performance improved in relation to prior year outcome
-  Ofwat target missed and performance worse than prior year outcome.

Our operational performance continued

Deliver great service continued

Water quality

The water reaching customers' taps continues to meet the Drinking Water Inspectorate's (DWI) stringent water quality tests, with 99.97% of samples meeting all the necessary standards.

We monitor water quality at treatment works, treated water storage facilities and customers' taps. The Compliance Risk Index (CRI) was introduced by the DWI to apply from 2020 onwards. CRI is weighted by population to better highlight risks to customers from treated water that fails to comply with the required standards. Of the 248,000 water quality compliance samples taken during 2020, 36 were found to not meet the required standards. Many of these failures were due to the customer's plumbing and we were able to give the appropriate advice to resolve the issue.

We had to make significant changes to our sampling programme to accommodate social distancing due to COVID-19; however, less than 0.01% of all the programmed samples were not able to be taken during the year. Our expected year-end CRI score of 4.53 is better than in 2019, however it is not as low as we would like it to be and we know we still have work to do to improve our performance in this area. We incurred a penalty of £1.591 million, reflecting our score.

We know that how our drinking water looks, tastes and smells, as well as how clean and safe it is, is very important to our customers. A specialist panel carries out quality control tests to measure the level of taste and odour and we provide information on our website about why there may be changes to the taste, smell or appearance of tap water.

The appearance (formerly discolouration), taste and odour of drinking water is measured by how many people contact us about it per thousand people. We unfortunately exceeded our 2020 targets for both measures with a score of 0.89 for appearance, and 0.26 for taste and odour. Accordingly, we have incurred penalties of £277,000 and £92,000 respectively. We have set a planned reduction for each metric of 0.46 from 0.93 and 0.21 from 0.26 respectively.

The replacement of lead customer pipes only applies in the Deal (Kent) water supply zone, where a co-delivery trial is being conducted, offering grants to affected customers (43 households will be awarded per year). The scheme is currently on hold until years two to five of this five-year period.

Supply interruption

Water supply interruption measures how much time a customer is left without water when there is an unplanned interruption, such as a burst water main. Over the past year, we experienced the highest number of bursts since 2015 and two significant events, on the Isle of Wight and in Hastings. In general, February also saw a high level of bursts due to the cold weather. Despite the best efforts of our operational teams, we achieved an average of 12.43 minutes with our target for this year at 6.30 minutes. Subsequently, we have received a penalty of £1.517 million.

Customer experience

The start of 2020–21 was dominated by our need to maintain our customer services during the COVID-19 pandemic. This tested our Business Continuity planning to the full, but we maintained access for all our customers who needed support whether that was over the phone or via our digital services.

Our performance against Ofwat's Customer Measure of Experience (C-MeX) for the year saw us finish 16th out of 17 companies, incurring a penalty of £4.772 million. While many of the changes delivered by our customer service improvement programme, have not yet been realised in our overall scores, we are confident that the steps taken so far will have a positive impact as we progress through this five-year period.

C-MeX sees each company's score calculated from responses to two surveys, the customer service survey (CSS) and the customer experience survey (CES), each contributing 50% to the calculation of the overall C-MeX score for each company.

We continue to track underlying performance metrics such as first contact resolution and increasing digital self-serve journeys, which indicate we are on the right track to achieve a forecasted C-MeX improvement over the current five-year period. Billing calls have reduced by 21% year on year as a result of proactive work with high usage customers and a focus on collections activity. Digital transactions have increased 47% compared to the same period last year as a result of improvements made to our 'Your Account' self-serve portal.

Year on year, our complaint volumes are higher. The key drivers of complaints have been consistent over the past five years, with increases seen in operational complaints around ownership and resolution. Despite reductions in Billing and Water complaints, the volume of written complaints received in 2020–21 was 5,934, which is higher than the previous year due to an increase in wastewater complaints.

With COVID-19 impacting in-person visits, we were unable to meet our void properties target of 2.78% (percentage of properties in our area that are void). We have run letter campaigns and continue to source occupier details through third-party partners. We achieved 3.47%, incurring the maximum penalty at £600,000.

The processes for Gap Sites were restricted to those areas covered by South East Water and operated under our associated Joint Billing Contract. This meant we identified 12 gap sites, which were brought onto charge for wastewater services. Our target was 65.

We will continue to focus on the identification of gap sites through the Joint Billing contract with South East Water. Outside of this we will be exploring the creation of our own processes to capture gap site information within our supply area, as well as neighbouring water company areas where we deliver wastewater services.

Sewer flooding prevention

Each flooding incident is hugely distressing for our customers. As such, preventing flooding from our sewers is one of our highest priorities.

In our business plan we set challenging targets to reduce the number of internal and external sewer flooding incidents year on year. Our target for internal flooding incidents for this year was 341, however, due to a peak in incidents in October we ended the year with a total of 393.

In terms of external sewer flooding, our increasing resilience is enabling us to perform better during extreme weather events, when flooding can be a risk to some properties. This year, we reported 4,409 external sewer flooding incidents against a target of 4,412. Ofwat rewarded £14,000 to us for successfully meeting our target.

Blockages continue to be a major factor, restricting the flow of water in our sewer. This is why we continued our fat, oil and grease (FOG) and Unflushables campaigns during the year, educating customers about what to flush down the toilet and pour down the sink.

Factors beyond our control, such as weather events, will always put pressure on our sewer networks. Our Zero Flooding project, which began in 2017, is aiming to eliminate sewer flooding incidents in key hotspots across our region, while our Pollution and Flooding Resilience team is focused on delivering best practice reduction programmes and continuously improving our incident response across our network.

Supporting the vulnerable

Much of our Customer Service activity over the past year has inevitably been shaped by the COVID-19 pandemic. Our immediate focus in March 2020 was to ensure that our vulnerable customers were getting the support they needed, and that we were providing as much assistance as possible to those who were impacted by the virus. As a result, we introduced a number of immediate measures, which included:

- payment breaks of up to three months for those in financial difficulty as a result of the impact of COVID-19. In total we offered around 8,500 customers a payment break
- automated renewals for those already on a scheme or tariff
- simplified application processes for our support tariffs to reduce the burden on customers
- a change to our policy in relation to priority services registration to allow referrals from relatives and trusted third parties
- increasing the income threshold for our Essentials social tariff from £16,105 to £21,000 in November 2020.

Our operational performance continued

Deliver great service continued

We will be surveying our vulnerable customers every year until 2025, to make sure that the non-financial support we provide is of a high standard. The first survey of its kind took place at the end of 2020. The survey told us that 81% of our vulnerable customers are satisfied with the overall services provided by Southern Water, with 70% being satisfied with the particular services we offer to help them. The results also showed that 79% are satisfied that information provided is clear and easy to understand and 64% were satisfied with the accessibility of services.

We have studied the results carefully to identify where improvements can be made to the services we provide to our vulnerable customers.

Our financial assistance packages help our vulnerable customers to maintain their water payment plans for as long as possible every year. This is the first year that our performance in this area has been covered by a new measure, which has shown that 65% of those we assisted were able to afford their water bill for 10 months out of a 12-month period or paid 80% of the amount owed within a 12-month period. This fell slightly short of our target of 70% of those we assisted.

In order to improve our performance in this area, we will be undertaking some analysis of the data for the first year of reporting, while working with our Debt Collection Agencies to develop more sustainable payment plans.

We focused on contacting those customers who we knew may be impacted by the restrictions on daily life that arose from the lockdown measures, for example those making cash or card payments, to let them know of the help they could access if they were struggling.

We also made contact with our Priority Services customers to tell them about the additional support available, but more importantly to 'check-in' and see if there was any further help we could offer. We attempted to contact 51.8%, and we actually spoke to 19.8%. This included an email campaign to encourage anyone who required a little bit of extra assistance to get in touch and sign up to our register. As a consequence we received approximately 15,681 new registrations, an increase of 80% since March 2020. This represents 1.9% of the households we supply with water or wastewater services, which is below our target of 2%.

Community engagement has been key to assisting vulnerable customers. We joined a UK Power Networks-led consortium to provide funding to Community Foundations in our area, enabling us to make a contribution of £25,000. We also worked in partnership with Job Centres in some of our most deprived areas and with the Home and Well project, which supports patients being discharged from hospital.

It is important that our customers feel that they are getting value for money when they pay their water bill. We measure customer satisfaction regarding the cost of their water and wastewater services in an annual survey. We aim to reach a level of satisfaction of at least 75%, however in our last survey we scored 71%.

We are working to keep bills as affordable as possible, by becoming a more efficient business to keep costs down, and supporting those that need the most help. By 2025, we will have reduced average bills by more than 18% in real terms, compared with 2020.

Water pressure

We are working proactively to reduce the risk of properties receiving low pressure. Although we have had a challenging year due to failures at some of our supply works, we have had some big successes with implementing changes to our network, which have benefited some of our Hove customers. We are also fitting a booster on a new main in Hampshire to solve low pressure issues for some of our customers there, which will also help to provide network resilience for any proposed future development.

Despite improvements, we added more properties to our 'at risk' register and the number of properties in this category at the end of the year was 310. This means that we did not reach our target, resulting in a penalty of £118,000.

Looking ahead

- To improve our CRI performance, we will continue our Hazard Reviews as part of our Water First initiative, investing in site improvement and continuing to improve our people and process capability.
- By 2025 we have set a target level of 4.6 contacts per thousand people regarding the taste, odour and appearance of our drinking water.
- We plan to improve our incident response information on our website during 2021–22 to reduce the amount of time customers are without water in the event of an operation incident, in addition to adding functionality to make it easier for customers to report incidents and bursts online.
- We are investing in a new complaints system which will not only improve our handling of customer complaints, but will also support more detailed root cause analysis.
- There is a plan underway to remove properties at risk of receiving low pressure from the register in five areas across West, Central and East operational areas.



Our operational performance continued

Use water wisely

The work that goes on behind the scenes to deliver drinking water and remove wastewater can sometimes be taken for granted. When informed, customers recognise the value these services bring to our daily lives, enabling everything that we do. They also understand water is a precious resource that needs to be looked after.

Link to risks

- Water
- Customer
- See Principal Risks on pages 125 to 139

Key outcomes	Why it is important	Associated ODI/PC	RAG status	Link to remuneration
Leakage	Customers say it is essential to reduce the amount of water lost through leaks from our network. They believe water is a precious, natural resource and expect us to look after and use it wisely.	Leakage		Indirect
Water consumption	Customers were interested in understanding more about their water usage. They see saving water as a partnership issue and are looking for us to help them save more.	Per capita consumption		Indirect
		Target 100		
		Water saved from water efficiency visits		
		Access to daily water consumption data		

Changes in the climate, our population size and other factors mean that we must plan ahead to avoid water shortages. How we use our water, and our ability to reduce how much we use, will be vital to making sure that we have enough water. This is true for us as a water company, as it is for our individual customers. Using water wisely is therefore a key focus for our forward planning as well as our day-to-day work.

Until last year, we had seen water use fall by 16% over the previous seven years. With people spending more time in their homes in 2020–21 due to the COVID-19 pandemic, household water usage has increased. The number of customers using less than 100 litres of water per day has decreased and the average amount of water each one uses has increased by 7%.

Changes in the way our customers have been using water during the COVID-19 pandemic have had an effect on the amount of water we need to put into supply. Increased customer usage, rather than leakage, has been found to be the main reason for the increase in the amount we need to put into supply, so our leakage levels have been recalculated to reflect this finding.

Reducing the water we waste through leakage

Reducing leaks helps us to keep more water in the water supply and means we need to take less water from the region's rivers and underground aquifers. Our long-term targets aim for a consistent reduction in the number of litres of water lost through leaks, until this is reduced by half by 2050. Our target is to keep our leakage down to a maximum of 97 MI/d as a three-year rolling average. During 2020–21, we achieved 98.5 MI/d (2019–20: 99.5 MI/d), which means our three-year rolling average is just over our target.

To help us meet our long-term ambition to halve leakage by 2050, we have been investing in new technology. This is helping us to further reduce leakage levels, such as the roll out of advanced pressure management and acoustic logging sensors. These sensors can quickly detect possible leaks, enabling us to send our find-and-fix teams out quickly. During 2020–21, we installed 7,400 acoustic loggers on our network, increased the number of find-and-fix teams on the ground and we have completed 20,000 leak repairs.

Helping our customers reduce their daily water use

The amount of water being used by our domestic household customers has significantly increased during the COVID-19 pandemic, with more people working from and spending time at home; individual daily water use is now at 137.6 litres per day. This increase presents us with a significant challenge not only in terms of our performance over the past year, but for the rest of this five-year period. We continue to work with Ofwat and the rest of the industry to understand the longer term effects on customer usage. The increase we have seen is not unique to our region, however as an area of water scarcity we need to work with our customers to try and drive down consumption in order to meet our target of 128.1 litres per person, per day by 2025 (this is a three-year rolling average).

The impact on our customers' water usage would have been even greater, had it not been for our history of proactive water efficiency engagement with customers. This includes working with the community to promote water reduction through our Target 100 campaign, which focuses on a mix of incentives, behaviour change communications

and water-saving home visits where our engineers fit free water-efficient products.

Our Target 100 campaign forms a commitment to our customers that we will support them to reduce personal water use to an average of 100 litres per day by 2040.

Our customers have told us that they value assistance using water more wisely and saving money, and our water-saving home visits give us an opportunity to focus on this part of the customer experience. The COVID-19 pandemic has meant that we were not able to make the usual visits during periods of lockdown. The number of visits has therefore significantly reduced over the past year and we did not meet our target. To address this, we have now launched virtual water-saving visits via our new online water calculator, Get Water Fit, which can be found at southernwater.co.uk/help-advice/getwaterfit-your-water-saving-calculator.

While reducing consumption remains a priority, a strategic decision was made to place our enabling access to daily water consumption data on hold and focus on other challenges. This is now under review to understand how we can progress this.

Looking ahead

- Our leakage performance is expected to improve as we continue the roll out of our Advanced Pressure Management system, which should be fully enabled by mid-year 2021–22. Our long-term plans are to reduce leakage by 15% by 2025 and 50% by 2050.
- Water efficiency remains a priority, to avoid water shortages from climate change and increased population size. We will continue to work with customers and champion programmes such as Target 100. We aim to help our customers consistently reduce the amount of water they use, helping them to save money and reduce the pressure on the environment.
- As part of this work we are working on how we can provide accurate daily information about water usage and hope to be able to announce a scheme in 2021–22.
- We will continue our home visit programme helping customers to save water, energy and money.

Key:



Ofwat target met or exceeded



Ofwat target missed but performance improved in relation to prior year outcome



Ofwat target missed and performance worse than prior year outcome.

Our operational performance continued

Protect and Improve the Environment

We are all responsible for the state of the environment. Customers want to see us protect and improve the environment; doing no harm is the absolute minimum they expect.

Link to risks

- Climate Change
- Compliance
- See Principal Risks on pages 125 to 139

Key outcomes	Why it is important	Associated ODI/PC	RAG status	Link to remuneration
Pollution	Customers want us to treat and dispose of wastewater in a way that does not harm the environment. They believe we have a duty to protect and improve the environment in which we operate, and ensuring we do no harm through pollution incidents is the minimum they expect.	Pollution incidents		Indirect
		Thanet sewers		
High quality bathing and river waters	Our customers want to see us do more to deliver excellent bathing and river water quality. They want us to recognise the importance of this to tourism.	Delivery of water industry national environment programme requirements*		Direct and indirect
		River water quality		
		Maintain bathing waters at 'Excellent'**		
		Improve the number of bathing waters to at least 'Good'		
		Improve the bathing waters at 'Excellent' quality		
		Treatment works compliance***		
		Combined Sewer Overflows (CSO) monitoring****		

Key outcomes	Why it is important	Associated ODI/PC	RAG status	Link to remuneration
Water resource abstraction	Customers want us to use a range of sources to provide reliable services in the future and expect removal of water from the environment to be done in a sustainable way	Distribution input		Indirect
		Abstraction incentive mechanism		
		Effluent re-use		
Renewables	We should be increasing the amount of renewable energy we use in our operations. There is a growing expectation that we should be using our own wastewater services to generate more energy as well.	Renewable generation		Indirect
		Natural capital		
		Satisfactory bio-resources recycling		

* Year one scheme deadlines have been moved into year two due to COVID-19 so there are no year 1 AMP7 deliveries with a deadline this year. Some Year 5 2015–20 deliveries were moved into this year. Based on information from the Environment Agency, we have 42 schemes to deliver, but unfortunately have missed one.

** We are unable to report performance against our performance commitment to maintain the number of bathing waters at Excellent water quality status. This is because the Environment Agency, which is responsible for sampling bathing waters, was unable to carry out the normal pre-season testing which is required to produce reliable bathing water statistics. As a result, no bathing waters results were available for the 2020 bathing water season. We report performance in this case as n/a."

*** This is a calendar year based measure. While the number of monthly sample breaches and exceptions has reduced, and we continue to make compliance a priority, the underlying risk remains high and we are forecasting a penalty in this area.

**** Whilst in the PR19 final determinations outcomes performance commitment appendix this measure is listed as financial year, this metric is reported against the calendar year in line with information provided to the Environment Agency as part of spills reporting. The outcome of this performance commitment is unchanged by the amendment. This change is to ensure we are providing consistent information to both regulators and an annex 2 change request has been raised with Ofwat accordingly.

Key:



Ofwat target met or exceeded



Ofwat target missed but performance improved in relation to prior year outcome



Ofwat target missed and performance worse than prior year outcome.

Our operational performance continued

Protect and Improve the Environment continued

Pollution

Reducing pollution incidents is key to keeping our rivers, reservoirs and bathing waters clean and healthy. While we continue our work to monitor CSOs and ensure that our treatment works meet the standards set by the Environment Agency, we have put in place two programmes to provide better information to our customers. The Beachbuoy platform offers online updates about any screened wastewater releases into the environment, which are sometimes necessary to prevent flooding during storms. While our Beauty of the Beach campaign celebrates our coastline and the beautiful bathing waters, encouraging customers to play their part in keeping them clean.

All water companies must monitor and report the number of pollution incidents and our annual pollution figures are published on our website, showing which category of incident has occurred. Our total number of reportable incidents for the year was 400, which was higher than we had predicted due to an extended period of wet weather in February. Our target was 24.51 incidents per 10,000 km of sewer which translates into 98 actual incidents. As a result of missing our target, we received the maximum penalty of £7.718 million. We forecast that we will remain in the penalty space for the remainder of this five-year period, although we continue to work hard to improve our performance.



However, our 2021 figures have shown some significant improvements, reflecting advances in our incident management processes as well as self-reporting. Our self-reporting culture has been a significant factor in the increase in pollution incidents reported at pumping stations and wastewater treatment works. The improvements made at the beginning of 2021, resulted in 17 incidents in February 2021, compared to 58 in February 2020.

We have now published a detailed Pollution Incident Reduction Plan (PIRP), which we have shared with the Environment Agency (southernwater.co.uk/media/3839/pirp-final-20200904.pdf). The plan is based on extensive data analysis and industry best practice, with its primary focus being on wastewater pumping stations and wastewater treatment works, where we have seen the largest increase in pollutions since 2018.

The Thanet Sewers enhancement scheme aims to reduce leakage from sewers located within tunnels in Thanet by 31 March 2025. Pollution incidents happen when the diluted storm flows have exceeded the capacity of the network and entered into the chalk tunnels. The scheme is currently in the development phase of the design programme, so there is no delay to report.

High river water quality and excellent bathing waters

The Water Industry National Environment Programme (WINEP) is an Environment Agency programme which requires all water companies in England to complete a set of actions between 2020 and 2025. Our performance in this area is assessed on an annual basis.

Due to social distancing requirements during the first lockdown, all schemes for this year were postponed by the Environment Agency to year two of the current five-year period so there were no schemes active in this first year.

However, some of the delayed schemes from the 2015–20 period have been rescheduled, including some eel schemes. The eel schemes are essential to protect eel colonies found at our water treatment plants. Out of the 39 schemes we were required to deliver on this year, we missed five (four eel schemes and one water).

In terms of drinking water catchment management, we have the highest number of Safeguard Zones (SGZs) in the country, which need constant investigation and mitigation. Over the next four years we are investigating the potential risk of nitrate to our drinking water supplies at 22 water supply works (WSWs) and implementing catchment management mitigation to address nitrate and pesticides at 46 WSWs. Any mitigation work is co-developed with our catchment stakeholders and rolled out in priority areas.

The Catchment Risk Management team is also investigating the impacts of our removal of water from the environment at 72 WSWs, with a view to developing a more sustainable approach.

Our river water quality metric will be measured from 2021–22, and we aim to have improved a cumulative length of 182.3 kilometres of river by the end of the current five-year period.

There are 83 bathing waters in our operating area. The categorisation for 2019–20 confirmed 58 bathing waters as ‘Excellent’, 21 as ‘Good’ and four called ‘Sufficient’ and none in the ‘Poor’ category. There are no classifications being published for 2020 as a result of the impacts of COVID-19 so we have reported that this metric is not applicable, in line with our peers.

The categorisation of 58 as ‘Excellent’ relates to Defra’s four-year cycle of categorisation. Based on 2019 data, 62 bathing waters would have been classed as ‘Excellent’. During the COVID-19 pandemic, the usual amount of testing by the Environment Agency could not be carried out to categorise bathing waters.

Starting next year, our continuing Bathing Water Enhancement Programme (BWEP) aims to improve bathing water quality still further. The programme relies on investigation data, which has been delayed due to the pandemic. So as not to lose time, improvements under this programme will be planned in advance of receiving the complete set of investigation data.

Our Beauty of the Beach campaign continues to celebrate our beautiful bathing waters. It was developed with the Environment Agency and involves local councils and wildlife and community groups, helping to protect the quality of our bathing waters. We will be running it again through the 2021–22 bathing water season.

We aim for 100% compliance at our wastewater treatment works. Unfortunately, we achieved 97.06% compliance during 2020–21 as a result of 10 failed works. For example, we experienced some solids management issues at our Horsham site. Our ‘intensive care’ processes are being reviewed to enhance the management of these sites. As a result of missing our target, we received a penalty of £19 million.

We currently have monitors installed at 938 of our 967 storm overflows, giving us 84.77% coverage, which means we did not meet our target of 95%. We do not expect to drop below target over the rest of the five-year period, however, our challenge is now to ensure all monitors remain fully functional.

The amount of water we take from the environment and put into supply

We measure the amount of clean drinking water available in our water system in millions of litres per day (MI/d). The amount of water our individual customers use and the number of leaks from pipes affect the amount of water required in the system.

Over the past year, we have not met our target of 525 MI/d, reaching an average score of 563 MI/d. This has been impacted by the increase in customer usage of water in households during the pandemic. The weather also had a significant impact. In February 2021, we had extremely cold temperatures which quickly froze and then thawed pipes, creating some bursts and leaks. As the weather warmed up in March, people started doing more activities outside and used more water for this.

Our operational performance continued

Protect and Improve the Environment continued

In terms of the amount of water we take from the environment (abstraction) we are set strict monthly targets by our regulators. This metric focuses on the River Itchen, and the trigger point is in September as this is when impacts of this environment are most severe due to hot weather. The September abstraction limit is 2,280 Ml; our target is to outperform this by 15 Ml/d, which we achieved.

Effluent re-use is the volume of treated effluent in cubic metres (m³) made available annually for direct re-use by customers. Reusing effluent helps improve the security of water supply for customers through reducing the demand for fresh water and improving the overall supply/demand balance of the company. This is a reward based metric with an annual target of 0 for each year. In 2020–21, 273 m³ was made available for reuse with a reward rate of £3.29 per m³.

Renewable energy generation

We have joined our peers in committing to Water UK's pledge to become carbon neutral by 2030, reaching net zero. Working with them, we developed and launched a sector route map in November 2020. The implementation plan that followed was put in place by a cross-sector team and approved by the Board and is due to be published in July 2021.

To achieve net zero, water companies, regulators, government, stakeholders and our supply chain will all need to show joined-up thinking to reduce or offset our impact on the environment.

In support of realising net zero, we have confirmed that all of the energy that we buy will be 100% renewable energy from 2021–22 onwards, which will help to improve our carbon footprint.

By 2025, we aim to increase the amount of renewable electricity generated to 24% of our total electricity used. The target for the financial year is 21.2%, and we achieved 16.42%, falling short of where we wanted to be. We incurred a penalty of £1.326 million. Energy consumption has increased in recent years, and while energy efficiency work is ongoing to minimise the impact of this, the trend is expected to continue for the short term. Our task to achieve the 2025 target requires a variety of projects to be developed.

Solar power is key to our renewable energy generation. The Hardham Water Supply Works now has some solar capacity. Funding has also been approved to develop a 0.5MW roof top solar array at Peel Common, with the aim of having this installed within the 2021–22 financial year.

We are looking at desktop feasibility assessments regarding the suitability of using solar on more Southern Water sites, which could improve our renewable generation by up to 3%.

We have included commitments to adopt a natural capital approach in our Water for Life Business Plan 2020–25. We have a commitment to establish natural capital accounts alongside our traditional financial accounts in 2022–23, to enable us to measure and monitor a wider breadth of 'value added' as a result of investment and activity.

This means embedding natural capital approaches into our planning and processes, and exploring nature-based solutions to shared challenges through local partnerships. Our long-term ambition is to ensure our activities and investment enhance the resilience of our natural environment.

We achieved a 100% biosolid recycling record during 2020–21. Biosolids (a by-product of the treatment process) is recycled as a fertiliser. Although we have reported our performance to the Environment Agency, this metric remains suspended from the official environmental performance assessment for Southern Water.

➔ Read more about our **net zero plan** on page 72

➔ Read more about our **natural capital plans** on page 71

Looking ahead

- Our Pollution Incident Reduction Plan was originally published in 2020, and updated in May 2021. It sets out how we will achieve a maximum of 80 pollution incidents per year by 2025, and zero pollution incidents by 2040.
- We will begin the construction of the third and final phase of the Thanet sewers enhancement scheme, which is protecting the area from sewer flooding.
- As part of the WINEP requirements we will deliver one of our largest-ever environmental improvement programmes, improving the water quality in 537km of river.
- We have committed to reach net zero by 2030, and we will be purchasing 100% renewable energy from 2021–22 onwards, which will improve our carbon footprint.
- Our award-winning Beauty of the Beach campaign has been enhanced with the recent launch of the second version of Beachbuoy, an online service giving people real time information on bathing water quality.
- Planned Solar Farms in Otterbourne and Testwood will play an important role in helping us to reach our renewables target by producing electricity and we are planning to install new and efficient CHP engines this AMP, replacing the oldest nine CHP engines in our fleet.



Case Study

Improving our online service for customers

Our customers expect to be able to access our services on demand, from any smartphone, tablet or PC.

20k
reduction in
monthly calls

70%
of self-serve
transactions
completed
successfully

Yet at the start of 2020–21, only about 30% of our customer transactions were happening online.

We recognised that helping our customers do more online would be more convenient for them, which would be a driver for improving our customer satisfaction scores over time. Meanwhile, a reduction in calls would be more efficient for us. So we set up a project to improve the functionality, visibility and uptake of self-serve options on our website.

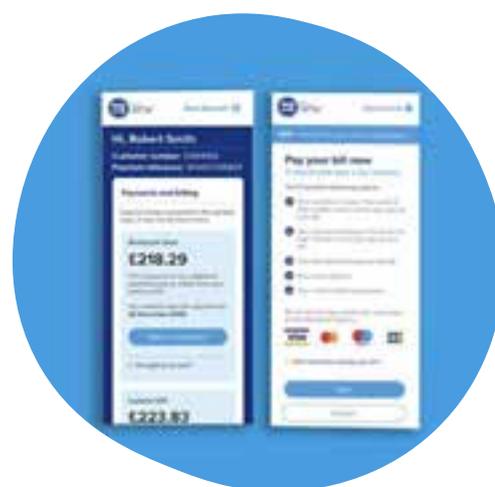
In a series of development sprints, we focused on the most popular customer transactions. We improved our online journeys for submitting a meter reading, paying a bill, managing a Direct Debit, moving home, viewing past bills and payments, changing a password – and more. In each case, our goal was to create an experience that allows customers to easily complete what they want to do online without having to pick up the phone.

In some cases, customers will need to talk to us or we will have to look more closely at an issue. So we explored how we could help, in the moment, by offering assistance online. We built prompts and triggers into the journeys so support is on-hand through Live Chat.

By February 2021, we saw a drop in the volume of calls by close to 20,000 a month. Meanwhile, 70% of self-serve transactions were successful and the number of digital-assisted contacts increased. Clearly, our improvements are reducing demand on our call centres while allowing our customers to interact with us in a way that suits their lifestyle.

Max Cappella
Customer Experience Manager

➔ Read more on customer experience on page 82





Our operational performance continued

Fit for the Future

Customers recognise the challenges we face and expect us to ensure that future generations have access to at least the same level of water services as we do today.

Link to risks

- Climate Change
- Transformation
- See Principal Risks on pages 125 to 139

Key outcomes	Why it is important	Associated ODI/PC	RAG status	Link to remuneration
Asset health	It is essential to be investing in our sewer networks, pipes and drains. Our customers want us to upgrade where we can and use innovative and sustainable solutions.	Mains repairs		Indirect
		Unplanned outage		
		Risk of Sewer flooding		
		Sewer collapses		
Water resilience	Customers want to ensure supply for future generations. They are willing to invest now to ensure that there is no deterioration of services in the future.	Water supply resilience		No link
		Long-term supply demand schemes		
		Risk of severe restrictions in drought		
		Impounding reservoirs		
Growth	Businesses think it is important to work with councils and developers on infrastructure. Customers recognise the challenge of new homes drawing on our network and expect us to ensure it is fit for the future.	D-MeX		Direct
		Surface water management*		

Key outcomes	Why it is important	Associated ODI/PC	RAG status	Link to remuneration
Community engagement	Keen for us to focus on our role in the community, our customers want us to collaborate with local groups on important issues, support community outreach programmes and educate the next generation in schools.	Community engagement Schools visited and engagement with children	 	No link

* This programme is under review and we are forecasting a penalty.

Our role in preparing for future generations means that we must ensure a resilient water and wastewater network, using the highest standards of operational excellence. This involves making sure that we are compliant with regulations, reducing risk for customers and helping the environment. We know that water and wastewater services do not operate in isolation; they are interconnected with, for example, energy generation, food production, housing development, environmental protection, our tourism sector and other vital industries and services.

One of our five transformational programmes, Networks 2030, looks at our water supply networks and aims to modernise and rationalise them. This includes the replacement of water mains and the use of smart water-quality sensors.

The new D-MeX compliance score measures our customer experience for newly connected customers through our developer services.

Working with our communities is an important focus of our work. The restrictions in place during the COVID-19 pandemic led us to adapt how we worked with our communities, such as local schools, to ensure that we maintained consistent and effective engagement.

We are creating a Learning Network working in partnership with our supply chain and local councils to create the skills we need for a resilient future. We will also continue our actions to help create vital and valuable water tourism through high-quality bathing waters and healthy chalk rivers.

Key:

-  Ofwat target met or exceeded
-  Ofwat target missed but performance improved in relation to prior year outcome
-  Ofwat target missed and performance worse than prior year outcome.

Our operational performance continued

Fit for the Future continued

Asset health

We measure the number of mains repairs per thousand kilometres of our entire water main network. Our target was 129.1, but during the year we achieved 150. Extremely low temperatures experienced over the winter months are the primary reason for this. As a result of missing our target, we have incurred a penalty of £1.756 million.

Unplanned outages occur when emergency works at our treatment plants cause us to lose water in the system. We measure this in terms of the percentage of water lost from the total capacity of the system. We have done extensive work to better understand and improve the resilience of our water asset health and more than halved unplanned outage to 9.21%, from 18.59% in 2019–20 and below our regulatory target of 9.44%.

We measure the risk of sewer flooding in terms of the percentage of the region's population at risk from flooding from a one in 50-year storm, based on modelled predictions. During 2020–21 our target was to achieve 12.42%, which we met, achieving 11.68%.

We have three flood protection schemes planned to 2025, totalling more than £9 million. We will invest around £4.5 million to reduce the risk of shingle blocking at our Black Rock short sea outfall in Brighton and approximately £5.1 million to reinforce the seawall at Portobello Pumping Station Wastewater Pumping Station, also in Brighton. We are planning to partially fund the co-delivery of a scheme to increase the resilience of our outfall at Seaford, in East Sussex, in partnership with the Environment Agency and local council. This will reduce the risk from flooding and increase the resilience of Seaford against coastal erosion.

Sewer collapses can cause a significant impact on service to customers or the environment, often requiring repairs to be made in order to reinstate the expected service. Our year-end target for sewer collapses was 228 incidents. The target was not met, as there were 315 incidents, resulting in a penalty of £4.036 million.

Water resilience

A number of schemes which will help increase availability of water supplies in our region are currently in the design phase and due to begin during 2021–22. Three water recycling projects are planned in Aylesford, Sandown and Ford. Another option under consideration is a desalination scheme, as well as a number of strategic pipelines.

These will allow us to make use of these new sources in our Western Area, and are being constructed to help reduce our reliance on the environmentally sensitive Rivers Test and Itchen, particularly during droughts. As well as improving the flow of water from East to West, they will also provide better connections between the South and the North of the Western Area, connecting our Andover and Southampton resource zones.

Effective drought preparation is vital. If there is not enough water during droughts for our needs, we may need to ask customers to reduce the amount of water they are using. Over the past year, we met our target of zero risk to customers for drought.

Water resources are increasingly being put under pressure for a variety of reasons including the impacts of climate change and population growth. We are currently leading work through Water Resources in the South East (WRSE) to develop a water resources strategy which identifies the best drought solutions for the region and beyond.

Our schemes in Thanet, the Isle of Wight and Brighton, aim to reduce the number of properties in these areas at risk of losing their water supply due to a lack of resilience.

Our Impounding Reservoirs performance commitment measures the progress that the company makes against its programme of work for enhancing the safety of four named reservoirs (Bewl, Darwell, Powdermill and Weir Wood), measured as the percentage completion of the schemes. The target for 2020–21 is 0% completion rising to 48.8% completion by March 2023. The schemes have been approved and design phases are complete with us forecasting to meet our targets for the rest of this five-year period.

Supporting growth

Our Business Channels team is making progress on the Developer Services improvement programme. Many of our legacy issues with legal claims and unreconciled projects have been resolved and our new workflow solution, which joins up the developer application lifecycle across multiple teams, went live in December. The workflow has improved reporting, and jeopardy management has already given benefits, with our best Levels of Service score in January since D-MeX started.

In addition, we have been simplifying our internal processes, specifically focusing on sewer and water adoptions and New Appointment and Variation processes. We have centralised our application management, improved our letter communication and enhanced our growth planning insight by partnering with Glenigan.

Our web pages have been overhauled to make it easier for customers to find information surrounding their application. Customer feedback on our new portal, GetConnected, has been very positive since its launch in June 2021.

We have also introduced new technical training for our internal teams, and we have worked with colleagues at Capita to launch a new knowledge-base tool, Reservoir. Both have helped with first contact resolution.

Changes to Ofwat's D-MeX methodology have meant our self-lay and new appointment and variation customers are now better represented in measuring levels of service. Additionally, changes to the wastewater adoption codes have taken place. In Ofwat's league table, we are currently 16th (out of 17) for D-MeX.

Our surface water management metric has been under review. Given the impacts of COVID-19 on our business, the decision has been made to focus on other more critical priorities. We are forecasting a penalty for the five-year period of £30,000.

Community engagement

Activities in this area were delayed due to the COVID-19 restrictions; however, we adapted our usual programme to provide support to our communities during this challenging time.

We made a joint donation with other water companies and the power network to give regional Community Foundations a sum of £500,000. In order to support food banks, we sent out 700 community care packs to partners working in this area.

While we were not able to carry out our schools visits programme due to the pandemic, we adapted our work in this area by providing educational video clips about the water cycle and water saving.

The opportunities for our employees to volunteer were adapted to provide remote volunteering support, for charities helping those in the community to reduce social isolation. Volunteer befrienders made weekly calls to vulnerable people throughout this time.

Working with four other water companies, we also held an online Big Virtual Water Quiz with National Geographic Kids.

For more information about our work in our communities this year, read pages 60 to 61.

Looking ahead

- We aim to reduce the number of sewer collapses in 2024–25 to 222.
- Our target for long-term supply and demand schemes is to deliver capacity of 182.5 MI/d by March 2027.
- Our work to ensure that we have enough water, even in a one in 200 year drought, includes schemes to improve water efficiency and leakage, which are currently in the early stages of design.
- Our Business Channels team will improve our Growth Planning and Financial Reconciliation processes, embedding them into our new workflow.
- Community engagement planned for 2021 includes supporting the Brighton Festival, South and South East in Bloom and Hampshire Heroes.

Case Study

Partnering to proactively and sustainably protect raw drinking water sources

Many of our raw drinking water sources in Sussex are situated in the region's famous chalk downland.

→ Read more on sustainability on pages 63 to 73

→ Read more on our work to protect and improve the environment on pages 88 to 93

Across the Brighton and Worthing Chalk Block, the level of nitrate within the aquifer can be high, and we have traditionally relied on water treatment processes in order to adhere to the strict drinking standards for customer supply.

Our new, more sustainable approach to protecting the current and future drinking water sources is based on the idea that prevention is better than cure. We're using catchment management to identify how land use, pollution hazards and groundwater pathways could impact on water quality. Then we're working to understand what we need to do to protect groundwater quality at source, so that costly and energy-intensive treatment can be minimised, or even avoided, further down the line.



Across the Brighton and Worthing Chalk Block, we've funded long-term land management incentives to implement best practice measures that reduce nitrate leaching into the groundwater. Alongside this, farmers can use our capital grants scheme to apply for funds towards infrastructure that will also help to reduce pollution.

In the Worthing Chalk Block, we are working with a cluster of farmers who have come together to form the Arun and Adur Farmer Group. Together, we're exploring more sustainable ways of using nitrate in these rural settings. For example, we have worked with farmers to carry out soil testing to identify exactly what their crops need – and how much – so fertilisers can be used more efficiently without impacting yields. This gives the farmer value for money while protecting our water sources and the environment.

Across the Brighton Chalk Block, we are part of The Aquifer Partnership (TAP), alongside Brighton and Hove City Council, the South Downs National Park Authority and the Environment Agency. Through this collaboration, we are undertaking research, engagement and awareness campaigns for both urban and rural pollution sources.

This long-term strategy will help to provide a resilient water supply for future generations while reducing the number of nitrate treatment works needed. The approaches implemented to protect water quality also provide benefits for soil health, carbon, as well as the wildlife and biodiversity of the iconic Chalk Block.

Claire Neale
Catchment Management Strategy Manager



Financial performance



Contents

Financial performance	104
Capital structure	112
Risks	118
Principal risks and uncertainties	125
Viability statement	140

Financial performance

The financial results have been prepared in accordance with FRS 101 and the accounting policies of the company as set out in note 1 to the financial statements.

Financial results

The financial results are summarised in the table below:

	Years ended 31 March	
	2021 £m	2020 £m
Income statement		
Revenue	784.2	878.0
Amortisation of regulatory settlement payments	35.6	0.0
Total revenue	819.8	878.0
Other operating income	1.7	1.4
Operating costs before charge for bad and doubtful debts	(360.0)	(373.5)
Charge for bad and doubtful debts	(34.8)	(29.6)
Depreciation, net of amortisation	(287.9)	(264.0)
Operating profit	138.8	212.3
Profit on disposal of fixed assets	0.8	0.9
Profit before interest and tax	139.6	213.2
Net finance costs	(51.6)	(119.2)
Fair value (losses)/gains on derivative financial instruments	(444.8)	339.9
(Loss)/profit before tax	(356.8)	433.9
Tax	64.8	(105.2)
(Loss)/profit for the financial year	(292.0)	328.7

Revenue

Revenue decreased to £784.2 million (2020: £878.0 million). This decrease in revenue was expected and principally results from the changes to our inflation-linked water and wastewater tariffs, which were agreed as part of our business plan for 2020–25. Our revenues were also affected by COVID-19, which reduced the level of trade effluent and developer income we received as well as reducing our main water and wastewater income.

As a result of COVID-19, we experienced a significant change in the mix of that revenue between household and non-household customers.

The national lockdown resulted in a large increase in household demand, with many customers spending more time at home. As a result, our household revenues for 2020–21 were £22.2 million above expectations. The increased household revenue was more than offset by a reduction in non-household revenue, resulting from the restrictions on businesses, which were £30.8 million below expectations.

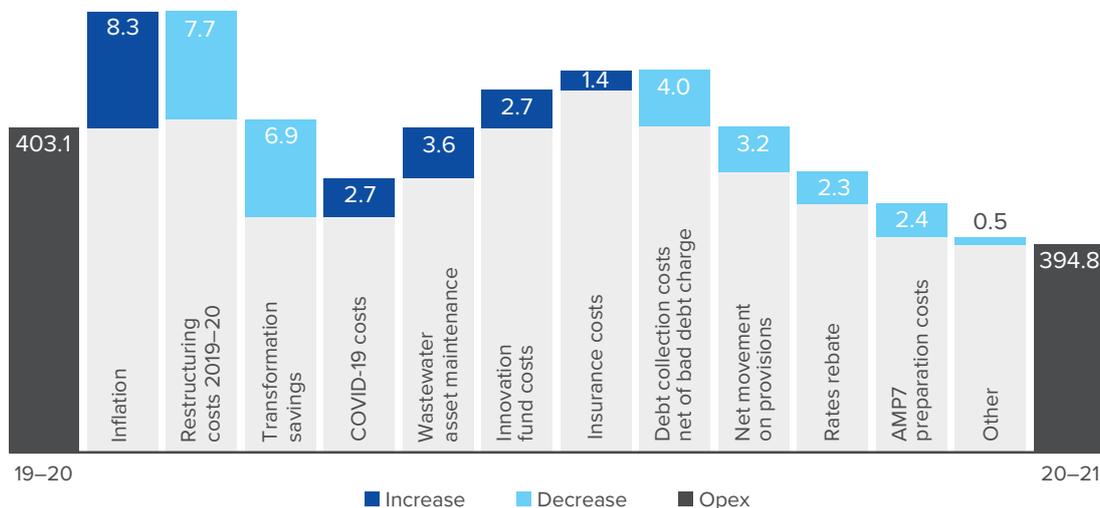
In 2018–19, we made provision for rebates, based on our regulatory settlement with Ofwat, to be provided to customers over the period from 2020–25. These rebates are now included within our tariffs and so part of the revenue reported in the income statement. The provision made in 2018–19 for these rebates is being released in line with the tariff adjustment over the same period.

An analysis of revenue is provided in note 5 to the financial statements.

Operating costs and charge for bad and doubtful debts

Operating costs including the charge for bad and doubtful debts for the year decreased by £8.3 million from £403.1 million to £394.8 million. This decrease is explained in the chart below:

Movement in operating costs including charge for bad and doubtful debts £m



In order to prepare for the challenge of this five-year period, improve our services and reduce costs, we undertook a number of restructuring activities during 2019-20. These included transferring the majority of our customer services activities to Capita, closing our final salary pension scheme and reshaping a number of teams across the business. As a result, we incurred a number of one-off restructuring costs, totalling £7.7 million in the prior year.

These transformation activities resulted in a reduction of £6.9 million in our ongoing operating costs for 2020-21 as a result of lower employee and pension costs.

Over the course of the year, we have experienced a number of cost increases, the most notable of these being:

- The impact of COVID-19 – excluding the impact on debt collection, the net impact of COVID-19 was £2.7 million. This increase largely resulted from additional costs to ensure the health and safety of employees and contractors and facilitate remote working for our office-based staff, the treatment and water supply costs to meet the significant increase in customer demand for water, in particular during the first lockdown in May, and support for our supply chain to cover additional operating costs as well as extended vehicle hire costs. These increases were partly offset by some cost reductions, most notably regarding travel and expenses as well as the deferment of some training activities.
- Wastewater asset maintenance – we increased maintenance expenditure on our wastewater assets by £3.6 million in order to improve our wastewater operational performance and reduce the risk of equipment failures.
- Innovation fund costs – for the current five-year regulatory period, Ofwat introduced an innovation fund to drive innovation across the water industry through a series of competitions to select projects to progress. There is an allowance within the revenues we collect from customers for the cost of this fund and this income is ring-fenced for use on the schemes selected through the competition. Our operating costs for 2020-21 include a provision of £2.7 million for the liability for our contribution to the fund.
- Insurance costs – during 2020-21, we have experienced an increase in insurance premium costs of £0.6 million together with higher insurance losses, following a higher number of claims, of £0.8 million.

Financial performance continued

The impact of these cost increases has been offset by a number of cost reductions:

- Debt collection costs – in response to COVID-19, and in order to support customers in financial hardship as a result of the pandemic, we suspended our debt collection activities during the year, which resulted in lower debt collection costs of £9.0 million. These savings were offset by an increase in our overall provision for bad debt of £5.0 million, reflecting the fact that the likely recovery of debt that has reached the end of the recovery process has worsened and the impact of the pandemic on our outstanding debt.
- Provisions – as reported in our Annual Report last year, we made provisions in 2019–20 of £3.0 million for historic guaranteed standards of service (GSS) payments for missed appointments and £1.0 million in relation to the charges presented by the Environment Agency to the court regarding historic wastewater performance. No additional provisions were made for these matters during 2020–21, resulting in a reduction in operating costs of £4.0 million offset by an increase of £0.8 million to the environmental provision held in respect of work to improve the resilience of the Rivers Test and Itchen in Hampshire for periods of severe drought. Further details regarding the Environment Agency investigation can be found on page 31 and in note 26 to the accounts.
- Rates rebate – following a successful appeal, we received a net reduction in our Business Rates charges of £2.3 million.
- AMP7 preparation costs – during the prior year, we incurred costs in relation to our business plan submission to Ofwat and our preparations for delivering our plans for this regulatory period. As a result, our operating costs fell by £2.4 million for this year.

Depreciation and amortisation

Depreciation and amortisation increased to £287.9 million (2020: £264.0 million) as a result of the completion and commissioning of a large number of our capital investment schemes. The most significant of these were our new wastewater treatment works at Woolston, which increased depreciation by £4.0 million, and a number of short-life IT and system related assets, which added over £4.0 million.

Operating profit

As a result, operating profit decreased to £138.8 million (2020: £212.3 million), a 35% reduction, the majority of which relates to the reduction in our revenues that was agreed as part of our business plan for 2020–25.

Financing costs and profit before tax

Net finance costs decreased by £67.6 million to £51.6 million (2020: £119.2 million). This reduction is largely driven by the refinancing activities undertaken in the prior year, which have resulted in a reduction in net interest payable of £51.2 million. There was also lower indexation on our index-linked debt of £8.8 million and a lower financing charge associated with our pension deficit of £2.9 million.

The fair value loss on our derivative financial instruments amounted to £444.8 million (2020: gain £339.9 million). The primary driver for changes in the valuation is the fluctuation in UK government bond yields, which are used to discount the future cash flows. As government gilt yields are constantly moving, the valuation of our derivative instruments can be volatile. This is particularly evident over the past year, largely as a result of the pandemic, and the gain experienced at March 2020 has reversed as markets have recovered. These changes do not represent cash flows.

The loss before tax for the year amounted to £356.8 million (2020: £433.9 million profit).

Taxation

We have recognised a total tax credit to the income statement of £64.8 million (2020: £105.2 million tax charge). This differs from the credit that may be expected of £67.8 million, based on the profit before tax of £356.8 million and the current period tax rate of 19%, as described in note 10. The difference is primarily due to the company receiving group relief losses surrendered by other companies in the Southern Water group for nil payment, and the announcement made in the Government's Budget Statement in March 2020 that the rate of Corporation Tax would not be reducing to 17% as announced and would remain at 19%. As a result, a charge of £40.3 million has been recognised in the income statement for the impact of this change on our deferred tax balance.

Cash flow statement

Overall, cash and cash equivalents increased in 2020–21 by £210.2 million (2020: £242.7 million decrease). This movement of £452.9 million principally results from the refinancing activities that we undertook during the year. Further details of the year-on-year movements are provided below.

	Years ended 31 March			Explanation
	2021 £m	2020 £m	Movement £m	
Net interest related transactions	(201.1)	(175.0)	(26.1)	In total, the net cash outflow in relation to interest increased by £26.1 million. The principal reasons were as follows. A payment of £194.5 million was made in 2020–21 (2020: nil) in relation to accrued indexation on our index-linked loans. This payment was offset by lower net interest payable in the year, following the refinancing activities completed in 2019–20 of £68.1 million. In 2019–20, net interest payments also included interest of £107.2 million in relation to 2018–19 as the 31 March 2019 fell on a weekend.
Net movement on borrowings	411.0	(202.8)	613.8	During the year, we made loan and credit facility repayments totalling £696.2 million (2020: £417.8 million); these were offset by proceeds from new bonds issued under our Sustainable Finance Framework in May 2020 and March 2021 totalling £1,107.2 million (2020: £215.0 million).
Payments on restructure of derivative instruments	–	140.0	(140.0)	During 2019, we restructured the cash flows associated with an existing financial instrument, which brought forward a cash receipt of £140.0 million at present value.
Equity dividends paid	(4.0)	(7.1)	3.1	In FY21 we have made lower dividend payments to SWSG. These dividends are used by SWSG to make interest payments back to SWS on an inter-company loan. Dividends for the second half of the year have not yet been approved or made; as a result, the interest due for the second half year has not been received and has been accrued.
Other	4.3	2.2	2.1	The net cash movement from operating activities and our capital investment programme. A reduction in cash received from operations, resulting from the reduction in our revenues, was offset by lower capital expenditure.
	210.2	(242.7)		

Statement of financial position

	31 March 2021 £m	31 March 2020 £m
Non-current assets	6,862.1	6,721.3
Current assets (excluding cash)	220.5	278.3
Cash and cash equivalents	339.5	129.3
Total assets	7,422.1	7,128.9
Current liabilities	(354.4)	(1,017.5)
Non-current liabilities	(6,166.9)	(4,857.9)
Total liabilities	(6,521.3)	(5,875.4)
Total net assets	900.8	1,253.5
Total equity	900.8	1,253.5

Financial performance continued

At the end of the year to 31 March 2021, we had non-current assets of £6,862.1 million (2020: £6,721.3 million), an increase of £140.8 million from March 2020. This increase results from our ongoing capital investment programme, which – after depreciation – increased the value of property plant and equipment and intangible assets by £266.9 million. This included the recognition of an intangible asset of £131.1 million, comprising payments of £6.5 million and a long-term liability of £124.6 million, for the future right to a bulk supply of water associated with a new reservoir at Havant Thicket, which is being constructed by Portsmouth Water. These increases in asset values were offset by a decrease in the value of our non-current financial derivative assets of £126.1 million.

Current assets decreased to £220.5 million (2020: £278.3 million). Following the reduction in our tariff, which reduced revenues, there was a reduction in our accrued income as well as a higher level of provision made against our outstanding historic gross receivables. The combined impact of these was a reduction in the value of our net receivables by £22.4 million. In addition, there was a reduction in the balance on our inter-company debtor with Southern Water Services (Finance) Limited of £39.4 million. This inter-company arrangement is used to pay the interest on our loans. The balance reduced this following the restructuring activities undertaken in the prior year, which reduced our net interest payable.

Current liabilities decreased to £354.4 million (2020: £1,017.5 million). This is mainly caused by loans of £679.5 million, which were repaid during the year, offset by additional accrued interest at March 2021 from refinancing activities and on our preference shares totalling £24.2 million.

At 31 March 2021, non-current liabilities totalled £6,166.9 million (2020: £4,857.9 million). This increase of £1,309.0 million was principally the result of the following:

- An increase in borrowings of £1,107.2 million as a result of new bonds issued under our Sustainable Financing Framework.
- An increase in the derivative financial instrument liability of £124.2 million.
- A decrease in the deferred tax liability of £79.0 million as a result of the loss recorded for the year and the increase in the retirement benefit obligation.
- An increase in retirement benefit obligations of £54.0 million. The final salary pension scheme was closed to future accrual on 31 March 2020. During the year, a lump sum deficit payment

of £17.5 million was made, but this was offset by the movement in market conditions at 31 March 2021, which increased the deficit by £70.0 million, together with past service and financing costs of £1.5 million.

- The transfer of £24.2 million of the regulatory settlement provision to short-term liabilities.
- The recognition of a liability totalling £124.6 million for future capacity charge payments, to be made to Portsmouth Water in relation to the Havant Thicket reservoir scheme, mentioned above, over the period to 2100.

Overall, net assets decreased from £1,253.5 million to £900.8 million.

Dividend policy

Our dividend policy is formulated to ensure a fair balance of reward between customers and investors. To deliver on our vision for the successful delivery of our business plan for 2020–25, all stakeholders must share in success: customers benefiting through enhanced service and lower bills, and shareholders earning a fair return on the near £2 billion of equity invested.

When proposing payment of a dividend, the directors of Southern Water Services Limited, acting independently in accordance with their directors' duties and in accordance with the company's licence, will apply the following principles:

1. Determination of a base level of dividend, based on an equity return consistent with our most recent Final Determination and our actual level of gearing. This recognises our management of economic risks and capital employed.
2. In assessing any adjustment to the base level of dividend, we will take into account all aspects of our performance. This would reflect our overall financial performance as compared to the final business plan as agreed by Ofwat and would explicitly consider a qualitative assessment of customer service levels and how customers share in our successes.
3. We will consider our financial resilience ahead of any dividend decision and whether any financial out-performance should be reinvested to benefit customers. This consideration will include taking into account the interests of our employees, other stakeholders, and our pension schemes.

Our dividend policy is intended to support the financial resilience and investment grade credit ratings of the business and ensure continued access to diversified sources of finance. As part of step three, we carry out an assessment of:

- a. headroom under debt covenants
 - b. the impact on the company's credit rating
 - c. the liquidity position and ability to fulfil licence conditions
 - d. key areas of business risk.
4. We will be transparent in the payment of dividends and will clearly justify the payment in relation to the factors outlined above.
 5. We will publish our dividend policy annually (as part of the Annual Report) and highlight any changes.

These tests have not been applied to the interim dividends of £4.0 million paid in 2020–21 to Southern Water Services Group (SWSG) as this dividend payment is instantly offset by a corresponding interest receipt from SWSG and is therefore immediately repaid to the company in a 'dividend loop' (see page 117), resulting in no net cash outflow for the company. The dividends to enable SWSG to pay the interest for the second half of 2020–21 have not yet been approved. This interest has been accrued in the financial statements at March 2021.

The Board has resolved that the company will not pay dividends, other than those associated with the 'dividend loop' mentioned above, until it is clear that to do so would not be detrimental to the company's financial position.

The Board has not approved the payment of preference share dividends for 2020–21 (2020: £9.0 million dividends and £50.1 million redemption). Preference share dividends are disclosed as interest in the financial statements and an accrual for £4.9 million in relation to this liability is included within the financial statements.

Tax strategy and policies

Southern Water and all Southern Water Group companies adopt the tax strategy and policies outlined below.

Our approach to the management of tax affairs is driven by our core values of succeeding together, always improving and doing the right thing, alongside the corporate strategy of the company. We have a low risk tax appetite and this is reflected in our management of tax.

The foundation of our tax strategy is to comply fully with tax legislation and to focus upon maintaining a strong tax compliance culture.

To enable this, we undertake regular compliance reviews to ensure our tax policies are consistently applied. Our approach to tax planning is to align to business decisions made in the best interests of customers and stakeholders, rather than use tax planning to drive or determine business decisions. The very nature of our business means we always take a long-term view on all the activities we undertake. We therefore ensure our tax strategy and approach to tax is sustainable and considers both social and corporate responsibilities. When faced with a business decision or business case, the ongoing tax impact is always considered as part of that decision-making process.

Our approach to tax management

We ensure we are fully compliant with tax laws, rules, regulations and reporting requirements in all operations. This extends to following both the letter of the law as well as the spirit of the law. A culture of doing the right thing is embedded in our core values and our approach to tax embodies this by ensuring we pay the right amount of tax, in the right place, at the right time. We also use the expertise of professional tax advisers to ensure we maintain best practice in our approach to compliance and in circumstances when additional advice is deemed appropriate.

Our management of tax risk

As indicated above, we adopt a conservative approach to tax risk. Our tax management focus is on compliance, systems and governance and our tax planning is always aligned with our commercial and economic activity. All companies within the Southern Water group are subject to UK tax and all companies are UK tax resident, irrespective of their place of incorporation, ensuring that each company is subject to UK tax.

Tax risk primarily emanates from the evolution and complexity of the Southern Water business, along with the ever-changing regulatory and legislative environment. We manage this risk by having an experienced Tax team dedicated to tax compliance and the identification and management of tax risks in our business.

Our Tax team works with the wider business to ensure there are sufficient processes and controls in place and determine what level of risk is acceptable. We also have a support network of industry tax experts who provide specialist tax services, check what we are doing and provide advice and guidance on new tax compliance requirements. Our Internal Audit team also carries

Financial performance continued

out assurance on the control environment relating to the transactional processes underpinning our payments to the Exchequer and our collection of taxes on behalf of the Exchequer.

Our relationship with Her Majesty's Revenue & Customs (HMRC)

A key factor in our management of our tax affairs is our relationship with HMRC.

We meet all statutory and legislative requirements and we manage our tax affairs in an open and transparent way. This extends to us sharing information with HMRC, which goes beyond the normal filing of statutory returns, such as the sharing of internal audit findings so that we can be open and transparent in our approach to managing tax risk. HMRC shares our view of our low risk approach to the management of our tax affairs with an HMRC assessment of us as a 'low-risk' company.

Maintaining public trust

As previously stated, we are committed to complying fully with tax legislation, maintaining a strong culture of compliance and having open and constructive relationships with tax authorities. We do not use tax avoidance schemes or take an aggressive approach on tax planning when interpreting tax legislation.

We apply government and fiscal authority tax incentives and exemptions, where they exist. For example, the UK tax system recognises the benefit to the economy of investment in infrastructure and environmental protection through the availability of capital allowances, which reduce the corporation tax Southern Water pays. Any benefits of this are passed to our customers through reduced bills.

Southern Water and all Southern Water Group companies pay taxes in the UK and have never used offshore companies to avoid tax or levies. We have a Cayman Islands-registered subsidiary company, which was set up to issue debt in the UK (see page 116 for more information). Its Cayman Island registration does not have any impact on the tax due by the group. However, we know that this company has contributed to misconceptions about our business practices, which is why we are working towards closing it. We hope to complete this process shortly.

Although our tax strategy is reviewed and updated each year, it is not expected to significantly change.

We regard this publication as complying with our duty under paragraph 16(2) of Finance Act 2016 for the financial year ended 31 March 2021.

Understanding our taxable profits and our corporation tax

Our taxable profits are generally different to our accounting profits for the following reasons:

- Capital allowances and depreciation – capital allowances are a way of obtaining tax relief on certain types of capital expenditure. These are treated as a business expense and so reduce our taxable profit. Depreciation represents how much of an asset's value has been used up and reduces accounting profit. Capital allowances are applied at different rates than used for depreciation. As a result, there is a difference between capital allowance deductions made against our taxable profits and depreciation made against our accounting profits. The annual variance between capital allowances and depreciation results in a difference between our taxable profit and our accounting profit. Due to the scale of our capital expenditure programme and the level of capital allowances utilised, our taxable profits are significantly reduced.
- The treatment of interest costs – we borrow money to finance our capital expenditure programme. The interest associated with this borrowing is recognised as both an accounting and tax expense, reducing profit and the amount of tax we pay. However, there are differences between the amounts of interest recognised for accounting profits and for taxable profits. Examples are that movements on the fair value of our financial derivatives are not recognised in our taxable profits and interest that is capitalised in our financial statements is treated as an expense when calculating our taxable profits.
- Group relief – Southern Water is part of the Greensands Holdings group of companies as set out on page 115. All of these companies are taxable as UK companies and profits or losses of the companies within the group can be set off against one another in the financial year.
- Deferred tax – the cumulative difference between taxable profits and accounting profits, which are expected to be temporary and reverse in future years, is presented as deferred tax on the statement of financial position. Changes to the future rate of corporation tax revise the carrying value of these differences.

Our tax charge is reduced by our large capital expenditure programme and the interest we are charged on borrowings. The benefit of this is passed to our customers through reduced bills. There is no corporation tax allowance within our customer bills for the regulatory period from April 2020 to March 2025.

Details of our tax charge for the current financial year are disclosed in note 10 to the financial statements and the current year charge to the income statement is also explained further on page 222.

Our other tax contributions

Our other contributions to the Exchequer amounted to £70.0 million. These are explained below:

- Business rates of £25.2 million paid to local authorities (2020: £27.5 million) and payments to the Environment Agency of £8.3 million (2020: £8.3 million) for abstraction licences and discharge consents, which reduce profits chargeable to corporation tax.
- Employment taxes of £36.5 million (2020: £36.1 million) paid to the Exchequer under PAYE (Pay As You Earn) and National Insurance contributions.

Payments have also been made to other group companies of £0.9 million for tax losses surrendered to the company. These were paid to SWSG, allowing SWSG to make interest payments back to Southern Water. Overall, Southern Water pays 2.4 pence in the pound for losses surrendered from group companies. As a result of capital allowances and interest charges, no corporation tax was paid by the company to HMRC in 2020–21.

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.

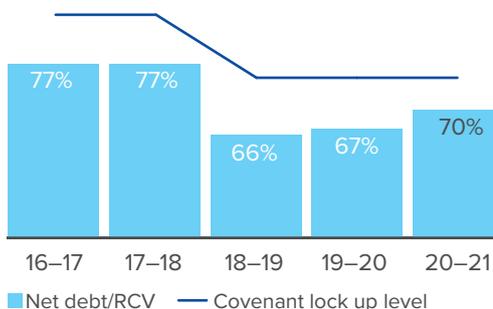
The net debt to RCV ratio is calculated as short and long-term senior borrowings less cash and short-term deposits to the RCV (all values taken from our Regulatory Accounts). The RCV is set by Ofwat at each five-year periodic review and reflects our initial market value plus subsequent capital investment and inflation. The RCV is adjusted at each periodic review for relevant changes to the level of expenditure or performance during the five-year period.

The adjusted cash interest cover is measured as the ratio of net cash inflow from operating activities less RCV depreciation to net cash interest expense.

The credit ratings are shown in the table above and the outlook for Standard and Poor’s is Negative Outlook, the outlook for Fitch is Ratings Watch Negative, and the outlook for Moody’s is Stable.

Debt covenant

Net debt/RCV



Adjusted cash interest cover ratio



The covenanted lock-up level/trigger level refers to debt covenants where payment of dividends by Southern Water is not permitted. These are structural buffers to protect against a default covenant, e.g. the covenanted default net debt to RCV level is at 95%.

Credit rating as at signing date of accounts

Standard & Poor’s

Class A debt:

BBB+

Fitch

Class A debt:

BBB+

Moody’s

Class A debt:

Baa3

A further credit rating downgrade by one or more Rating Agencies would result in a Trigger Event under our Common Terms Agreement, which would restrict the payment of dividends and require the preparation of a remedial plan for our lenders.

Southern Water has obtained a waiver from its lenders to continue to access permitted financial indebtedness to refinance the business in the event of a downgrade Trigger Event.

A further credit rating downgrade, or the assignment of a negative outlook, by Moody’s would lead to a restriction on the payment of dividends under the terms of our Licence.

Under our Common Terms Agreement, a Trigger Event would occur if any two of the credit ratings fall to BBB (Standard & Poor’s), BBB (Fitch) or Baa2 (Moody’s) or below; and a default would occur if any two of the credit ratings are less than the minimum rating required for the status of investment grade.

Capital structure

Where the money comes from

Main customers – income for the provision of services.

Developers – income from the provision of services to developers for the provision of infrastructure and new connections.

Non-price control – income from non-appointed activities.

New borrowings – additional financing raised to support delivery of our capital investment programme.

Where the money goes

Operating costs – day-to-day running costs include wages, power, chemicals, materials and bad debt costs – the cost of providing for unpaid charges.

Capital investment – maintenance of pipework and treatment works and construction of assets.

Rates and licences – business rates on buildings, wastewater treatment and water supply works and EA licences.

Working capital – the timing and growth of the difference between expenditure and receipts.

Interest – interest on money we have borrowed to finance improvements.

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.

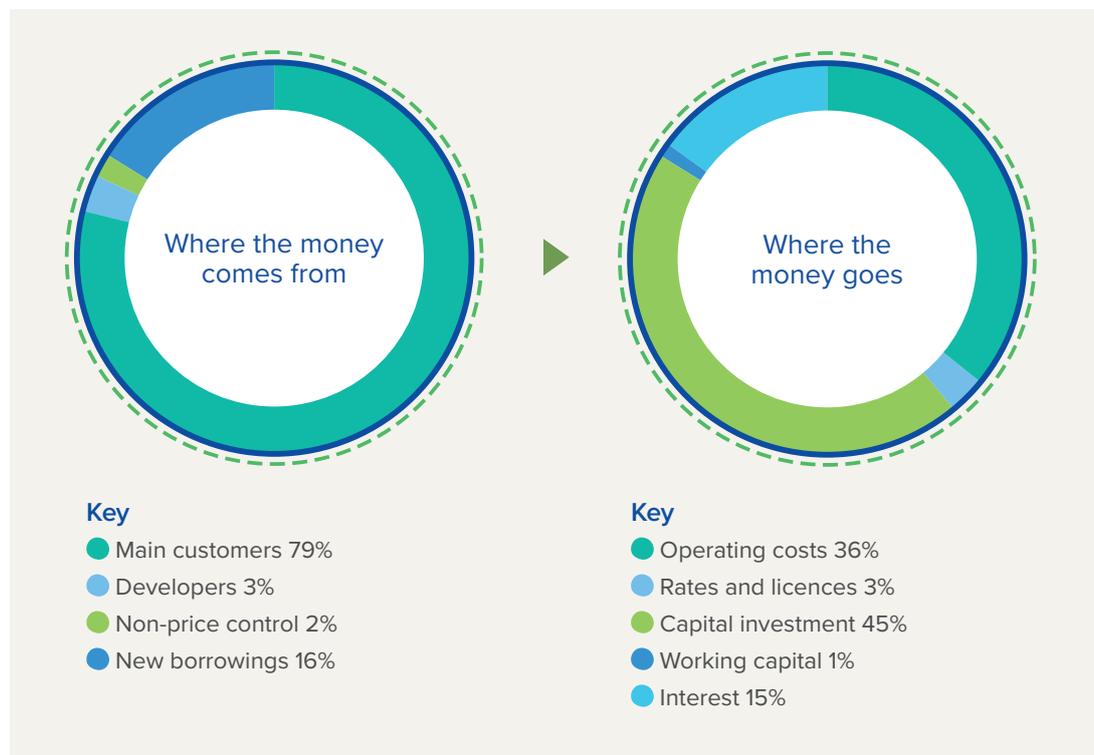
As an example, before privatisation, 350,000 cubic metres of wastewater per day was discharged into our coastal waters untreated, but the completion of our £300 million Cleaner Seas for Sussex scheme in 2013 marked the conclusion of a programme of capital investment to fully treat wastewater of the coastal towns and cities from Kent to Hampshire and the Isle of Wight. A further example is our £100 million construction project at Woolston, which will improve the quality of effluent discharged into the River Itchen and reduce odours.

We raise finance to pay for the construction of new assets and to repay loans taken out in previous years. We cannot rely wholly on raising

new finance in order to pay for the construction of new assets as we also rely upon our shareholders to finance approximately 30% of the funds we require and to also provide the financial buffer we need to absorb financial risk.

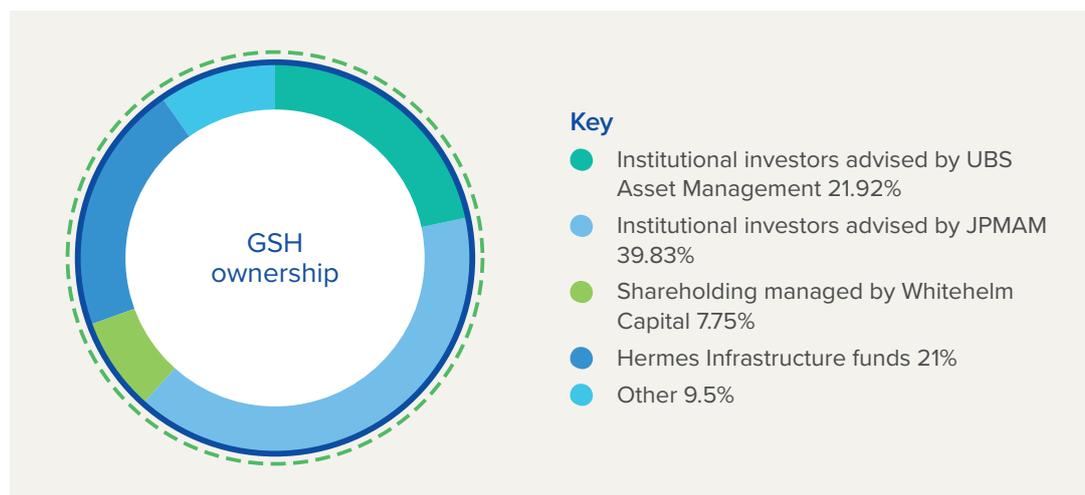
Revenues from our customers are used to meet the costs of running the business (our operating expenditure), the cost of maintaining our assets, and to pay for the interest on the finance we raise and a return on the equity provided by our shareholders. Our economic regulator, Ofwat, ensures that we can only charge our customers for an efficient level of cost, which is benchmarked against our peers.

The charts below illustrate the sources and uses of expected cash flows for the business plan 2020–25 and demonstrate our requirement to raise finance to fund our capital investment programme. The data is based upon the regulatory price determination for 2020–25, which sets out both our performance obligations and the limits on customer bills for this five-year price period.



How we are structured

Southern Water Services Limited (SWS) is a privately owned company and is the principal subsidiary of Greensands Holdings Limited (GSH). All companies in the group are UK tax resident and liable for tax in the UK.



GSH Board

The GSH Board comprises five directors. Three of those members, including the Chairman, are appointed by institutional investors advised by JP Morgan Asset Management; one director is appointed by shareholders represented by UBS Asset Management; and one is appointed by shareholders represented by Hermes. Another shareholder is entitled to appoint an observer to attend and take part, but not vote, at GSH Board meetings. No members of the Southern Water Board sit on the Board of GSH.

The purpose of GSH is to act as a single-purpose entity as the ultimate holding company for Southern Water and the other companies within the group. The GSH Board complements and supports the aims of Southern Water for its long-term success. While certain matters are reserved to the GSH Board and/or shareholders, they do not impact the day-to-day operations of Southern Water and nor do they materially affect Southern Water's ability to function as a company in providing an essential public service.

Ownership

GSH is owned by a consortium of long-term investors representing infrastructure investment funds, pension funds and private equity, and no single shareholder has majority control.

Key

- Institutional investors advised by UBS Asset Management 21.92%
- Institutional investors advised by JPMAM 39.83%
- Shareholding managed by Whitehelm Capital 7.75%
- Hermes Infrastructure funds 21%
- Other 9.5%

Group structure

In September 2007, the Greensands group of companies was established for the purpose of the acquisition of 100% of the share capital of Southern Water Capital Limited, the then ultimate parent company of Southern Water, from the Royal Bank of Scotland (investing £1.9 billion of equity and debt to finance the acquisition).

During 2018–19, additional Greensands financing companies were added to the group structure as part of a financing plan to improve financial resilience of Southern Water ahead of the five-year price review period starting April 2020.

GSH ownership

UBS Asset Management
Shareholding advised by UBS Asset Management, a large-scale global asset manager, offering investment capabilities across all major traditional and alternative asset classes.

IIF Int'l SW UK ParentCo Ltd
A constituent entity of the Infrastructure Investments Fund, a fund advised by JP Morgan Asset Management (JPMAM), a large-scale global asset manager advising institutional investors.

Whitehelm Capital
Shareholding managed by Whitehelm Capital on behalf of Motor Trades Association of Australia and Prime superannuation funds.

Hermes Infrastructure funds
Hermes Infrastructure is part of Federal Hermes International and is a specialist infrastructure manager operating a diversified, well-established, UK-focused shared investment platform. With £4.1 billion of assets under management, Hermes Infrastructure is one of the UK's largest direct investors.

Other
Minor shareholdings held by infrastructure investment companies.

Capital structure continued

Financing in 2020–21

A Sustainable Financing Framework was put in place at Southern Water during 2019–20, which aligns our long-term strategy with our social and environmental commitments. An independent Second Party Opinion is also provided by DNV-GL to ensure alignment with the relevant bond/loan principles and guidelines.

The framework also sets out a robust process for project evaluation, project selection, the management of proceeds and reporting.

The majority of our assets and expenditure on projects and programmes of work fall within the eligible green categories and the eligible social categories taken from the Green Bond Principles and the Social Bond Principles.

We issued our inaugural financing under the Sustainable Financing Framework in May 2020 with a dual tranche public bond amounting to £825 million.

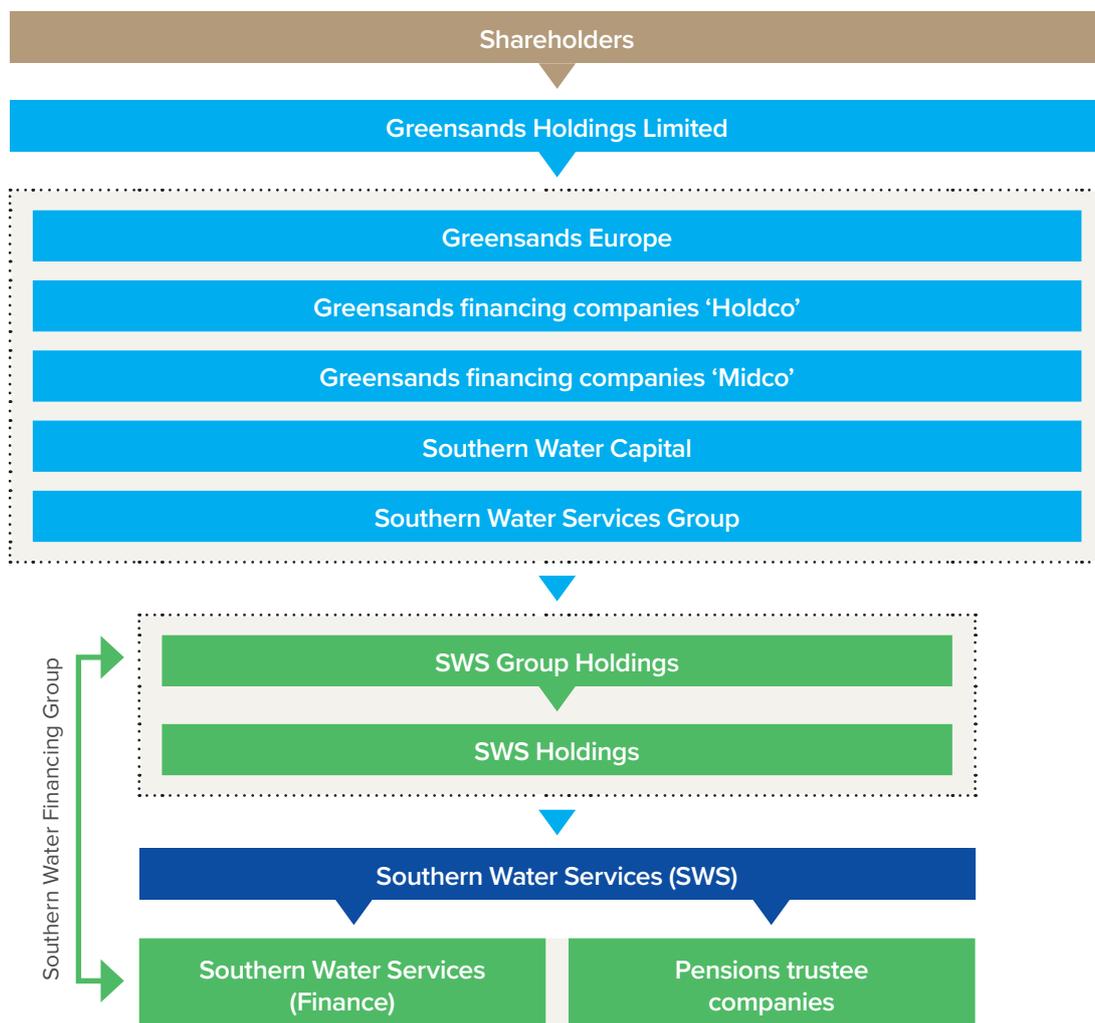
In March 2021, we also issued a further public bond of £300 million under the Sustainable Financing Framework.

The proceeds of these bond issuances were used to repay a £350 million public bond, which matured on 31 March 2021 and will be used to finance the capital investment programme until at least December 2022.

The Greensands financing companies also maintain liquidity facilities, which can provide a short-term source of finance.

The holding company structure for Southern Water is shown in the diagram below and this is followed by an explanation on the next page of the principal companies in the structure.

Southern Water ownership structure summary



Greensands Holdings (GSH)

The ultimate parent company within the group. GSH was established in 2007 for the acquisition of the Southern Water Capital group from RBS by the shareholders. The company is Jersey-registered, but it is UK tax resident and, as such, is liable for tax in the UK. The company was incorporated in Jersey because Jersey law allows greater choice than the UK about the way distributions can be made to shareholders. GSH holds 100% of the share capital of Greensands Europe and has no direct holdings in any other entities.

Greensands Europe (GSE)

A subsidiary of GSH incorporated in England and Wales and resident for tax in the UK. GSE was established to issue bonds as part of the financing for the acquisition of the Southern Water Capital group in 2007. GSE has issued debt, Eurobonds, which are held by our shareholders in proportion to their respective shareholdings. This bond debt meets the eligibility requirements of the 'quoted Eurobond exemption' for tax purposes. The Eurobonds are listed on the International Stock Exchange in the Channel Islands, which is a recognised stock exchange for the purposes of the quoted Eurobond exemption by HMRC. The bonds were issued on this stock exchange for ease of administration, as they are issued to the shareholders of the group and are not traded.

Greensands financing companies 'Holdco'

A number of companies, all incorporated in England and Wales and resident for tax in the UK, were established to provide additional external financing for the acquisition of the Southern Water Capital group in 2007. A further £250 million of additional finance was secured during 2019, the proceeds of which were invested into SWS. The security granted to the lenders of this financing is limited to the share capital of Greensands Holdings Limited. There are no debt guarantees in place between the Greensands financing companies and the Southern Water Financing Group, with the result that SWS is fully protected, and fully isolated, from a default at any Greensands company.

Greensands financing companies 'Midco'

The Greensands Midco group of financing companies was incorporated in 2018 as part of a financial restructuring exercise to improve the financial resilience of Southern Water. The objective of the restructuring was to reduce the total leverage within the Southern Water Financing Group and to reduce interest payments

at Southern Water to help manage financial covenants. The debt issued by Midco companies is senior to that issued by the Greensands Holdco group of financing companies.

Southern Water Services Group (SWSG)

The immediate parent company of the securitised group, which acts as a holding company for this group, following the financial restructuring in 2003. SWSG is incorporated in England and Wales and resident in the UK for tax.

Southern Water Capital (SWC)

The previous holding company for the Southern Water group, established as part of the sale of Southern Water by ScottishPower in 2002. SWC is incorporated in England and Wales and resident in the UK for tax. It does not trade and holds preference shares in SWS, from which it receives dividends.

Southern Water Financing Group

In 2003, following its sale by ScottishPower, Southern Water established a financing structure, known as a Whole Business Securitisation (WBS). The WBS sets strict rules, which demonstrate to investors that Southern Water is a safe and reliable business in which to invest. This structure helps to reduce our financing costs and improves access to long-term and secure sources of finance. Reducing financing costs ultimately benefits customers in the form of lower bills.

In 2018–19, SWS repaid its £400 million of outstanding Class B debt and entered into a deed that no further Class B debt will be issued for so long as Midco debt is outstanding. The £400 million of outstanding Class B debt was repaid out of £700 million of new finance invested into SWS (net of £12 million costs).

The WBS works by creating a ring-fence around the Southern Water business in the form of a financing group. 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 event that either Southern Water or SWSF was to default on its debt obligations, Southern Water would continue to operate as usual. Debt providers are not permitted to either break up or interrupt the business and can therefore only look to a new owner of the financing group to recover their debt in the unlikely event of serious default.

The WBS also sets out arrangements for the ongoing management of the debt issuance

Further details can be found in the GSH Annual Report and Financial Statements which are published at southernwater.co.uk/our-story/our-governance/our-ownership

Capital structure continued

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 WBS arrangements is a limit on the indebtedness of Southern Water and SWSF. This includes precautionary 'early warning' limits, which prevent the payment of dividends if a limit is breached. We seek to 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.

SWS Group Holdings

An intermediate holding company, forming part of the securitised group. The company is incorporated in England and Wales and resident for tax in the UK.

SWS Holdings

The immediate holding company for Southern Water, forming part of the securitised group. The company is incorporated in England and Wales and resident for tax in the UK.

Southern Water Services

This is the only operating company within the group, providing water and wastewater services to customers across Kent, Sussex, Hampshire and the Isle of Wight. Southern Water is incorporated in England and Wales and resident for tax in the UK. It is the company that this Annual Report and financial statements relates to.

Southern Water Services (Finance) (SWSF)

Our financing subsidiary, SWSF, was established for the express purpose of raising debt finance on our behalf under the securitisation in 2003.

Due to administrative reasons applicable at the time of the WBS, it was necessary for SWSF to be registered in the Cayman Islands in order to raise debt listed on bond markets. This original requirement for it to be registered in the Cayman Islands is no longer necessary and we are in the process of closing this company.

SWSF is wholly and exclusively resident for tax in the UK and files tax returns only with HMRC. This means that any profit or loss made by this company is subject only to UK tax.

How we finance the business

In note 20 to the financial statements, we provide an analysis of our outstanding debt at 31 March

2021 and 31 March 2020. Our loans comprise: sterling bonds, issued by our financing subsidiary SWSF and listed on the UK Stock Exchange; other loans, including loans from US insurance companies; bank loans; and a loan from the European Investment Bank.

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 only sterling debt, but will ensure 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% 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% 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% of RCV in any two consecutive years and 40% of RCV within any five-year regulatory period. The maturity profile of loans extends 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), which is an important consideration given that we have negative cash flow generation in the majority of years as a result of our continuing capital investment programme.

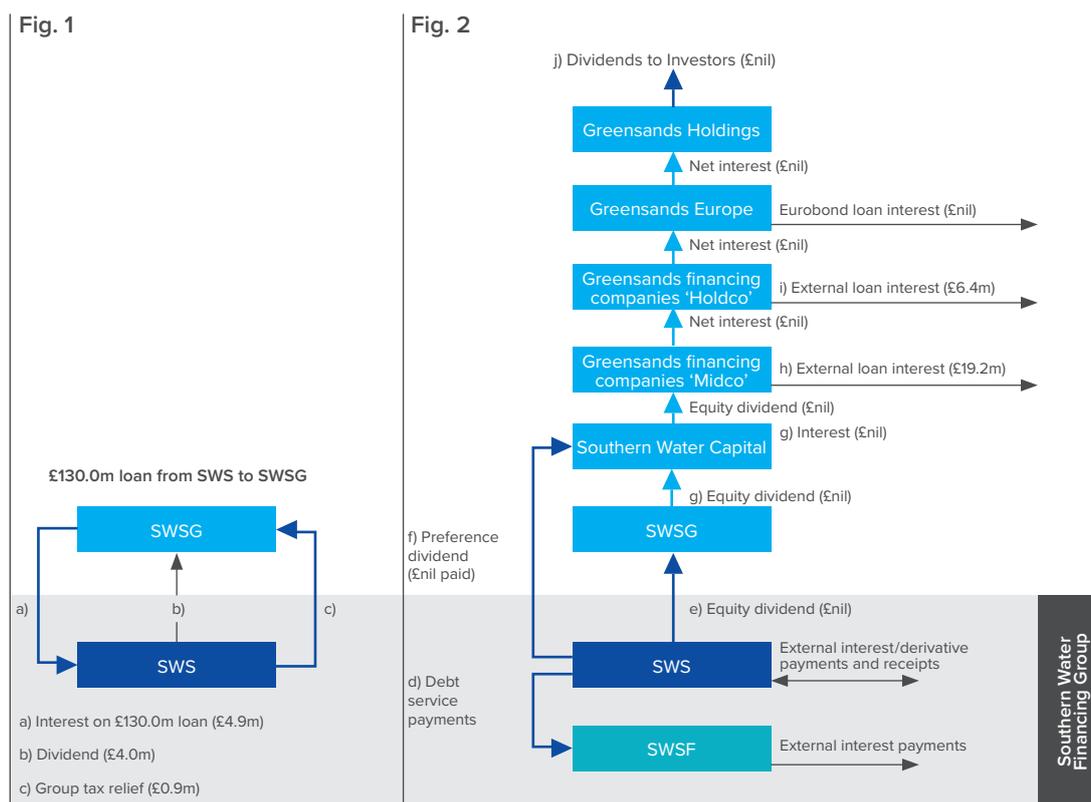
As a result of our prudent liquidity policy, we can have large cash balances at times. We reduce the risk of losing cash on deposit, from bank or fund failure, by setting maximum limits on cash deposits and minimum credit ratings for each bank or fund. Banks must have, as a minimum, a credit rating of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

In addition to our loans, as analysed in note 20, we have in issue a loan with SWSG, which was put in place as part of the refinancing in

2003 (note 15). The original value of this loan was £812.3 million and, as part of the financial restructuring undertaken during 2018–19, £682.3 million was repaid, reducing the balance to £130.0 million.

We received £9.5 million interest on this loan from SWSG during 2020–21, of which £4.9 million was paid and £4.6 million has been accrued at 31 March 2021. In order to enable SWSG to make this payment, it received dividend and tax payments from us. For the year ended 31 March 2021, the dividend was £4.0 million and the tax payment, in respect of the taxable losses incurred by SWSG, amounted to £0.9 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.

Interest and dividend payments 2020–21



The Greensands companies also have their own loans:

- Loans issued by Greensands Finance Limited and Greensands Financing Plc, represented in the diagram below as part of the ‘Midco’ financing companies.
- Eurobonds issued by Greensands Europe.
- The Greensands financing companies also maintain liquidity facilities (£100 million at Greensands Midco financing companies and £40 million at Greensands Holdco financing companies), which can provide a source of finance to pay interest on loans.

The Greensands financing companies comprise

- Holdco:**
- Greensands UK Limited (GSUK)
 - Greensands Junior Finance Limited (GSJF)
 - Southern Water (Greensands) Financing plc (SWGF)
 - Greensands Senior Finance Limited (GSSF)
 - Greensands Investments Limited (GSI)

- Midco:**
- Greensands Finance Holdings Limited (GSFH)
 - Greensands Finance Limited (GSF Limited)
 - Greensands Financing plc (GSF plc)

In summary, SWS has paid £nil to internal companies. Greensands companies have paid external loan interest payments of £25.6m. No interest or dividends have been paid to investors.

Notes:

- Interest receivable by SWS on the £130.0m loan from SWS to SWSG amounted to £9.5m.
- Dividends paid by SWS to SWSG to facilitate the interest payment on the £130.0m loan.
- Payment of group tax relief by SWS for the taxable losses at SWSG.
- Interest payments from SWS to SWSF on the loans taken out by SWSF on behalf of SWS. This is then used by SWSF to pay the interest on these external loans.
- There were no ordinary dividends during the year.
- Dividend payments on the preference shares issued by SWS and repayment of preference share capital.
- Dividend paid by SWC to GSF Ltd to facilitate interest payments on external loans.
- External interest paid by GSF Ltd and GSF Plc, funded from interest receivable and cash held at ‘Midco’.
- External interest paid by SWGF, funded from interest receivable and cash held at ‘Holdco’.
- Dividends paid to investors.

Risks

Risk management is a core component of our wider governance and internal control framework, which provides the overarching structure through which the company conducts its business.

We face a diverse range of risks and uncertainties. Those risks that have the potential to have a material impact on our company are our principal risks. We manage, monitor and report on the principal risks that can impact our ability to deliver our objectives. These risks are described on pages 126 to 139.

Managing risk

Southern Water's approach to risk management is designed to provide a clear and consistent framework for managing and reporting risks associated with our operations, to executive management and to the Southern Water Board. The framework seeks to promote better decision-making, avoid incidents and encourage the best outcome for the company and our customers by allowing us to:

- understand the risk environment, identify the specific risks and assess the potential exposure for Southern Water
- determine how best to manage identified risks to balance overall potential exposure
- take action to manage the risks we do not want to be exposed to, ensuring our resources are effectively and efficiently prioritised and used
- define our appetite for the range of risks and monitor and report risks against our desired risk appetite
- report up the management chain and to the Board on a periodic basis on how significant risks are being managed, monitored, assured and the improvements that are being made.

Risk management embedded in business processes

We want a risk management process that provides a consistent basis for measuring risk to:

- establish a common understanding of risks on a like-for-like basis, taking into account potential impact and likelihood
- report risks and their management to the appropriate levels of the company
- inform prioritisation of specific risk management activities and resource allocation.

All areas of the company review significant risks and business processes to help inform and enable risk-based decision-making. As part of Southern Water's annual planning process, the Executive Leadership Team and Board review the business' principal risks. These may be updated during the year in response to changes in internal and external circumstances.

Risk appetite

The Southern Water Board defines our risk appetite, enabling Southern Water, in both quantitative and qualitative terms, to judge the level of risk it is prepared to take in achieving its overall objectives.

We have aligned our risk appetite to our principal risks, and we have streamlined and simplified the process. This has included a review of our risk categories and our risk assessment criteria and is linked to wider improvements to our risk management framework.

➔ Read more on our operational performance on pages 74 to 99

The risk appetite for each of our principal risks underpins our governance and reporting framework and is reviewed regularly by the Board. The alignment of principal risk with risk appetite allows for an informed analysis and discussion of our risk position and has provided the Board with risk insight to inform key decisions.

As a company we are tolerating a level of risk which is outside our current risk appetite, and is reflected in the review of our principal risks on pages 126 to 139. This can result in more focus on short-term issues rather than longer-term resilience. The Board and the Risk Committee are actively engaged in reviewing and confirming our risk appetite as well as prioritising areas of focus to bring risks within appetite over the next few years.

COVID-19

The COVID-19 pandemic has brought a great amount of uncertainty. However, our role as a provider of vital water and wastewater services has not changed. What has become apparent is our need to be responsive and agile in our plans to protect public health as the pandemic continues to develop.

At the start of the pandemic, we moved in just one week from business as usual to a well-rehearsed Business Continuity Plan running against four simple priorities which have underpinned our COVID-19 response:

- Maintaining provision of essential services at all times.
- Protecting the health, safety and wellbeing of our employees, including our supply chain, and our customers.
- Providing the maximum practicable level of assistance to our vulnerable customers.
- Protecting the financial stability of our business.

The pandemic continues to impact our domestic customers, many of whom are facing uncertain futures and are struggling to pay their water bills. We have supported them in the short term, offering payment breaks and increased access to our support tariffs, while making sure that we monitor and prepare for the potential of increasing bad debt in the long term.

In addition to keeping customers informed, we created a dedicated COVID-19 area on our website, which included a letter from our CEO, Ian McAulay, and answers to common questions about the impact of the pandemic on our services,

changes to our ways of working, and the support available to them.

Our front line employees were identified by the Government as key workers, so we also published details of essential work that would carry on during the lockdown.

COVID-19 continues to challenge all parts of the business. The second lockdown in November 2020 and the third lockdown in January 2021 have stressed the importance of managing this element of risk to the business. All areas continue to monitor, review, and update their risks with reference to the pandemic as appropriate to reflect the latest view of COVID-19 impacts.

COVID-19 risks continue to be reviewed at a monthly risk session. As the pandemic evolves, and in light of government announcements of 22 February, 5 April and 14 June 2021, we are in preparation for the transition out of the national lockdown. We continue with COVID-19 adaptations where appropriate to mitigate continued risks, with regular monitoring and the ability to revert to business continuity mode as required. As the situation could change at any time, regular monitoring and risk assessment will remain in place.

There can be no assurance that the COVID-19 pandemic will not have a material adverse impact on the future of the company, should the situation change with future variants or waves of infection in the UK or other countries.

Brexit

As we moved towards the UK leaving the European Union at the end of December 2020, we undertook significant planning and preparations to ensure that the company was able to maintain its operations. Specific focus was given to our preparations for the supplies of chemicals, asset parts, and logistics. Additional work included preparations to confirm our operations in and around some of our coastal ports (Dover and Southampton) were not disrupted by any transport delays related to border crossings.

As we moved into January 2021, the risks we identified did not materialise and were relatively minor when compared to the scenarios for which we had planned and prepared. There was no significant financial impact.

Risks continued

Emerging risk

To reflect the requirements of the UK Corporate Governance Code, we have identified emerging risks facing Southern Water:

- **Drinking Water Inspectorate (DWI) enforcement regime** – during February and March 2021, the DWI has been consulting on a change to its method of regulatory enforcement. The DWI is considering a new approach to include a punitive financial penalty regime within its regulatory framework. Southern Water is currently subject to a number of DWI notices; this could lead to a risk of additional financial penalties.
- The potential introduction of a UK version of the Sarbanes Oxley Act will require close monitoring, reporting and understanding, to appropriately determine the impact on our business. These changes, which will impact the UK Corporate Governance Code, are not likely to impact until 2025. We are making preparations in this area by reviewing and making improvements to our system of internal control across both financial and non-financial aspects of the company.
- Further mutation and establishment of new variants of COVID-19 significantly impact the recovery of the UK economy or supply chain links in other countries. Additional and prolonged national lockdowns may also be required; this could give rise to increased customer and employee health and wellbeing issues that would need careful management.
- As COVID-19 continues to impact the economy, the potential for long-term solvency issues could see tighter bank lending standards that could impact on both our own ability to raise funds, but also our supply chain.
- As we begin to direct efforts to meet our net zero carbon obligations, there may be legislation and significant costs involved with market-based mechanisms designed to support the process. For example, carbon -offsetting may be cost prohibitive and limit our ability to meet targets.
- Environmental stakeholders are increasing pressure on water companies to limit their impact on the environment. This has emerged as a national debate on the future use of Combined Sewer Overflows and their impact on the environment.

Risk oversight and governance

To successfully embed risk management across Southern Water, the process is supported by a governance structure that defines roles and responsibilities at each level of the company.

The Board has overall responsibility for risk management but discharges this role through the Board Risk Committee. The formal Risk Committee report is included on pages 192 and 193. The committee meets three times a year and allows a detailed focus on risk factors to be discussed.

The Risk Committee advises the Board on the company's overall risk appetite, tolerance and strategy, taking into account the current and prospective regulatory, legal, political, macroeconomic and financial environment. The Board retains ownership and approval of the company's overall risk appetite, tolerance and strategy. The Southern Water Board also has ultimate accountability for risk management in Southern Water.

The Risk Committee oversees and advises the Board on the current risk exposure of the company and future risk strategy. It has a key role in risk assessment, including:

- reviewing the company's overall risk assessment processes that inform the Board's decision making, ensuring both qualitative and quantitative metrics are used
- reviewing regularly and approving the parameters used in these measures and the methodology adopted
- setting a standard for the accurate and timely monitoring of large exposures and certain risk types of critical importance.

In addition, the Risk Committee reviews the company's capability to identify and manage new risk types and reviews reports on any material breaches of risk limits and the adequacy of proposed action.

The Executive Leadership Team (ELT) is responsible for ensuring the corporate risk management system is effective and embedded in the business, and operates in accordance with the Southern Water's risk management approach.

➔ Read more about the Board's role in mitigating risks on pages 192 to 193

Key responsibilities include:

SWS Board	<p>The Board retains overall accountability for risk management in the company</p> <p>Attendees: SW Board members (including Executive, Non-Executive Directors)</p>	↑
SWS Board Risk Committee	<p>Responsible for oversight and challenge of the effectiveness of the risk management environment – meets three times a year</p> <p>Attendees: SW Board members (including Executive, Non-Executive Directors)</p>	↑
Executive Risk Committee	<p>Reviews enterprise risks, risk improvements, strategic risk review – meets quarterly</p> <p>Attendees: Executive committee (ExCom) of the Executive Leadership Team</p>	↑
Executive Leadership Team	<p>Receives monthly updates on operational risk dashboard</p> <p>Attendees: Executive Leadership Team</p>	↑
Enterprise Risk Management and Resilience Team (ERM)	<p>Provides support, guidance, training and management reporting</p> <p>Development, maintenance and embedding of the risk framework</p>	↑
Directorate Risk Forum	<p>Responsible for ensuring that effective risk management is in place and operating across all activities within their remit – meets at least quarterly</p> <p>Attendees: Senior Management team and Delegates</p>	↑

Our transformation

The Board continues to recognise the importance of effective risk and resilience management, champions its use within decision-making forums and is deeply committed to embedding risk management at every level of the organisation. As part of our transformation, we have recognised the need to improve our approach to risk and resilience management. Additional resource and expertise has been brought into the company to support the further development of risk management. A key aspect of this development is the implementation of a new business partnering model developed to ensure teams across the company are supported, facilitating risk-informed insight into day-to-day business activities.

Our Risk Management team has proactively engaged and collaborated with key stakeholders from across the business to identify improvements and enhancement to the existing risk management framework. Through extensive engagement with the Executive Leadership Team, Executive Risk Committee and wider company, a number of areas of improvement were identified.

Risks continued

Transforming our approach to risk management

Framework:

- Collaborating across the company to better understand the needs of the key stakeholders and identify any gaps and inconsistencies in the existing framework.
- Redefining the Enterprise Risk Management and Resilience framework, aligning it to industry best practice in the form of ISO 31000 – Risk Management.

Risk criteria:

- Through engagement with the Board and other key stakeholders, revised criteria for assessing material impact have been developed to be more reflective of our business operations.
- The downside areas of impact for each risk assessed have been refreshed and broadened to reflect our priorities and values.
- The impact descriptions are now more detailed and prescriptive to help teams across the business better understand the downside consequence of risk events.

Risk taxonomy:

- We have refreshed our taxonomy and aligned the structure to our principal risks.
- The new taxonomy allows for clear, enhanced identification and allocation of risk from both a top-down and bottom-up perspective.
- Risk tolerances have been added to each risk component within the risk taxonomy, allowing each element to be confirmed against the Board-approved risk appetite.

Risk appetite:

- The Board has refreshed its view of risk appetite, and it is underpinned by the updated risk taxonomy.
- A new simplified three-band approach to risk appetite has been implemented.
- The refreshed framework now supports the company in understanding where we should be reducing the impact of downside risk, versus those risks where we should or could be seeking risk if there is a possibility of upside opportunities.
- The new approach is being actively used to support decision-making, not least at Board level, where risk appetite is considered on key decisions, including the approval of the latest execution plan.

Roles and responsibilities:

- The Board has championed an approach to managing and owning risk in Southern Water.
- Each directorate's senior management team reviews and monitors its risks and has an established risk forum that meets at least quarterly.
- These forums are actively supported by the Enterprise Risk team, which supports as part of its business partnering approach and provides a forum for focused discussion on risk management, supporting and promoting a dialogue on risk and supporting decision-making.

Data cleanse:

- As part of the wider changes detailed above, a full review of the risk data in our systems was initiated.
- Working with teams across the company, a revised set of priority risks has been identified. The new risk profile has now been shared with senior management, the Executive Leadership Team, the Risk Committee and the Board.

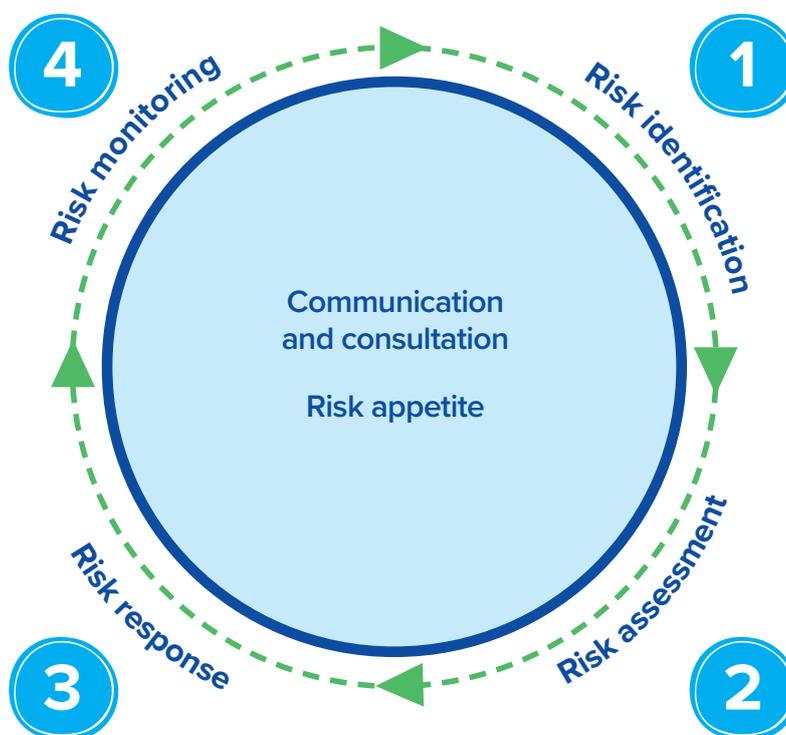
The next 12 months

The coming year will see continued embedding of our risk management approach; it is recognised that our journey is not complete and additional improvements have already been identified to further support risk-based decision-making across the company. This will see effort focused on maturing in a number of areas:

- Continued training with teams across the company, through the use of virtual and workshop sessions.
- To support our approach to risk management, and to deliver on commitments to Ofwat, we are implementing a Governance, Risk and Control (GRC) system. The project solution will provide a robust system to strengthen our risk management improvements and will also support assurance and control work across our Risk and Compliance teams.
- Enhancing our ability to report our risk position is a key focus and priority and will be achieved through the integration of enhanced reporting tools. The ability to extract and tailor assurance data will support the business in fully understanding the risk landscape and its relationship to our risk appetite, helping the company make better, risk-informed decisions.
- The improvements we are making to our risk management approach are setting the company up for future success. As we further embed these improvements, we will be able to demonstrate to our customers and external stakeholders that the decisions we make are considered, well thought through, and demonstrate a continued commitment to our values.

Risks continued

The purpose of our approach to risk management is to support better decisions through an improved understanding of risk.



The objectives of our risk management strategy relating to principal risks are to:

- 1 identify and understand all the principal risks that we face
- 2 select and proactively adopt strategies and plans to address, including seeking opportunities from those risks that deliver the right returns, and understanding their potential impact on the company
- 3 take action to mitigate our exposure to the principal risks, ensuring our resources are effectively and efficiently prioritised and used
- 4 use the analysis of our principal risks to inform our strategy and to monitor and report the risks we are taking against our desired strategic objectives.



Principal risks and uncertainties

Operational risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

1 Water

Description:

We must ensure we can supply enough good quality drinking water to cater for a growing population of more than 2.6 million people across Kent, Sussex, Hampshire and the Isle of Wight.

Should operational water treatment processes fail, the water supply become contaminated, or our water distribution network fail:

- there is a risk that water could be supplied to customers that is unfit for consumption
- large numbers of customers could find their water supply becomes cut off
- harmful chemicals could be released to the environment.

Executive accountability:

Director of Wholesale Water Services

Link to our values:

Doing the right thing / Succeeding together / Always improving

Forecasted business impact:

Long term

Areas impacted:

Customer experience, business disruption, brand and reputation, legal and regulatory, financial

Cross reference:

- ➔ Read more on our business model on pages 52 to 53
- ➔ Read more about how we deliver great service on pages 80 to 85

Risk climate: ●

Our risk profile has deteriorated following the introduction of challenging regulatory targets in the 2020–25 business plan; in particular, the amendment of regulatory limits on the amount of water that can be abstracted for water supply in our western region is proving challenging. Furthermore, increased demand from our customers, particularly within our Sussex North region, during the ongoing COVID-19 pandemic has placed additional stress on our asset infrastructure. In addition, we are now working to challenging performance targets, with respect to leakage, interruptions to supply and Compliance Risk Index (CRI) and Event Risk Index (ERI) and Security of Supply Index (SoSi).

Risk drivers:

- Levels of investment in maintenance and growth schemes to support asset capability and capacity.
- Ageing infrastructure increasing the frequency and severity of asset failure.
- Non-adherence to established processes and procedures when under pressure of operational incidents.
- Challenging regulatory targets from source to tap.
- Management of contracts for operational and maintenance services.
- Fluctuation and severity of weather events.

Mitigating strategy

- New bulk supply arrangement with SES Water and improvements to assets to support resilience in Sussex North.
- Portsmouth and Havant Thicket reservoir to provide additional long-term resilience.
- Water for Life Hampshire – significant capital and asset improvements providing long-term resilience in Western area.
- Introduction of a rolling 12-month strategy plan that identifies the needs of the business to meet its commitments.
- Water First – our improvement programme strengthening internal processes and asset performance.
- Water quality hazard review programme complete at our water production sites, with similar programmes being undertaken at network booster stations and treated water storage assets.
- Maintained ISO 9001 accreditation for continuous improvement.
- Robust and extensive regulatory monitoring programme of samples from source to tap.
- Incident and emergency planning system, process and procedures in place.
- Proactive leakage detection monitoring and reporting.
- Customer education programme supporting an improved understanding of the value of water – Target 100 water efficiency programme.

Operational risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

2 Wastewater

Description:

Our region benefits from a high-quality environment, both inland and coastal. We are fortunate to have some extremely rare habitats, as well as some of the best quality river fishing and coastline in the UK. Reliable wastewater services are essential to maintain public health and protect the environment

Should operational wastewater treatment processes fail, or our sewers and pumping stations become blocked or fail, our assets may discharge sewage, which is not of the required standard, to the environment. This may cause risks to the environment or public health from pollution and/or sewer flooding. There is also the potential to cause damage to the environment or distress to customers. This could lead to prosecution and fines by the Environment Agency and a reduction in stakeholder and customer confidence.

Executive accountability:

Director of Wastewater and Asset Management

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Long term

Areas impacted:

Customer experience, business disruption, brand and reputation, legal and regulatory, financial

Cross reference:

- ➔ Read more on our business model on pages 52 to 53
- ➔ Read more about how we protect and improve the environment on pages 88 to 93

Risk climate: ●

The environment this risk relates to has deteriorated over the past 12 months; this is largely due to increased challenges, specifically in light of increased capacity demand, fluctuations in extreme weather events and challenging regulatory targets that are expected to be more onerous should newly-planned restrictive regulation be implemented. A national debate on the water companies' impact on the environment, and particularly the use of Combined Sewer Overflows has intensified over the last year. This could lead to additional regulatory scrutiny or intervention. We are working to increasingly challenging targets in the business plan period 2020–25, a number of which were not funded in the price review, with respect to wastewater treatment compliance and pollution.

Risk drivers:

- Asset capability performance due to ageing infrastructure.
- Increase in regional power outages.
- Investment requirements to support growth schemes for new housing developments.
- Levels of investment in maintenance and development schemes to support asset capability.
- Meeting the required standards of wastewater treatment and asset management to protect the environment and/or public health from pollution and/or sewer flooding.
- Non-adherence to established processes and procedures when under pressure of operational incidents.
- Drive to meet obligations on carbon neutrality (net zero).

Mitigating strategy

- Pollution Incident Reduction Plan (PIRP) delivery is ongoing and leading to improvements in underlying performance.
- Introduction of a rolling 12-month strategy plan that identifies the needs of the business to meet its commitments.
- Dedicated growth planning team established, tasked with developing plans and strategies that consider long-term resilience over the next 25 years.
- Generator maintenance programme in place with new contract process being embedded throughout 2021.
- Regular testing of power management systems and our back-up generator capacity to ensure continuity of services.
- High voltage equipment maintenance programme in place with external suppliers.
- Customer awareness/education programmes on avoiding blocked drains, targeted at catchments with blockage hotspots.
- Climate Adaptation Plan will be published by December 2021.
- Drainage Water Management Plans (DWMPs) are supporting work to improve drainage and environmental water quality.
- A culture transformation programme to develop a behavioural competency framework for our employees.

Principal risks and uncertainties continued

Operational risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

3 Customer

Description:

Providing an excellent customer experience is a key objective for us. We recognise the importance of prioritising our customers, and that accomplishing our strategic goals is contingent on providing the level of service expected by our customers and our regulators. We may not be able to provide the desired standard of service to our customers if there is inadequate capability in our people, process or systems.

Executive accountability:

Director of Customer Service

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Medium term

Areas impacted:

Customer experience, brand and reputation, legal and regulatory, financial

Cross reference:

- ➔ Read more on our business model on pages 52 to 53
- ➔ Read more about how we deliver great service on pages 80 to 85

Risk climate: ●

The scale of the challenge is significant if the period 2020–25 business execution plan is to be delivered; the spend on Customer Service in 2015–20 is £95 million more than the allocation in the Final Determination (FD) for 2020–25, therefore the scale of improvement required to deliver the FD is significant. Our performance on key performance metrics is improving, although our performance is not where we would like it to be for both key performance metrics (C-MeX and D-MeX).

There has been no significant change in our risk profile during 2020–21. We continue to deliver improvements through our customer transformation plan (Velocity), and supported many of our customers impacted by the effects of the COVID-19 pandemic. Improvements to how we run our developer services channels have also been implemented, strengthening performance in this area.

Risk drivers:

- Customer and wholesale business impact on our C-MeX and D-MeX performance.
- New property builds requiring additional odour mitigation measures.
- Manual processes, which may lead to errors that require automating.
- Potential weakness of third-party customer service providers.
- Transformation project (Velocity) does not deliver in improvement of cost to serve.
- Increased number of growth schemes.

Mitigating strategy

- Our transformation project continues to develop the processes and technology underpinning our customer service.
- Contractual targets in place with key third-party suppliers providing customer service.
- Leadership team-led Operations Committee held monthly tasked with monitoring C-MeX and D-MeX performance.
- Cross-functional C-MeX group ensures appropriate accountability and management focus across the business.
- Dedicated team in place to proactively engage with local authorities and new-build developers to ensure the appropriateness of supply planning and connection.
- Specific incident management process and procedures for customers in the event of service impacts.
- Process in place to support vulnerable customers affected by an incident such as COVID-19 or water emergency.
- Customer insight work to better understand customer requirements.

Financial risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

4 Financial

Description:

Exposure to financial markets and other macroeconomic factors, impacting the ability to accurately forecast and ensure the continued ability to meet our short-term and long-term financial obligations. A failure to maintain certain credit ratings could lead to an increase in interest cost and reduced availability of finance. This could put pressure on our ability to finance our capital investment programme or refinance our existing debt maturities in the future. We only enter into treasury transactions to manage inherent risk and support prudent funding, not to speculate.

Executive accountability:

Chief Financial Officer

Link to our values:

Doing the right thing / Succeeding together

Forecasted business impact:

Medium term

Areas impacted:

Brand and reputation, legal and regulatory, financial

Cross reference:

- ➔ Read more on our business model on pages 52 to 53
- ➔ Read more on our financial performance on pages 102 to 111

Risk climate: ●

Our risk profile has deteriorated due to significant adverse financial impacts as a result of a challenging final determination, and managing the effects of the COVID-19 pandemic with revenue loss through an increase in bad debt and additional COVID-19 related costs.

During the year, we have remained at risk of downgrade in the credit ratings as a result of concern regarding perceived challenges facing the company in delivery of the business plan 2020–25, difficulties in meeting Ofwat Outcome Delivery Incentives (ODIs), and potential fines from the outstanding prosecution from the Environment Agency.

Our current credit ratings are provided on page 111.

Risk drivers:

- Accuracy of forecasts to meet long-term financial liabilities and obligations.
- Ability to access cost effective capital through maintaining an appropriate credit rating.
- Revenue impacts caused by counterparty defaults due to delayed Brexit or ongoing COVID-19 influences.

Mitigating strategy

- Liquidity testing and reporting is carried out on a regular basis, forming part of the going concern assessment.
- Sufficient cash and facilities are maintained to mitigate such risks as bond market closures.
- We ensure the aggregate nominal value of debt maturities does not exceed 40% of RCV in any single regulatory period (and 20% of RCV in any 24 months).
- Flexible dividend policy supports management of financial risk.
- Regular discussion with ratings agencies to evaluate financial health.
- We take each of the main credit agency ratios, relevant for our ratings, into account when setting the plan (one-year, five-year).
- Regular discussion with bank groups and lenders.
- We established a Sustainable ESG Framework during the year, and issued our first dual tranche sustainable bond in May 2020.
- Current borrowings are 'fixed rates' or 'index-linked' and we have no exposure to interest rate rises on our current borrowings.
- We ensure sufficient funds are available for our operational and capital investment programme.

Principal risks and uncertainties continued

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

5 Compliance

Description:

We are a highly-regulated business with three main regulators: Ofwat, the Drinking Water Inspectorate (DWI) and the Environment Agency (EA).

Inadequate culture, structure, capability, governance and assurance could result in failure to meet these high standards consistently. The consequences can be regulatory enforcement, fines, legal action and, in the worst case, the loss of our appointment as a water and wastewater company. As with all companies, we are also required to comply with corporate legislation (for example Competition Law and the Bribery Act).

Existing and changing legal and regulatory requirements encourage the business to operate in an agile way to ensure continued compliance with our obligations.

Risk climate: ●

This risk remains high as a result of regulatory compliance issues, which have been raised by our regulators. We continue to be the subject of intense regulatory scrutiny. We are being prosecuted by the EA for wastewater permit breaches, we have pleaded guilty to charges in court and we are assisting the EA with its investigations into legacy issues relating to wastewater sampling compliance. Further detail on these and the Ofwat investigation can be found on pages 30 and 31 and in our Annual Performance Report.

The DWI and the EA continue to monitor our delivery of regulatory schemes (outputs) and this is likely to continue. Challenging performance on the Compliance Risk Index (CRI) from the DWI, and one-star performance on the EA's Environment Performance Assessment (EPA), is reflected in continued scrutiny from both regulators. Ofwat continues to focus on our ODI performance and compliance with Section 19 Undertakings.

Executive accountability:

Director of Risk and Compliance

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Short term

Areas impacted:

Brand and reputation, legal and regulatory

Cross reference

- ➔ Read more about our regulators on page 30
- ➔ Read more on pages 186 to 193

Risk drivers:

- Failure to comply with the requirements of our Licence of Appointment with Ofwat (including our Section 19 undertakings).
- Failure to meet our obligations with the EA, as reflected in the Environmental Performance Assessment (EPA).
- Meeting our Water Quality obligations as reflected in key performance metrics (CRI and ERI) and DWI notices and enforcement.
- Failure in the ability to embed core controls over key processes, either financial or non-financial.
- Threat of a breach in our business ethics or Code of Conduct by an employee or contractor.
- Protection of data – GDPR.

Mitigating strategy

- Embedding of a robust three lines of defence compliance model and a dedicated Risk and Compliance function.
- Improved training, investment, internal business processes and controls via our transformation programmes.
- Company values linked to culture change programme and performance management, promoting ethical business practice.
- Subject matter experts and mandatory compliance-related training.
- Annual reporting is externally verified by financial and technical auditors to provide assurance on our compliance.
- Technical assurance of front line operations is supported by ISO 9000, ISO 17025 and ISO 14001 accreditation.
- A compliance framework with internal monitoring and assurance and an ethical business framework.
- Compliance with company procedures is reviewed through self-assessment every six months.
- Mandatory training courses are identified and communicated to all employees for completion.
- Contractors sign up to our Code of Conduct and supply evidence of operating within legal and regulatory environment.
- Enhancements delivered across the system of internal control, specifically within the assurance functions.

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

6 Climate change

Description:

The impacts of climate change will continue to increase our related risks of water resources, drought, flooding, and extreme weather events. We supply drinking water to a growing population in areas already classified as under 'severe water stress'.

If we are unable to improve our resilience to the extreme weather events predicted by the physical impacts of climate change:

- we will find it increasingly difficult to supply sufficient water to meet the growing demands of our customers though scarcity of water resources, or contamination by saline intrusion of existing water reserves
- the assets on our sites, or our sewer system network, could more easily be overwhelmed by storm events, leading to flooding or pollution in our region
- our coastal sites may become inundated from rising sea levels or at risk of coastal erosion.

Risk climate: ●

Our risk profile has deteriorated due to continued worsening external climate change factors impacting the ability to supply sufficient water to meet the growing demands of our customers. Ongoing challenges with more stringent, revised abstraction licences in Hampshire, which limits our ability to access water in Hampshire and makes us more vulnerable to weather events. In addition, we have seen the emergence of supply issues in our Sussex North area.

Combating climate change is also about mitigating the causes of climate change. In terms of Southern Water's efforts to join the global response to climate change, we have made a Public Interest Commitment (PIC) to become a carbon neutral (net zero) company by 2030 (as part of the English water companies).

Mitigating strategy

- Public Interest Commitment to become a carbon neutral (net zero) company by 2030.
- Board-approved net zero plan.
- 50-year Water Resources Management Plan, to provide resilience against drought and climate change.
- Drought Plan containing measures to conserve water, operate our sources and secure additional resources.
- In excess of £400 million was invested in the existing water and wastewater infrastructure through 2015–20.
- Established climate change working group.
- Customer campaigns supporting an understanding of the value of water – Target 100 water efficiency programme.
- Investment in new infrastructure, including the Havant Thicket Reservoir.
- Drainage Water Management Plans (DWMPs) supporting work to improve drainage and environmental water quality.
- RAPID process will lead to new investment in the Western Area as part of Water For Life – Hampshire.

Executive accountability:

Director of Environment & Corporate Affairs

Link to our values:

Doing the right thing / Succeeding together / Always improving

Forecasted business Impact:

Long term

Areas impacted:

Customer experience, business disruption, brand and reputation, legal and regulatory, financial

Cross reference

- ➔ Read more on sustainability on pages 63 to 73
- ➔ Read more on environmental disclosures on pages 70 to 73

Risk drivers:

- Failure to adapt to the long-term effects of climate change.
- Challenging regulatory targets.
- Unless there is unprecedented investment, there is an inability to meet the demands of a significantly-increased customer base.
- Onerous and challenging targets to mitigate the effects of our carbon footprint.
- Fluctuation and severity of weather events.

Principal risks and uncertainties continued

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

7 Delivery

Description:

We have a planned investment programme of £2.1 billion between 2020 and 2025. We have plans in place to ensure we will deliver this and we are working hard to ensure our focus is maintained to complete all works on time.

If we are unable to deliver significant parts of the programme on schedule, our ability to provide an excellent service to our customers could be compromised. Any failure to deliver would also prevent us from fulfilling the promises that we have made in our business plan with regard to performance measured by our outcome delivery incentive measures, along with commitments to our regulators.

Executive accountability:

Director of Engineering and Construction

Link to our values:

Succeeding together / Doing the right thing / Always improving

Forecasted business impact:

Medium term

Areas impacted:

Customer experience, brand and reputation, financial, people

Cross reference:

➔ Read more on about how we are getting fit for the future on pages 96 to 99

Risk climate: ●

The scale of the requirements of the capital investment delivery programme, combined with a tight financial settlement in the period 2020–25, has increased risk in this area.

Our risk profile has deteriorated due to the size and scale of the requirements of the capital investment delivery programme, during the unprecedented time of managing the effects of the ongoing COVID-19 pandemic. The financial pressure on the capital programme, plus stringent requirements from regulators to deliver extensive programmes of work, has seen an increase in risk in this area. Key recent focus has been on delivery of our WINEP obligations and on key notices from the DWI.

Risk drivers:

- A tight Financial Determination from Ofwat has put pressure on capital delivery budgets.
- Delivery delays as a result of on-site restriction and COVID-19.
- Supply chain restrictions as a result of Brexit.
- Challenging delivery efficiencies that are required to deliver value for the wider business.

Mitigating strategy

- We have brought significant investment capability in-house including:
 - an embedded engineering and capital delivery function
 - an established long-term delivery partner supply chain.
- Enhanced management information procedures ensure the delivery of the business plan is given the greatest level of focus.
- Risk and value are considered at each step of the investment cycle to provide best value for money to our customers.
- Enhancing and continuously developing our asset planning systems, processes and capabilities.
- Monitoring the delivery of our final determination obligations, continually assessing our financing status.

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

8 Information Technology (IT)

Description:

If we do not maintain the resilience of our operational and enterprise IT systems, their failure could have a significant impact on our business reputation, ability to operate, and the resilience of our operational assets.

Additionally, we hold and process personal and payment data about our customers and employees, so it is important that we treat this information with respect and in accordance with the requirements of information governance.

Failure to properly protect the data we hold could lead to reputational damage and loss of confidence from our customers, as well as significant fines under Data Protection (GDPR) and the Network and Information Systems (NIS) Directive.

Risk climate: ●

There has been no significant change in the risk climate, notwithstanding managing the effects of the COVID-19 pandemic by providing additional IT infrastructure, hardware, and other key equipment to support remote working. Although, there is a heightened risk of cyber attack that could disrupt our key systems.

We continue to rebuild our IT capability. This transformation has been ongoing for the past four years and has featured in-sourcing of our IT capability and seen an improvement in our IT estate.

Executive accountability:

Managing Director

Link to our values:

Doing the right thing / Always improving / Driving results

Forecasted business impact:

Long term

Areas impacted:

Customer experience, business disruption, brand and reputation, legal and regulatory, financial

Cross reference:

➔ Read more on our business model on pages 52 to 53

Risk drivers:

- Lack of cyber security controls and monitoring in place for business systems.
- Technology failure through the use of, and dependency on, legacy systems.
- Appropriate business continuity processes to reduce any impact on our IT systems.
- Mishandling or deliberate sabotage of employee or customer data.
- Non-compliance with NIS directive requirements.
- Inability to monitor and manage operational functions (telemetry and control) or to provide IT-supported customer services, including billing or new service provision.
- Weakness in the security of our telemetry network, where physical access to the network can be obtained.
- Malicious attacks from sabotaged plant activity or the loss of control of major site systems.

Mitigating strategy

- We have implemented two new data centres – these are focused on resilience and protecting our core services.
- Active programme for migration of services off heritage infrastructure and onto new fully-managed infrastructure.
- Migration of existing critical and core service solutions to the new data centres which are focused on resilience, protecting core services and preventing issues before they occur.
- Enhanced suite of IT general controls identified following alignment to the Network and Information System – Cyber Assessment Framework.
- Mandatory business-wide cyber security and data protection training provided to all employees.
- Information Governance Council with the responsibility of oversight and governance of our GDPR and NIS compliance.
- Continued investment in cyber threat mitigation strategies in response to the ever-changing risk landscape.
- Cyber-security investment to implement new tools and processes.
- New end-user Windows 10 and virtualised desktop roll-out.

Principal risks and uncertainties continued

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

9 Resources

Description:

The nature of our business model includes the use of long-term contracts for the provision of critical goods, services and works, as well as some outsourced activities. Some of our most critical resources include the supply of chemicals, fuel and spare parts to ensure continuity of service, as well as the energy required to power our operational equipment on a continuous basis, at a commercially viable price.

There is a risk that a failure to have the required external market capability and capacity would lead to Southern Water being unable to deliver its committed obligations, required efficiencies in our business plan, and a return for our shareholders. There is a risk that a failure to have an effective resilient energy model in place will lead to power interruption at our sites and subsequent operational interruption, and cost inefficiencies.

Executive accountability:

Managing Director

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Short term

Areas impacted:

Business disruption, brand and reputation, financial

Cross reference:

➔ Read more about our COVID-19 response on page 15

Risk climate: ●

In light of the COVID-19 pandemic and conclusion of Brexit, there has been no significant change in the risk climate.

Risk drivers:

- Failure to effectively manage third-party suppliers and contracts to ensure availability of critical chemicals and services.
- Ineffective assessment of supplier criticality and resulting vendor management plan thereafter.
- Lack of central monitoring of supplier base and related performance versus contractual terms and service levels. Failures in due diligence process when tendering or on-boarding new suppliers.
- Cost inefficiencies through the use of multiple suppliers contracted to deliver similar or the same products and services.
- Failures through non-compliance with internal policy when procuring goods and services from suppliers.
- Lack of a swift reconciliation of projects following closure, leading to financial claims by suppliers.
- Failure to have an effective resilient energy model in place would lead to power interruption at our sites, subsequent operational interruption, and cost inefficiencies.

Mitigating strategy

- Supplier procurement framework in place that mandates the processes required to be completed, including management approval and sign-off in line with authority levels.
- Processes in place to identify key suppliers with additional alerts and monitoring processes in operation.
- A reconciliation hub for completed projects has been implemented to ensure accounts are completed.
- Working group established to review alternative key sourcing options.
- Key working groups established and operational to manage the effects of Brexit and COVID-19.
- Each business function has a continuity plan in place in the event that the supply of critical resources from our suppliers is interrupted. The plans will include identification of alternative suppliers or stockpiling of necessary resources (e.g. chemicals) supported by our dedicated contract and supplier managers.
- We created a new centralised Contract and Supplier Management capability.
- The Supplier Relationship Management framework is in place, which covers principles to drive the right collaborative relationships with our key supply chain partners.

Operational risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

10 Health, Safety, Security and Wellbeing

Description:

The health, safety, security and wellbeing of our employees and the public while we provide our services is of the highest priority. The nature of our work requires that our employees and contractors undertake activities or use equipment which, if uncontrolled, have the potential to cause significant harm.

Failure to comply with our Health and Safety Management System and associated procedures could result in death, serious injury or adverse health effects. We could be liable for prosecution under the Health and Safety at Work and Corporate Manslaughter Acts, civil claims and employers' liability and professional liability.

Executive accountability:

Chief Executive Officer

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Short term

Areas impacted:

Business disruption, brand and reputation, legal and regulatory, financial

Cross reference:

➔ Read more on pages 57 to 58

Risk climate: ●

There has been no significant change in our risk profile during 2020–21.

We have seen an increase in reported instances this year; however, this reflects improvements in our reporting of incidents which is giving us a much more accurate view of our level of risk.

Risk drivers:

- Incidents as a result of deteriorating assets, trips and hazards.
- Lack of training and controls to prevent incidents through poor behaviours and the handling of hazardous materials.
- Environmental from damage, disturbance and nuisance as a result of business activities.
- Integrity of dams and reservoirs.
- Threats to asset security and personal safety due to unexpected incidents.

Mitigating strategy

- Clearly defined strategy, safety protocols and standards are set to help prevent injury and occupational ill health to our employees and contractors, and are continuously reviewed and changed in line with legislation and industry best practice.
- Site safety inspections and audits to assess working practices and equipment.
- Supplier and delivery partner performance is monitored to ensure they meet our standards and expectations for health safety and wellbeing.
- Mechanism for reporting near misses and lost-time incidents, with follow-up investigation process, established.
- Health, safety and wellbeing performance and compliance is monitored and reported monthly to the Executive Leadership Team and the Board.
- Mandatory health, safety and wellbeing training for all employees, including mental health awareness training.
- Employees have access to a digital mental health platform 'Unmind' and Mental Health First Aiders.

Principal risks and uncertainties continued

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

11 Corporate affairs

Description:

During recent years, there has been a significant focus on the water industry at a political and regulatory level. Failure to effectively monitor and adapt to any changes in our regulatory frameworks, or a failure to influence change to the political or regulatory landscape, may lead to potential unforecasted increases in administrative costs, reduced revenue, and ultimately non-compliance. Our current business plan and approved pricing structure runs until 2025. The Final Determination has stringent financial constraints, performance incentives and targets, making longer-term resilience more challenging.

There is a risk that changes in the political landscape (e.g. Brexit) may cause costly consequential impacts on the water sector to which we will have to adapt.

Risk climate: ●

Risk maintained following Ofwat's Final Determination and potential changes in future regulatory environment and future price reviews. There has been no significant change in our risk profile during 2020–21.

Executive accountability:

Director of Regulation

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Long term

Areas impacted:

Customer experience, brand and reputation, legal and regulatory

Cross reference:

➔ Read more on page 50

Risk drivers:

- Inability to meet assumed performance as reflected in Operational Delivery Incentive (ODI) performance.
- Ineffective regulatory change horizon scanning.
- Lack of influence in shaping the outcomes of change.
- Ability to adapt and transform the business to meet the changing environments in which we operate.
- Inability to influence the perception of the business, following past events.

Mitigating strategy

- Closely monitor developments in the requirements from all of our regulators on key issues.
- Maintain close dialogue with the Government, Ofwat and other regulators on key issues.
- Work with our customers to understand their perception of our delivery, and future ambitions.
- Continue to engage constructively with all of our regulators in regards to the water scarcity challenges we face in the South East of England.
- Assessing the outputs of the appeals to the Competition and Markets Authority by four companies in the sector against their final determinations, and their implications for the next price review.
- Work with our regulators on how we better understand and address our customers' needs to enable successful outcomes in the next price review period 2025–30.
- Meeting new environmental priorities such as carbon net zero.

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

12 Transformation

Description:

The business is committed to delivering the level of service our varied stakeholders expect and deserve. Our ongoing transformation programme, and the degree of change it brings, can lead to risk and opportunities, which we will closely monitor.

The business is delivering a significant volume of change required to transform the business over the 2020–25 period. There is a risk that these business changes will not lead to delivery of efficiencies, improve our general performance, and support our incentive performance.

Due to financial constraints, and the impacts caused by the COVID-19 pandemic, our ability to conclude and sustain the volume of change could be impacted due to further restraints in capacity or capability. As a result, we may not be able to effectively coordinate the required changes, which might result in the possible failure to deliver some customer promises, including financial targets and incentives.

Executive accountability:

Managing Director

Link to our values:

Doing the right thing / Always improving

Forecasted business impact:

Medium term

Areas impacted:

Customer experience, business disruption, legal and regulatory, people, financial

Cross reference:

- ➔ Read more on our progress on pages 26 to 27
- ➔ Read more on sustainability on pages 63 to 73

Risk climate: ●

There has been a deterioration in our risk profile during 2020–21 – our execution plans are comprehensive but also challenging, and the financial pressure on the company as a whole will be substantial. This is notwithstanding managing the effects of the COVID-19 pandemic, ensuring that our employees and contractors are able to carry out their work safely.

Risk drivers:

- Failure to deliver transformation and realise strategic benefits.
- A lack of governance in the management and delivery of business-wide transformation programmes.
- Negative impact on employee morale and fatigue through continued change.
- Ability to attract and retain the right skills to get optimum value from our people.
- Failure to appropriately train and develop employees to retain key capability.

Mitigating strategy

- Several strategic projects have been initiated to support the delivery of efficiencies.
- Comprehensive approach to the development of our execution plan that includes a range of activity to support the realisation of strategic benefits.
- A high-level strategic talent review has been completed across the organisation.
- Workforce planning analysis that has captured external market trends and labour statistics has been completed across the business.
- Control Transformation Project underway which includes People Plan.
- Annual workforce planning process to be implemented, which will review existing workforce, obtain market insight on industry needs and identify critical data feeds.
- Talent review board to be put in place to provide insight to senior management of the future business capability and capacity needs.
- Plan to develop People Plans for each directorate and functions to identify skills for the future that will feed into the overarching HR People Strategy.
- Transformation portfolio, office, and governance forums established.
- All business initiatives are developed with standard processes, ranked in order of priority, resources and wider business impacts.
- Annual engagement surveys are used to assess our employee satisfaction, with action plans developed to identify and improve any areas of concern in the business.

Principal risks and uncertainties continued

Corporate risk

Risk Climate Key: ● Deteriorating ● Stable ● Improving

13 COVID-19

Description:

The COVID-19 pandemic has put unprecedented pressure on the overall operation of the organisation. This has impacted all areas.

However, we have moved quickly to ensure we maintain service levels to our customers and are ensuring that our employees and contractors are able to carry out their work safely. We have provided payment breaks to support customers during challenging financial circumstances. The move to home working for a large proportion of our employees has impacted the way we work. If uncontrolled, COVID-19 would have potential to cause significant harm to our ability to carry out our essential services and put our colleagues at risk of becoming ill.

Risk climate: ●

Coming on top of a very tight Final Determination, the COVID-19 pandemic has impacted the way we carry out our business and has presented significant challenges to our finances, our ability to provide our essential services to customers and meet regulatory targets and expectations. In addition, the risk has led to us transforming the way we do our business with increased remote working and additional processes to enable safe field-team working.

Executive accountability:

Chief Executive Officer

Link to our values:

Doing the right thing / Always improving / Succeeding together

Forecasted business impact:

Short term

Areas impacted:

Customer experience, business disruption, legal and regulatory, people, financial

Cross reference:

➔ Read more about our COVID-19 response on page 15

Risk drivers:

Failure to manage this risk could lead to the realisation of a number of issues including:

- Colleagues could be at risk of COVID-19, anxiety or other health and wellbeing issues.
- Our supply chain could not meet our needs, with the consequential impact upon our services.
- Operational failures due to resource gaps, chemical supplies/parts restrictions and customer demand increases/behaviour change could impact our essential services to customers of water supply, wastewater collection and customer contact.
- Managing concurrent events (e.g. asset failure, heat wave, property flooding) during COVID-19 will be more challenging due to additional social distancing and/or the increased number of vulnerable customers that will need additional support.
- Operational performance or regulatory duty issues linked to COVID-19 could result in challenges associated with regulatory penalties (ODIs) or other regulatory action such as enforcement or prosecution.
- Adverse financial impact due to revenue loss, increased bad debt and additional COVID-19 costs.

Corporate risk

13 COVID-19 continued

Mitigating strategy

We have developed a COVID-19 continuity plan, which is reviewed and adjusted as appropriate. All decisions and changes implemented as a result of COVID-19 are managed through existing governance processes.

At the start of the pandemic, we moved in just one week from business as usual to a well-rehearsed Business Continuity Plan running against four simple priorities which have informed our COVID-19 response:

- Maintaining provision of essential services at all times
- Protecting the health, safety and wellbeing of our employees, including our supply chain, and our customers
- Providing the maximum practicable level of assistance to our vulnerable customers
- Protecting the financial stability of our business.

In terms of our domestic customers, many are facing uncertain futures and are struggling to pay their water bills. This means we supported them in the short term, offering payment breaks and increased access to our support tariffs, while making sure that we monitor and prepare for the potential of increasing bad debt in the long term.

To keep customers informed, we created a dedicated COVID-19 area on our website, which included a letter from our CEO, Ian McAulay, and answers to common questions about the impact of pandemic on our services, changes to our ways of working, and the support available to them. Our front line employees were identified by the Government as key workers, so we also published details of essential work that would carry on during the lockdown.



Viability statement

Southern Water Services (SWS) is a regulated utility which is characterised by a long-term investment horizon, over multiple-price control periods with stable revenues. Ofwat sets price controls for five-year periods, which reduces the potential for variability in revenues from the regulated business. The company benefits from a rolling 25-year operating licence which, it is assumed, will not be revoked.

Ofwat regulates the water industry in England and Wales and has a statutory obligation to ensure that water and wastewater companies can finance their functions. In addition, the regulator has a primary duty (under the Water Act 2014) to ensure that water and waste companies have the long-term resilience to meet the needs of customers.

In preparing the long-term viability statement (LTVS), Southern Water has conducted an assessment covering the period up to March 2030. The analysis has taken into account current performance, planned performance improvements, funding of the defined benefit pension scheme and the principal risks that affect the business as documented in the Strategic Report on pages 126 to 139, including the ongoing impacts of COVID-19. Stress tests on downside scenarios, which were developed with reference to a risk weighting of the likelihood and financial impact of principal risks, were performed as well as consideration of the gearing sharing mechanism. These considered both individual and combined scenarios. Additional detail on this analysis is provided below. Mitigating actions to reduce the magnitude of these risks and the effectiveness of these actions were also considered.

The analysis has also taken into account the long-term financing needs of the business, including the maturity profile of existing debt, which extends to 2056, and the restructuring activity conducted in recent years to support long-term financial viability.

New finance of £1,125 million was raised during 2020–21 under our financing sustainability framework which ensures proceeds are used for environmental, green, and social purposes, including the repayment of debt issued for the same purpose. Future financing plans assumed for the long-term viability statement includes £2.5 billion of new finance used for the capital investment programme and the scheduled repayment of debt maturities during this period.

Assessment period

For the 2020–21 LTVS, the Board continues with a forward-looking term up to 31 March 2030. This is in line with Ofwat expectations and industry-practice. The period to 2025 is reasonably certain, given SWS has accepted the commitments and

customer promises in the Final Determination for 2020–25 and the SWS Board has agreed an execution plan for the period to March 2025.

The Board, however, notes that analysis of resilience over the period 2025–30 is highly uncertain. A high-level plan was produced for the period from 2025–30 as part of the business plan submission to Ofwat in 2019. The main purpose of this plan was to provide an indication of future customer bills and also to provide a reasonable basis for an assessment, albeit recognising that the period to 2030 is inherently uncertain, given the likelihood of further evolution of the regulatory framework and the potential impact from, as yet, unknown factors which may affect the shape of the plan. Moreover, cost allowances, performance challenges and returns are yet to be set, implying a wide range of potential outcomes.

Stress tests

The ‘principal risks’ identified (pages 126 to 139) are recognised as the key risks facing SWS and those that will have the greatest impact on the business. These are regularly reviewed by the Board. Based on the principal risks, the following risk factors are considered to have a negative impact on the financial position of SWS.

- **COVID-19:** the impacts of COVID-19 and the resulting effect of revenue recovery have been assessed.
- **Outturn inflation is different to forecast:** SWS’s financial projections are sensitive to inflation scenarios, given the nature of its index-linked swap portfolio.
- **Outcome Delivery Incentive (ODI) penalties:** These may materialise as a result of under performing on performance commitment targets set by Ofwat, which are significantly more challenging compared to the previous price control.
- **Totex overspend:** Totex overspend has been considered carefully in light of the more challenging cost allowances set in the PR19 Final Determination as well as unexpected costs from incidents such as severe weather, cyber security events, pension deficit contributions and major operational events.
- **Retail:** The the companies may underperform due to factors such as bad debts, which has increasingly been an issue recently, given COVID-19.
- **Financial penalties:** This captures the risk of exceptional events, i.e. companies receiving (non ODI) fines from Ofwat, or through the Court for matters related to the EA or DWI.

The likely financial impact of these risks has been estimated and used in the construction of severe, but plausible, downside scenarios. In developing these scenarios, we have considered

combinations of risk factors and taken into account potential correlations between risk factors.

Stress test	Link to principal risks	Specification of stress test
COVID-19	COVID-19	The scenario assesses the impact of the revenue and liquidity risk in the short term resulting from costs incurred and the revenue true-up profile.
ODI penalty	Water and wastewater delivery	ODI penalties resulting from failing to deliver on performance commitments due to operational failures.
Totex underperformance	Regulatory and corporate affairs Resources Water and wastewater Customer Delivery IT Health, safety and wellbeing Compliance	Additional Totex resulting from unplanned costs associated with extreme weather events, asset failure, operational failure and pension deficit funding or a decision to invest over and above the allowances in the Final Determination.
Macroeconomic shock – low inflation	Financial	Inflation -1%
Macroeconomic shock – high inflation	Financial	Inflation +1%
Combined operational scenario	Water and wastewater Customer Delivery	Totex overspend and ODI penalties resulting from operational shocks, and high inflation.
Severe scenario (high inflation)	Resources Water and wastewater	Totex overspend and ODI penalties resulting from combined risks, e.g. operational failure, regulatory fines, failure of key IT infrastructure, data breaches and financial penalties, under high and low inflation scenarios.
Severe scenario (low inflation)	Customer IT Health, safety and wellbeing Compliance Delivery	

Assessment of results and mitigating actions

There is limited financial flexibility within the current credit ratings for Southern Water, given a negative outlook and a rating watch on two of the credit ratings, and the other rating at minimum investment grade. There is a risk of a further downgrade if SWS is unable to deliver its planned improvement to operational performance and business efficiency for the remainder of the current regulatory period to March 2025.

A Trigger Event (under the Common Terms Agreement) would occur if either of the negative outlooks are acted upon, and a dividend restriction under our Licence of Appointment would occur where a credit rating negative

outlook is assigned to the lowest investment grade credit rating. A Trigger Event would result in restrictions on the payment of dividends.

The analysis of the downside sensitivities included the impact on the group financial metrics, debt covenants and the likely impact (if any) on external ratings. In all of the scenarios and sensitivities tested, the Board's assessment is that the business would remain viable, even though in a number of the combined downside scenarios there would be a downgrade in external ratings. In anticipation of these potential risks, Southern Water has obtained a waiver from its Lenders to continue to access permitted financial indebtedness to refinance

Viability statement continued

the business, even in a downgrade Trigger Event scenario, which would have been the other key restriction on the company's operations. This is for the current regulatory period to March 2025 and it is assumed that either this would be granted in the following regulatory period to March 2030 or that it is not required or other mitigating action could be taken in this timeframe. In most of the downside

scenarios, the impact on projected metrics is not sustained over the medium term, which would likely support an investment grade outlook.

For each of the scenarios tested, we have identified appropriate mitigating actions in the event that stress tests would result in projected metrics deteriorating materially. These mitigating actions are set out in the table below.

Description of risk	Scenario	Potential mitigating actions
Costs incurred are higher than allowed in the FD	Totex underperformance	Costs to be mitigated by a separately identified risk contingency within the delivery plan to 2025.
Underperformance on ODIs and totex	Combined operational scenario	SWS identifies and implements further sustainable cost savings and reviews discretionary expenditure.
Severe event – totex overspend, ODI penalty and high inflation	Severe scenario (high inflation)	Cost to be mitigated by a separately identified risk contingency within the delivery plan to 2025.
Severe event – totex overspend, ODI penalty and low inflation	Severe scenario (low inflation)	Discuss impact on debt covenants with lenders and seek a temporary waiver if necessary.

Viability

The Board has assessed the viability of SWS to the period March 2030. In doing so, it has considered SWS's current position, the principal risks facing the company and resulting stress tests, and the impact of mitigating actions.

The other companies in the wider Greensands group are principally in place to support the viability of the regulated business. The Board has taken into consideration the activities of other group companies (pages 112 to 117) as well as the overall group structure and is satisfied that it poses no additional risk to the financial flexibility of SWS.

In making their assessment, the directors have assumed capital markets will be available to provide funding for the significant ongoing capital investment programme as well as for the refinancing of debt, credit facilities and financial derivative maturities when they fall due. The directors anticipate the ability to efficiently raise new finance and a stable and supportive regulatory environment.

The Board is satisfied that it has sufficient information to judge the viability of the company, and has a reasonable expectation that the company will be able to continue to operate and meet its obligations over the period to March 2030.

Governance and assurance

The Board has reviewed the medium-term plan and reviews the company's principal risks from a strategic perspective, which form the basis of the stress tests modelled.

The Audit Committee supports the Board in reviewing the results of the analysis as part of its normal procedures. To support the Board in its assessment, third-party assurance was obtained over the calculations and stress tests applied to the financial projections for the LTVS.

The Strategic Report, including the directors' Section 172(1) statement on pages 20 to 143, was approved by the Board of Directors on 30 June 2021 and signed on its behalf by Richard Manning, General Counsel and Company Secretary



Richard Manning
Company Secretary

30 June 2021



Corporate governance



Contents

Chairman's statement	146
Board of directors	148
Our approach to governance	154
Corporate governance report	157
Director's remuneration report	194
Director's report	212

Chairman's overview



“ This year has seen one of the most significant events of many of our lives, with wide-ranging changes and adjustments to both our personal and working lives as a result of the continuing impact of the COVID-19 pandemic ”

Keith Lough
Chairman

Southern Water has had to rapidly adjust to the 'new normal' in terms of its operations and the near-immediate need for its workforce, wherever possible, to work from home.

Not surprisingly, therefore, the impact of the pandemic has been one of the key underlying themes of the discussions at the Board throughout 2020–21. However, while COVID-19 has had, and will likely continue to have, a significant impact, the Board has spent much of 2020–21 focusing on the future to ensure that Southern Water can continue to deliver for its customers, local communities and the environment over both the current five-year business plan period and beyond.

Delivering for customers

Even prior to the impact of COVID-19, the Final Determination by Ofwat for the 2020–25 period represented a tough set of circumstances for the company in delivering on its plans. Therefore, much effort over the past year has been spent on refining and improving our execution plan, which not only seeks to deliver on the company's ambitious plans, but does so within the financial envelope set by Ofwat.

As such, the company has carried out significant work, supported by the Board, in ensuring that it delivers the right projects and does so in a manner that is timely, appropriate and delivers the right solution to the issue. This process has involved a material shift in terms of the Board's view of risk and the types of assets to be procured by the company. In addition, there has been a need to change the company's culture such that more proactive expenditure is undertaken upfront to prevent having to expend ultimately greater sums and effort further down the line. An example of this was the decision to contract for tankers at the beginning of the summer to ensure that these resources were available should the need arise, which represented something of a step change in terms of the company's approach.

In addition, the Board spent much time over the course of the year discussing further transformational activities to ensure that the company can deliver in the most cost-effective manner, including a number of potential organisational changes and the introduction of a new integrated facilities management function.

Our culture

One of the key lessons from both the settlement reached with Ofwat and the ongoing prosecution by the Environment Agency was that a culture had been able to exist within Southern Water, which did not in any way align with either its values or the expectations of society more generally. Therefore, one of the main priorities of the Board is ensuring that not only that there are no repeats of such actions, but also that they are unthinkable in terms of the views and opinions of our workforce and organisation. Accordingly, the company's culture is one of the most important factors over and above the more formal, legalistic or compliance-based solutions. After all, if a company's workforce is motivated by the right cultural, ethical and moral perspective, such actions should not occur in the first place.

As a result the Board has spent much time considering and developing appropriate measures of culture to ensure that it truly reflects our purpose, vision and values. While these metrics have been in development, the Board has, nonetheless, monitored the culture of the organisation through mechanisms such as employee surveys, weekly ‘conversations’ between all employees and the Chief Executive as well as through the activities of Kevin McCullough, who was appointed director with the remit of communicating the views of the workforce to the Board.

Delivering for the environment

Owing to the nature of our operations, protection of the environment and steps to reduce our impact are essential components of our ability to continue to deliver water and wastewater services for our customers.

The Board has devoted much time this year to discussing and agreeing ways in which we can improve on our arguably poor historical performance in areas such as pollution incidents. As such the Board has agreed a new Pollution Incident Reduction Plan incorporating changes to our operations in order to both reduce the number of incidents resulting in pollution, and also take proactive steps to ensure that such incidents, wherever possible, do not occur in the first place, or, if exceptionally they do occur, the impact is mitigated.

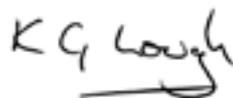
In addition, the Board is fully aware of the increasing strain on water resources in the South East as a result of factors such as increasing development in the region and climate change. As such, the Board was heavily involved in the development of the plan and agreement with Portsmouth Water to construct a new reservoir at Havant Thicket in order to alleviate the water supply situation in the region. Furthermore, the need to address water supplies in the west of Hampshire has also featured frequently on the Board’s agenda, including the potential construction of a desalination plant at Fawley.

One of the key outputs from the Board this year in terms of the company’s longer-term environmental impact has been the agreement of certain steps representing our environmental ambition for the future, including a commitment to net zero carbon by 2030, which would place the company at the forefront among those seeking to reduce their impact and help mitigate climate change. In addition, our ambition seeks to implement steps to significantly improve Southern Water’s performance in terms of its impact on the environment, as well as working with other stakeholders in the region, such as farmers, to protect water courses and bathing waters.

Improving corporate governance

Southern Water is expected to meet the objectives set out in the Board leadership, transparency and governance principles issued by Ofwat (the ‘Ofwat Principles’). The principles make an important contribution not only to set consistent expectations for the sector, but also in terms of driving improvements. The Board noted the feedback published by Ofwat in February 2021 in respect of how companies had met the objectives during the 2019–20 reporting year. The Board believes that it has met the objectives of the Ofwat Principles and, on pages 154 to 156, we set out a summary of our compliance with the Ofwat Principles, together with relevant cross-references.

Finally, the Board has further sought to embed more consistently its consideration of section 172(1) factors in its decision-making. Our section 172(1) Statement can be found on pages 66 to 69.



Keith Lough
Chairman

30 June 2021

Board of directors



Keith Lough Chairman

Non-Executive

Independent: On appointment

Committee membership:

N

Date of appointment:

01/08/2019

Experience:

Keith has extensive experience in the natural resources and energy sectors in both finance and leadership roles, including as finance director for British Energy plc between 2001 and 2004 during a period of major restructuring.

In addition, Keith served as non-executive chairman of Gulf Keystone Petroleum plc following a successful debt restructuring. Immediately prior to his appointment to the Board of Southern Water, Keith was a non-executive member of the Gas and Electricity Markets Authority (Ofgem), where he was chairman of the Audit and Risk Assurance Committee, having served on the board since 2012.

Keith holds an MA in economics and MSc in finance and is a Fellow of the Association of Chartered Certified Accountants.

External appointments:

Keith holds non-executive directorships in a number of oil and gas companies, including at Hunting plc as senior independent director, Cairn Energy plc and Rockhopper Exploration plc.



Ian McAulay Chief Executive Officer

Executive

Independent: No

Committee membership:

N/A

Date of appointment:

01/02/2017

Experience:

Ian joined Southern Water as Chief Executive Officer in January 2017 and was appointed to the Board from 1 February. He is a member of the Executive Committee and the Executive Leadership Team.

Ian has more than 30 years of global water and environmental experience, operating in both publicly quoted FTSE100/250 companies and privately-held enterprises. He has managed utility, construction and consulting businesses in the UK, Belgium, India and the USA, and has enhanced his experience with professional executive education, most notably at Harvard Business School.

In his previous role, he served as an executive director of the Pennon Group plc and chief executive of its subsidiary company, Viridor.

In a non-executive capacity, he served as a member of Greater Manchester Authorities Low Carbon Hub Board and the Scottish Government's 2020 Climate Change Board. He has also provided expert input into government review groups and industry partnerships.

Ian holds an honours degree in Civil and Environmental Engineering and is a Chartered Member of the ICE, CIWEM.

External appointments:

Ian is currently chair of the Greater Brighton Infrastructure Panel.

Key

- A Audit Committee
 N Nomination Committee
 ● Committee Chair
RI Risk Committee
 RE Remuneration Committee



Sebastiaan Boelen

Chief Financial Officer

Executive
Independent: No

Committee membership:

N/A

Date of appointment:

14/12/2018

Experience:

Sebastiaan started his career with 10 years in the Royal Navy, followed by management consulting (McKinsey; C&L – now PwC) and senior finance roles in telecoms (infrastructure), consumer goods, business services and financial services, for listed and private equity portfolio companies.

He also worked with Electricity North West and has been CFO and Board member of Southern Water since December 2018. He is a member of the Executive Committee and the Executive Leadership Team.

Sebastiaan has worked and lived in the Netherlands, France, Switzerland, Belgium, Luxembourg and the UK.

External appointments:

None.



Paul Sheffield

Senior Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:

RE N

Date of appointment:

01/06/2014

Experience:

Paul joined the Board in June 2014 and was appointed as senior independent non-executive director in July 2015. Between 1 April and 31 July 2019, Paul served as acting Chairman while he led the search for a new Chairman.

In his executive career, he spent over 32 years with Kier Group plc – the construction, services and property group. Graduating as a Civil Engineer in 1983, Paul spent 15 years working on major capital projects around the world before taking responsibility for a number of business units within the group. Paul was on the board for 10 years and served as chief executive officer between 2010 and 2014. Between 2014 and 2017, he headed up the construction operations for the European and Middle Eastern businesses for Laing O'Rourke Services, delivering some of the biggest capital projects such as Crossrail, Hinkley Point C Nuclear Power Station and major capital projects in the water industry.

Through his various roles in business leadership, Paul has gained significant experience of strategy, productivity innovation and efficiency and the vital role that ethics plays in determining the long-term success of an organisation.

External appointments:

Paul is a member of the Supervisory Board of BAM Group in the Netherlands. He is also a Fellow and former president of the Institution of Civil Engineers.

Board of directors continued



Rosemary Boot Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:

A RE

Date of appointment:

01/03/2015

Experience:

Rosemary joined the Board in March 2015.

Rosemary was the chief financial officer of Future Cities Catapult, one of a network of technology and innovation centres established by the UK government. She also 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, Rosemary 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.

External appointments:

Rosemary is Senior Independent Director of Impact Healthcare REIT plc and Triple Point Energy Efficiency Infrastructure Company plc. She is a non-executive director of Urban&Civic plc. She is also a trustee of Green Alliance, and a founder and director of Chapter Zero Limited.



Mike Putnam Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:

Ri A

Date of appointment:

26/09/2017

Experience:

Mike has over 25 years' experience leading and managing multiple businesses across development and construction. He is known for his values-based approach to leadership. He has since transitioned to a plural career with a portfolio of non-executive directorships.

Mike was president and CEO of Skanska UK between 2009 and 2017, responsible for a business with circa £1.8 billion revenues and 6,000 employees. Prior to this he was executive vice president and main board director from 2001, as well as working across the group as a non-executive director on some of the international boards. Throughout his career he has been closely involved with the successful delivery of many high-profile projects and programmes.

Mike is a member of the Construction Leadership Council. He has also been chair of the Green Construction Board; a member of the CBI Construction Council; and a non-executive director of the Association of Consulting Engineers.

Mike is a Chartered Engineer and a Fellow of both the Institution of Civil Engineers and Royal Institution of Chartered Surveyors.

External appointments:

Mike currently serves on the boards of Network Rail, Arcadis NV and Bazalgette (Tideway) Tunnel Ltd.

Key

- A Audit Committee
 N Nomination Committee
 ● Committee Chair
RI Risk Committee
 RE Remuneration Committee



Dame Gillian Guy DBE

Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:

RE RI

Date of appointment:

12/11/2018

Experience:

Gillian joined the Board in November 2018.

Gillian served as a non-executive board member and chair of the Audit Committee of the National Audit Office and as a non-judicial member of the Sentencing Council for England and Wales. Gillian was awarded a CBE in the New Year's Honours List in 2015 and was awarded a Damehood in the 2020 New Year's Honours List for services to public and voluntary sectors.

Gillian is a lawyer and spent 11 years as chief executive officer of the London Borough of Ealing before becoming chief executive officer of Victim Support.

External appointments:

Gillian was formerly chief executive officer of the independent charity Citizens Advice. She is also currently chair of the UK Finance Consumer Advisory Group and a member of the Banking Standards Board.



Kevin McCullough

Independent Non-Executive Director

Non-Executive
Independent: Yes

Committee membership:

RI

Date of appointment:

18/07/2019

Experience:

Kevin joined the Board in July 2019 and was appointed as the non-executive director with the remit for communicating the views of the workforce to the Board in February 2020.

Kevin has over 35 years of experience in the utility sector. He has developed a strong reputation for delivering results in the most arduous of business environments, having held significant executive positions with RWE Innogy and npower, Horizon Nuclear Power and UK Coal Production Ltd.

He has been responsible for the development and construction of some of the UK's largest power plants, including large-scale offshore wind and high-efficiency combined cycle gas turbine. Kevin's career has seen him take key roles interfacing with, and in some cases advising, government directly on all aspects of UK energy generation.

As chairman of Horizon Nuclear Power, he helped nurture the opportunity for new nuclear capability in the UK.

Kevin is a Chartered Engineer and a Fellow of both the Institute of Mechanical Engineers and the Energy Institute.

External appointments:

None.

Board of directors continued



Malcolm Cooper

Independent Non-Executive Director

Non-Executive

Independent: Yes

Committee membership:



Date of appointment:

23/12/2019

Experience:

Malcolm joined the Board in December 2019 and was appointed as Chair of the Audit Committee.

Malcolm has extensive experience in the regulated utility sector, having worked for around 30 years at National Grid plc, British Gas plc and other companies. He was a member of the board of both National Grid Gas plc and National Grid Electricity Transmission plc.

Malcolm was previously a non-executive director of St William. He is also a past president of the Association of Corporate Treasurers and was a member of the Listing Authority Advisory Panel of the FCA.

Malcolm has a degree in Pure Mathematics and is both a Fellow of the Association of Chartered Certified Accountants and the Association of Corporate Treasurers

External appointments:

Malcolm is a non-executive director at: Morgan Sindall plc where he chairs the audit committee and the health, safety and environment committee; MORhomes plc where he is Senior Independent Director and chairs the credit committee; and the UK Residential REIT plc where chairs the audit committee. He was also a non-executive director at CLS Holdings plc, where he was senior independent director and Audit Committee chair. He is a member of the Audit Committee of Local Pensions Partnership Ltd.



Sara Sulaiman

Non-Executive Director

Non-Executive

Independent: No

Committee membership:



Date of appointment:

26/09/2017

Experience:

Appointed in September 2017, Sara is an executive director at JP Morgan Asset Management.

Before joining JP Morgan, Sara was an investment director at Arle Capital Partners, a London-based mid-market private equity firm. Prior to that she worked on corporate finance transactions both within Simmons & Company International, a specialist energy investment bank, and KPMG's Global Infrastructure and Projects Group (within the Energy & Natural Resources team).

Sara started her career in industry working as a finance analyst in Petroleum Development Oman and Shell Chemicals in London.

Sara holds a Bachelor of Arts in Economics from Yale University, an MPhil in Economics from the University of Cambridge and is an Associate of the Chartered Institute of Management Accountants.

External appointments:

Sara currently serves as a non-executive director on the holding companies of Nortegas, a Spanish gas distribution business and North Sea Midstream Partners, a gas transport and processing business in the UK.

Key

- A Audit Committee
 N Nomination Committee
 ● Committee Chair
RI Risk Committee
 RE Remuneration Committee



Marykay Fuller

Non-Executive Director

Non-Executive
Independent: No

Committee membership:

RI

Date of appointment:

15/06/2020

Experience:

Marykay joined the Board in June 2020 as a shareholder representative non-executive director for Greensands Holdings Limited.

Marykay's executive career was in finance and consulting with significant experience in organisational transformation in both the public and private sectors across a variety of industries, including infrastructure, transportation, energy and construction.

Marykay previously served on the board of British American Business and retired from KPMG LLP in 2016 as a senior advisory partner.

External appointments:

Marykay is currently a director of the UK Civil Aviation Authority (CAA) where she sits on the audit committee and the management advisory board for the CAA's subsidiary, CAA International.

She is the chair of the Air Travel Trust and a director of GCP Asset Backed Income Fund Ltd where she is a member of the audit and remuneration committees as well as chair of the management engagement committee.

She also serves on the Alumni Advisory Board of Carnegie Mellon University Heinz College in the USA.



Richard Manning

General Counsel and Company Secretary

Secretary to all committees

Date of appointment:

24/07/2018

Experience:

Richard joined Southern Water in July 2018 as General Counsel and Company Secretary and now has overall responsibility for leading the Risk and Compliance directorate alongside his legal and governance roles. He is a member of the Executive Committee and the Executive Leadership Team.

He has held similar roles in a number of listed and private companies including GCap Media plc, JJB Sports plc and Waterstones, and brings a wide experience of legal and governance matters.

Richard holds a law degree and an MBA and is a qualified solicitor.

External appointments:

None.

Our approach to governance

Ofwat Principles

In 2019 Ofwat published its Board leadership, transparency and governance principles and, subsequently, in July 2019, amended the licences of water and wastewater companies to require such companies to meet the objectives set out in the Ofwat Principles.

The Ofwat Principles represent a major update of the previous principles published in 2014 and include many of the principles and provisions of the Financial Reporting Council's (FRC) UK Corporate Governance Code. Therefore, Southern Water seeks to apply both the Ofwat Principles and the relevant principles and provisions of the UK Corporate Governance Code in terms of its approach to corporate governance.

The Ofwat Principles are based around four objectives (set out below), each of which is supported by a number of provisions designed to assist companies in demonstrating that they are meeting the relevant objective.

➔ Find more information on [ofwat.gov.uk](https://www.ofwat.gov.uk)

1 Competence and independence

Boards and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high-quality decisions that address diverse customer and stakeholder needs.

➔ Read more on pages 158 to 167

Objective/provision	Compliant	Page(s)
Boards and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high-quality decisions addressing stakeholder needs.	Yes	162-166
i. Boards and board committees have the appropriate balance of skills, experience, independence and knowledge of the company. Boards identify what customer and stakeholder expertise is needed in the boardroom and how this need is addressed.	Yes	163, 166, 167, 184
ii. Independent non-executive directors are the largest single group on the board.	Yes	158, 163, 164-165
iii. The chair is independent of managers and investors on appointment and demonstrates objective judgment throughout their tenure. There is an explicit division of responsibilities between running the board and executive responsibility for running the business.	Yes	163, 164
iv. There is an annual evaluation of the performance of the board. This considers the balance of skills, experience, independence and knowledge, its diversity, how stakeholder needs are addressed and how the overarching objectives are met. The approach is reported in the annual report and any weaknesses are acted on and explained.	Yes	178-180
v. There is a formal, rigorous and transparent procedure for new appointments which is led by the Nomination Committee and supports the overarching objective.	Yes	184
vi. To ensure there is a clear understanding of the responsibilities attached to being a non-executive director in this sector, companies arrange for the proposed, final candidate for new non-executive appointments to the regulated company board to meet Ofwat ahead of a formal appointment being made.	Yes	184
vii. There is a majority of independent members on the Audit, Nomination and Remuneration Committees and the Audit and Remuneration Committees are independently led.	Yes ¹	182, 187, 196

1. The membership of the Nomination Committee is: the Chairman, one independent non-executive director and one non-executive director. The Chairman, whilst not independent under the UK Corporate Governance Code is independent of management and the shareholders

2 Purpose, values and culture

The regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

➔ Read more on pages 168 to 175

Objective/provision	Compliant	Page(s)
The regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.	Yes	168-175
i. The board develops and promotes the company's purpose in consultation with a wide range of stakeholders and reflecting its role as a provider of an essential public service.	Yes	174
ii. The board makes sure that the company's strategy, values and culture are consistent with its purpose.	Yes	168-175
iii. The board monitors and assesses values and culture to satisfy itself that behaviour throughout the business is aligned with the company's purpose. Where it finds misalignment it takes corrective action.	Yes	170-171, 172-173, 175
iv. Companies' annual reporting explains the board's activities and any corrective action taken. It also includes an annual statement from the board focusing on how the company has set its aspirations and performed for all those it serves.	Yes	146-147, 160, 168, 170-171, 175

3 Effectiveness

The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.

➔ Read more on pages 178 to 185

Objective/provision	Compliant	Page(s)
The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.	Yes	148-153, 158-159, 160-166, 178-180, 183-185
i. The regulated company sets out any matters that are reserved for shareholders or parent companies (where applicable), and explains how these are consistent with the board of the regulated company having full responsibility for all aspects of the regulated company's business, including the freedom to set, and accountability for, all aspects of the company's strategy.	Yes	113, 158-159
ii. Board committees, including but not limited to Audit, Remuneration and Nomination Committees, report into the board of the regulated company, with final decisions made at the level of the regulated company.	Yes	159, 161
iii. The board of the regulated company is fully focused on the activities of the regulated company; takes action to identify and manage conflicts of interest, including those resulting from significant shareholdings; and ensures that the influence of third parties does not compromise or override independent judgment.	Yes	158-160, 166, 185

Our approach to governance

4 Transparency and accountability

The board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.

➔ Read more on pages 186 to 193

Objective/provision	Compliant	Page(s)
The board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.	Yes	158, 186-191
Regulated companies publish the following information in a form and level of detail that is accessible and clear for customers and stakeholders:		
i. An explanation of group structure;	Yes	113-116
ii. An explanation of dividend policies and dividends paid, and how these take account of delivery for customers and other obligations (including to employees);	Yes	108-109
iii. An explanation of the principal risks to the future success of the business, and how these risks have been considered and addressed;	Yes	118-139
iv. The annual report includes details of board and committee membership, number of times met, attendance at each meeting and where relevant, the outcome of votes cast; and	Yes	148-153, 162, 182, 187, 192, 196
v. An explanation of the company's executive pay policy and how the criteria for awarding short and long-term performance-related elements are substantially linked to stretching delivery for customers and are rigorously applied. Where directors' responsibilities are substantially focused on the regulated company and they receive remuneration for these responsibilities from elsewhere in the group, policies relating to this pay are fully disclosed at the regulated company level.	Yes	194-209

Corporate governance report

How we are becoming a more resilient organisation and ensuring long-term success

➔ Read more on our **operational performance** on pages 74 to 99

Our journey of delivering better outcomes for customers

As a provider of essential water and wastewater services to customers in the South East, the company's and the Board's focus is on improving our performance to deliver for our customers. Owing to the nature of our business and the 25-year licence to supply services, the Board and company must take a long-term view in order to ensure provision of services in the future within a challenging and changing environmental, demographic and regulatory context.

Delivering our 2020–25 business plan

The Board extensively reviewed, discussed and challenged management's execution plan to deliver the 2020–25 business plan within the financial envelope set by Ofwat. This resulted in a refined and updated execution plan and changes to the company's risk appetite and tolerance to make it consistent with delivery of such an ambitious plan.

In addition, the plan necessitates something of a cultural shift within the business in order to proactively undertake certain activities, including proactive maintenance, delivery of capital programmes early on in the 2020–25 period and changes in approach to design and construction of the company's assets. A key underpinning objective of the plan is to significantly improve the company's resilience to events such as power outages and thereby improve delivery for customers and other key stakeholders.

Embedding risk management at every level of the organisation

During the year, the company adopted a new approach to risk in order to make expression and understanding of risk clearer and therefore improve management of risk.

Taking steps to address water supply

It has become apparent in recent years that for a number of reasons, including substantial development in the South East and the restrictions on abstraction from the rivers Test and Itchen, that the so-called Western Area around Southampton will face significant issues over the coming years in terms of water supply.

Therefore, the Board has played an active role in developing, reviewing and challenging the company's strategy to ensure a resilient water supply in the region. This included the signing of a bulk supply agreement in 2021 with Portsmouth Water in connection with a new reservoir to be constructed at Havant Thicket. In addition, the Board has had oversight of the company's longer term plans, which include construction of a desalination plant at Fawley and transfers of water resources via pipes across the region.

Improving our environmental performance

The Board is clear that our environmental performance has significant room for improvement, including in particular in terms of the prevention of and management of pollution incidents. Therefore, the Board approved the company's Pollution Incident Reduction Plan, which seeks to take steps to improve the company's management of incidents in order to reduce the severity of pollution events if and when they occur. In addition, the plan seeks to implement more proactive maintenance of the company's assets in order to reduce the likelihood of such events occurring in the first place.

Furthermore, the Board has approved the company's environmental ambition which intends to significantly improve the company's overall impact on the environment as well as a commitment to 'net zero' carbon by 2030.

Corporate governance report continued

1

Competence and independence

Boards and their committees are competent, well run, and have sufficient independent membership, ensuring they can make high-quality decisions that address diverse customer and stakeholder needs.

“ To provide effective leadership, the Board must exhibit independent decision-making informed by diverse perspectives ”

Keith Lough
30 June 2021

Executives	2
Non-Executives	
Independent on appointment	1
Independent	6
Shareholder nominated	2

Overview of the Board's responsibilities

The Board's role is to:

- establish the company's purpose, strategy and values,
- develop and promote the company's purpose in consultation with a wide range of stakeholders,
- determine overall strategic aims and direction consistent with the company's purpose,
- monitor and assess the company's values and culture to ensure that behaviour throughout the business is aligned with the company's purpose,
- have full responsibility for all aspects of the company's regulated business in the long term,
- ensure that the company's obligations to, and interests of, all its stakeholders, including customers, employees, key partners, contractors and regulators, are known and met appropriately,
- provide effective leadership and collective responsibility for the long-term success of the company for the benefit of its members, taking into account the interests of a wide range of stakeholders, including customers, local communities, employees, suppliers and the company's impact on the environment,
- ensure that sufficient resources are available to the Chief Executive Officer and his team to operate, manage and develop the business appropriately to provide an essential public service to our customers, and
- ensure that appropriate and effective processes and controls are in place to assess and appropriately manage risk.

Greensands Holdings Board

The Shareholders' Agreement of our parent company, Greensands Holdings Limited, reserves certain matters by exception to the Board and shareholders of that company. A schedule of those matters reserved to Greensands Holdings Limited is published at southernwater.co.uk/greensands-ownership-of-southern-water.

During the year 2020–21 a number of matters required shareholder approval. These included the raising of finance via the 'Green Bond' in May 2020 and additional finance raised in March 2021 and approval of the company's execution plan for the 2020–25 period.

Governance structure

Shareholders

Greensands Holdings Limited Board of Directors

Certain key matters are reserved to the Board of Greensands Holdings Limited and/or the Shareholders.

Southern Water Services Limited Board of Directors

The Board of Southern Water is ultimately responsible for the company.

Executive Committee (EXCOM)

Comprising the Chief Executive Officer, Chief Financial Officer, Managing Director, General Counsel, Director Wastewater and Asset Management, Director of Environment and Corporate Affairs and Company Secretary, it meets regularly to discuss and make decisions on areas of strategy and other matters critical to the company.

Executive Leadership Team

The Executive Leadership Team supports the CEO in driving the implementation of strategy in the company. Comprised of the senior leaders of the functions and operational units, the ELT meets regularly to:

- Consider performance and make decisions on operational matters;
 - Oversee the company's transformation programme; and
 - Consider health and safety, risk and compliance.



Corporate governance report continued

1. Competence and independence continued

The Board

The Board comprises the non-executive Chairman, two executives – the Chief Executive Officer and Chief Financial Officer – and eight non-executive directors, six of whom are independent.

It routinely determines the following matters:

- Business and financing strategy
- Business plans
- Approval of annual budgets
- Fixing of principal charges and schemes
- Approval of financial statements
- Key regulatory submissions
- Key customer and stakeholder publications
- Entering into significant contracts or commitments
- Approval of dividends
- Commencing new businesses
- Appointment or removal of the auditor, directors and company secretary
- Remuneration of independent non-executive directors.

What was on the Board's agenda during the year

- Refined and improved the company's execution plan for 2020–25.
- Reviewing and monitoring the impact of COVID-19 on the company's operations and workforce.
- Developing and approving the company's Pollution Incident Reduction Plan.
- Approval of the company's environmental plan, including a commitment to net zero carbon by 2030.
- Reviewing proposed transformational and strategic programmes to ensure that the company can deliver on its ambitions.
- Approval of the bulk supply agreement with Portsmouth Water in respect of the Havant Thicket reservoir.
- Developing measures for and monitoring the company's culture.
- Reviewing and monitoring the company's progress against the undertakings given to Ofwat following the settlement in 2019–20.
- Bond issues and other financing measures.
- Risk appetite and risk monitoring.

Board committees

In line with both the Board leadership, transparency and governance principles published by Ofwat and the UK Corporate Governance Code as well as best practice, the Board has established a number of standing committees with specific responsibilities. These committees are:

Audit

Risk

Nomination

Remuneration

These committees assist the Board by monitoring and reviewing performance and issues within their respective scopes. Specific responsibilities have been delegated to these committees.

Each committee has written terms of reference, which are published at [southernwater.co.uk/board-committee-terms-of-reference](https://www.southernwater.co.uk/board-committee-terms-of-reference). These terms of reference are reviewed at least annually.

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

Southern Water Board and committee responsibilities

The Board

- Has full responsibility for the company's business over the long term.
- Establishes the company's purpose, values and culture and sets its strategy.

➔ Read more about our purpose, values and culture on pages 2 to 3

Audit Committee

- Monitors the integrity of the company's financial statements by challenging the basis of preparation and the judgments made.
- Monitors the integrity of non-financial information reported by the company.
- Keeps under review the company's internal controls and risk management systems.
- Oversees Internal Audit and the relationship with the external auditor.

➔ Read more on pages 187 to 191

Risk Committee

- Advises on the company's overall risk appetite, tolerance and strategy and level of resilience.
- Oversees and advises on current risk exposures.
- Reviews the company's capability to identify and manage new risks.
- Monitors and advises on health, safety, security and wellbeing and makes appropriate recommendations to the Board.

➔ Read more on pages 192 to 193

Nomination Committee

- Reviews the size, structure and composition of the Board.
- Evaluates the balance of independence, skills, experience and diversity on the Board.
- Leads the process for identifying and nominating candidates for approval by the Board of directors.

➔ Read more on pages 182 to 185

Remuneration Committee

- Sets remuneration policy for all executive directors and the Chairman.
- Recommends and monitors remuneration for senior leaders.
- Approves the design of and determines targets for any performance-related pay schemes.
- Reviews the design of all long-term incentive plans.
- Oversees major changes to employee benefit structures.

➔ Read more on pages 194 to 211

Corporate governance report continued

1. Competence and independence continued

Board meetings and attendance

A total of six Board meetings were scheduled to take place during the year.

The attendance at scheduled Board meetings during the year was as follows:

Member	Attendance
Keith Lough	6/6
Ian McAulay	6/6
Sebastiaan Boelen	6/6
Paul Sheffield	6/6
Rosemary Boot	6/6
Mike Putnam	6/6
Gillian Guy	6/6
Kevin McCullough	5/6 ¹
Malcolm Cooper	6/6
Sara Sulaiman	6/6
Marykay Fuller	5/5 ²

1. Absence due to illness.

2. Marykay Fuller was appointed to the Board on 15 June 2020.

The agenda and papers are sent to Board members in advance of each meeting. The monthly financial and performance reports are also distributed for the months when there is no scheduled meeting.

Ordinarily, the Board would hold its meetings at the company's head office in Worthing or in London. However, owing to the COVID-19 pandemic, the Board has held its meetings remotely during 2020–21 using tele- and video-conferencing facilities. In a 'normal' year, the Board also endeavours to hold one meeting 'off site' during the year coupled with a strategy day in order to provide an opportunity to discuss the company's future strategy and plans. The Board held a strategy day in September 2020 at which it reviewed the current environment and sought to outline the company's medium and long-term vision and plans, including discussion of use of technology and organisational structure.

Where a director has a concern over any unresolved matter, they are entitled to require the Company Secretary to record that concern in the minutes of a meeting. Should the director later resign over the issue, the Chairman would bring it to the attention of the Board.

All members of the Board were and are able to allocate the necessary time to the company in order to be able to discharge their responsibilities effectively.

Board composition

Unlike in previous years, there has been little change in terms of the Board composition during the year.

Keith Lough has served as Chairman since 1 August 2019 and Ian McAulay and Sebastiaan Boelen have served as executive directors since 2017 and 2018 respectively.

As stated in the 2019–20 annual report, Marykay Fuller joined the Board as the shareholder representative non-executive director for Greensands Holdings Limited in June 2020.

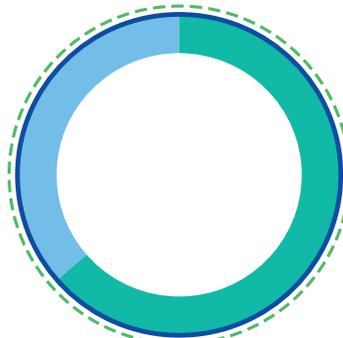
As at 31 March 2021, women made up 36% of the Board (four out of 11 directors). The company is committed to having a diverse workforce that reflects the communities it operates in. The company publishes a Gender Pay Gap Report. Our report showed that the median pay gap has reduced from 2.4% in favour of male employees to -2.0% in favour of female employees. In terms of the bonus gap, we have seen a reduction from 26.8% to 24.5% in favour of male employees.

We are committed to supporting the aspirations of our talented female workforce and are implementing plans to address the gender pay gap. Read the full report at southernwater.co.uk/gender-pay-gap.

In accordance with good governance practice, the roles of the Chairman and Chief Executive Officer are separate.

Board composition at a glance

Board gender profile



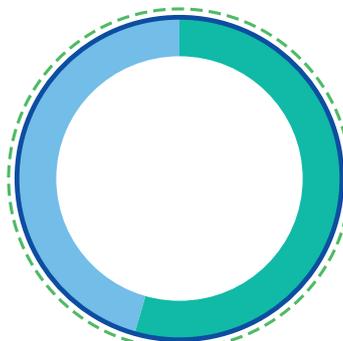
● Male (7) ● Female (4)

Board background



● Financial (6) ● Public sector/Government/charity (1)
 ● Operational (1)

Board independence



● Independent (6) ● Not independent (5*)

*Note the Chairman was independent on appointment, but does not fulfil the criteria set out in the UK Corporate Governance Code applicable to an independent non-executive director and is therefore included in this figure.

Corporate governance report continued

1. Competence and independence continued

Board composition continued

Chairman

The role of the Chairman 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. Keith Lough has served as the company's Chairman since 2019. In line with the Ofwat Board leadership, transparency and governance principles as well as the UK Corporate Governance Code, Keith was viewed as independent on appointment.

The Chairman discusses and agrees Board meeting agendas with the Chief Executive Officer and Company Secretary, although any director may sponsor an item to be included on the agenda. The Chairman has authority to act and speak for the Board between its meetings, which includes engaging with the Chief Executive Officer. The Chairman reports to the Board, chairs of its committees and individual directors as appropriate on decisions and actions taken between Board meetings. The Chairman also meets with the non-executive directors, without the executive directors present, to consider the performance of the executive directors and to provide feedback.

The Chairman is not a member of the Greensands Holdings Limited (the company's ultimate parent company) board, although he and others from the company are regular attendees to report on the company's progress.

Chief Executive Officer

The Chief Executive Officer is a member of the Board and has all the responsibilities of a director of the company. Ian McAulay has served as the company's Chief Executive Officer since 2017. In his executive role, responsibility has been delegated to him to deliver the company's strategy. He is empowered to take all decisions and actions that further the company's strategy and which, in his judgment, are reasonable within the Chief Executive Officer's limits set out in the company's internal controls and matters reserved to the Board. The non-executive directors, led by the Chairman, appraise his performance annually.

Chief Financial Officer

The Chief Financial Officer is a member of the Board with all the responsibilities of a director of the company. Sebastiaan Boelen was appointed as the company's interim Chief Financial Officer and member of the Board in December 2018 and this appointment was made permanent in September 2019. In his executive role and reporting to Ian McAulay, he has the responsibility for managing the company's financial affairs and assisting the Chief Executive Officer in the delivery of the company's strategy. His performance is reviewed annually by the Chief Executive Officer.

Senior independent non-executive officer

Paul Sheffield is the senior independent non-executive director. Paul chairs the Remuneration Committee and is also a member of the Nomination Committee.

As senior independent non-executive director, ordinarily Paul would chair Board meetings in the event that the Chairman was unable to do so for any reason. In the capacity of senior independent non-executive director, he is available to discuss matters or concerns with investors as required.

Independent non-executive directors

The largest single group on the Board are the independent non-executive directors in accordance with the Ofwat Principles and as a matter of good governance practice. The number of independent non-executive directors is also in accordance with the company's licence conditions, which require at least three independent non-executive directors on the Board.

They provide independent advice and perspectives and review and challenge decisions and reporting on behalf of all stakeholders, including customers and the workforce. 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, capital project delivery, regulation, transformation and for the range of their experience of general corporate management.

The non-executive directors also appraise the Chairman's performance.

The standard terms and conditions for the appointments of independent non-executive directors can be viewed at southernwater.co.uk/corporate-governance.

Company Secretary

All directors have access to the advice and services of the Company Secretary, Richard Manning, and the Company Secretariat team. The Company Secretary is responsible for ensuring that the Board operates in accordance with the adopted governance framework 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 a matter reserved to the Board.

Directors have access to the advice and services of the Company Secretary and are able to obtain appropriate independent professional advice in connection with the performance of their duties.

Shareholder representative non-executive directors

Under the terms of the Subscription and Shareholders' Agreement, certain investors have a right to nominate for appointment a non-executive director to the Board of Southern Water. As a statutory director, such an individual has all the duties, obligations and rights of a director of Southern Water and, as such, act in accordance with the directors' duties set out in the Companies Act 2006, including those set out in section 172 to promote the success of the company for the benefit of its members as a whole, having regard to the long term and the interests of the company's stakeholders.

Sara Sulaiman joined the Board in 2017 and was nominated by one of the company's three major investors. In June 2020, Marykay Fuller joined the Board having been nominated by Greensands Holdings Limited, the group's ultimate parent company. Please refer to pages 148 to 153 for details of the background and experience of the shareholder representative non-executive directors.

Sara Sulaiman does not receive any remuneration from Southern Water.

➔ Read more about **employee engagement** on pages 56 to 59

Corporate governance report continued

1. Competence and independence continued

Board independence

Throughout the year the majority of non-executive directors have been independent and independent non-executive directors were the largest single group on the Board in accordance with the Board leadership, transparency and governance principles published by Ofwat.

In accordance with best practice, the Board takes into account those matters listed in Provision 10 of the UK Corporate Governance Code as well as any other relevant circumstances or considerations in forming its assessment of the independence of directors.

The Board considers that the independent non-executive directors were throughout the year,

and continue to be, independent in character and judgment 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, communities, workforce, suppliers and the environment and how these can be respected and protected.

Conflicts or potential conflicts are governed by the Companies Act 2006. The Board does not have power to authorise conflicts under the company's Articles of Association. If a conflict should arise, the conflicted director takes no part in discussions and may not vote on that issue. During 2020–21, no director declared a material interest at any time during the year in any contract of significance with the company.

Balance of skills and experience of the Board

The Board, as a whole, has an appropriate balance of skills, experience, independence and knowledge of the company, and the Board provides independent support and advice as well as new ideas and healthy challenge. The number of directors with significant and/or material skills, knowledge and experience related to the key areas necessary to deliver the company's strategy is summarised below. Details of the individual Board members' experience are on pages 148 to 153.

	1	2	3	4	5	6	7
Capital programmes							
Operations							
Customer							
Environment							
Governance							
Regulation							
Financing							
Transformation							
Utilities Sector							

Moving towards creating a resilient water future for our customers

In order to be able to deliver for our customers and the communities we serve, the Board requires a diverse range of skills and experience. The table below shows the current Board members in terms of their primary skills and experience and how these contribute to ensuring a more resilient water future.

Ensuring Southern Water contributes to a more resilient water future	Board skills/experience required	Board members
Succeeding together	Customer, capital programmes, operations, financing, transformation	Keith Lough, Ian McAulay, Sebastiaan Boelen, Paul Sheffield, Rosemary Boot, Mike Putnam, Gillian Guy, Kevin McCullough, Malcolm Cooper, Sara Sulaiman, Marykay Fuller
Doing the right thing	Customer, environment, governance, regulation	Keith Lough, Ian McAulay, Rosemary Boot, Mike Putnam, Gillian Guy, Malcolm Cooper, Sara Sulaiman, Marykay Fuller
Always improving	Customer, capital programmes, operations, transformation, utilities sector	Keith Lough, Ian McAulay, Sebastiaan Boelen, Paul Sheffield, Rosemary Boot, Mike Putnam, Gillian Guy, Kevin McCullough, Marykay Fuller

Corporate governance report continued

2

Purpose, values and culture

The regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

“ A company's values and culture must be consistent with its purpose and underpin its ability to deliver its strategy ”

Keith Lough
30 June 2021

Purpose statement:

To provide water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy.

Vision:

To create a resilient water future for customers in the South East.

Establishing Southern Water's purpose

A company's purpose should be the principle that guides all actions within the company. Its strategy must be to deliver its purpose. In simple terms, the company's purpose is the reason it exists.

The Board is responsible for establishing Southern Water's purpose and for ensuring that its decisions in respect of its strategy enable it to deliver this purpose. As such, the Board and the company must consult with and take into account the interests of a wide array of stakeholders, including customers, employees, local communities, suppliers, government and investors to ensure that the decisions made with respect to matters such as support for the vulnerable, infrastructure investment, measures to protect the environment and engagement with the public to reduce water consumption support the company's purpose to deliver water for life to enhance health and wellbeing, protect and improve the environment and sustain the economy.

Alignment of Southern Water's purpose with values and culture

The values and culture of a company aim to achieve the company's purpose. Its values dictate how it delivers its purpose and the company's culture ought to be in complete agreement with the values of the organisation. Therefore decisions should be made in a certain way, underpinned by certain core principles for the reason of delivering the company's purpose.

One of the key articulations of the company's values is its Code of Ethics, which sets out the expectations for the company's workforce and its partners. Southern Water's Code of Ethics makes clear the basic expectations of how Southern Water conducts its business.

The Board fulfils a key role in setting the tone for the business, and has consistently supported the commitment to embedding ethical business practice throughout the organisation. All Board members have signed up to the Code of Ethics, and the Chairman and Chief Executive Officer have personally endorsed it.

It is essential that the Board monitors the culture of the company in order to take corrective action where the values and behaviours exhibited do not align with the company's values and purpose. Monitoring of this is a priority for the Board in order to ensure that there is no repeat of the unacceptable behaviours of the past. The metrics for monitoring the culture of the company have been developed in the year and one of the Board's key priorities is to ensure that an ongoing robust system of reporting and monitoring is implemented.



Corporate governance report continued

2. Purpose, values and culture continued

➔ Read more about our purpose on pages 2 and 3

A key area of focus for the Board is to monitor culture

Monitoring and assessing our culture

A core component of the company's cultural change programme is the development of appropriate and informative measures that can be used to inform the Board about the culture within the organisation and the progress made in terms of the attempts to change culture for the better.

Such concepts as 'culture' are difficult to measure but, based on advice, best practice examples as well as the outputs required by the Section 19 Undertakings given to Ofwat, the company has developed a number of measures which are reported regularly to the Board. These measures include key metrics in terms of collaboration within the organisation, driving results, customer focus and ethical working. More detail can be found on pages 172 to 173.

In addition, the Board is seeking to develop further measures to ascertain the extent to which ethical business practices have been embedded within the organisation by means of monitoring company and individual behaviours as well as enterprise risk actions and controls.

Culture Change Group

The Culture Change Group has met since December 2019 on a monthly basis. It includes representation from Risk & Compliance, Human Resources, Health, Safety, Security and Wellbeing, Communications and Legal. The aim of the group has been to share ideas and best practice on culture change and has included reviewing the outputs from the Gallup employee engagement survey.

During 2020–21, following discussion and agreement at the Culture Change Group, it was agreed to implement a number of measures to coordinate activities in terms of culture. This included in areas such as line manager training and engagement, the activities of the Health, Safety, Security and Wellbeing team, improvements to the Speak Up policy and the embedding of ethical business practice across the business.

In addition to the work of the Culture Change Group, a new monthly People and Culture meeting was added to the cycle of Executive Leadership Team meetings in order to give greater focus to the company's workforce and its culture.

Our culture journey

2017: December

Customer research and 'brand' review.

2018: January

Stakeholder mapping – what do customers think about us?

Spring to summer

Brand propositions test, 70+ colleagues/partners review.

July

Board holds a session focusing on ethics.

September

Customers review Water for Life. Behavioural expectations launch.

October

Board review. Quick Check decision-making tool released.

November

Values tested at colleague roadshow.

December

Purpose approved by Board.

2019: January

Engagement survey expanded to include culture measures.

February

Water for Life launch. Values approved by Board.

June

Code of Ethics approved by the Board and launched.

October

Values week. Dilemma scenarios released.

November

Board session on ethical business practice facilitated by the Institute of Business Ethics.

2020: January

Ethics and Speak Up training for senior and line management with Institute of Business Ethics.

How the Board monitored culture in the past year

Link to culture

Introduction of the culture change dashboard

Throughout the year, the Board received semi-annual reports of a number of measures to provide an indication of, and inform discussions with respect to, the company's culture.

By monitoring the culture within the organisation, the Board is able to form a view regarding the extent to which the organisation's culture is changing and how. This facilitates the Board's plans and potential interventions.

Development of embedment metrics

The Board has monitored and received updates on management's proposals to measure the embedding of ethical business practices within the business. This includes behavioural metrics, 'ethics interventions' and enterprise risk and control measures and actions.

By monitoring the behaviour and actions of employees and the company more generally, the Board is able to ascertain whether there has been an improvement in terms of the culture of the company and whether and what further actions are required.

Regular reports on Speak Up

The Audit Committee receives regular reports on the company's Speak Up policy, including information in respect of the number and seriousness of the reports.

By monitoring concerns raised, often anonymously, the Board is afforded insight into the potential ethical culture within the business and can take steps accordingly.

Reviewing the results of employee engagement surveys

Both the all-employee GALLUP and targeted 'pulse' surveys provide valuable insight into the attitudes within the company.

By reviewing the high-level results, the Board is informed about the level of engagement across the business. Engagement, values and ethics have a positive correlation.

88%

Self-reported pollutions

The majority of pollution incidents are reported by the company itself.

3.89

Gallup survey score out of 5

These results provide valuable insight for the Board.

2020: June – 2021: March

Publication of quarterly dashboards.

2020: July

ELT paper Culture Change Initiatives.

August/September

Code of Ethics Policy Board Sign up.

September

Board paper for Culture review including Measures of Culture Dashboard and refreshed Code of Ethics.

October

Publication of revised Code of Ethics.

2021: March/April

Board Culture review including Measures of Culture Dashboard and recommendations for revisions for 2021–22 dashboard metrics and targets.

April

Production of guidance for senior managers.

May

Draft ethics ELT embedment indications.

Corporate governance report continued

2. Purpose, values and culture continued

Measures of culture

Our past experiences show us it is essential to do the right thing and the importance of driving performance by behaving correctly and compliantly.

The company has introduced a Culture Change Dashboard to provide a point of focus for thought, discussion and action around our organisational culture.

Collaboration

Each other

Metrics

- ▲ **Employee Engagement**
 Overall company GALLUP survey score out of 5.
3.89
- ▲ **Employee sickness**
 % of all employees
1.87%
- **Gender hourly pay**
 Median difference male/female salaries
2%
- **Gender bonus pay**
 Median difference male/female bonuses
24.5%
- **Gender distribution**
 Split of male/female employees
75/25%
- **Near misses**
 Reports by employees and supply chain partners per 100 FTE
1.2
- ▲ **Rule of two**
 % of reporting of incidents compliant with timescales
67%
- ▲ **STAR Award nominations**
 Number of employee STAR nominations
1,979

Driving results

Our environment and public health

Metrics

- ▲ **Pollution incidents**
 Number of Category 1-3 pollutions
400
- ▲ **Self-reported pollutions**
 % of total incidents self-reported
88%
- ▼ **WWTW Effluent Compliance**
 % permit compliance at numeric wastewater treatment works
97.1%
- ▲ **Water quality compliance**
 Calculated score using DWI Compliance Risk Index (CRI)
4.62

Key:

 Improving
  Static
  Worsening
  No target

Customer focus

Our customer

Metrics

-  **Escalated complaints**
 Number of written escalated complaints per 10k customers
2.31
-  **GSS payments**
 Number of payments made
26,613
-  **C-MeX Satisfaction**
 Overall quarterly C-MeX score out of 100
74.77
-  **Net Promoter Score - service**
 Net Promoter Score achieved in C-MeX quarterly reported service survey
5
-  **Net Promoter Score - experience**
 Net Promoter Score achieved in C-MeX quarterly reported experience survey
22

Ethical working

Our business

Metrics

-  **Values/Ethics Q15 survey scores**
 Scores out of 5 in GALLUP/Pulse surveys – Q15 Confidence in company
4.05
-  **Values/Ethics Q16 survey scores**
 Scores out of 5 in GALLUP/Pulse surveys – Q16 Integrity of colleagues
N/A
-  **Values/Ethics Q17 survey scores**
 Scores out of 5 in GALLUP/Pulse surveys – Q17 Understand values
4.26
-  **Code of Ethics sign ups**
 % of employees who have completed mandatory training to sign up to the Code of Ethics
97%
-  **Speak Up – cases opened**
 Number of Speak Up cases opened
37
-  **Speak Up – cases closed**
 Number of Speak Up cases closed
56
-  **Speak Up – anonymous cases**
 % of Speak Up cases reported anonymously
86%
-  **Speak Up – days to close**
 Average days to close Speak Up cases
308

*All metrics for the 12-month period ending 31 March 2021, with the exception of those under Driving Results, which are in respect of the 12-month period ending 31 December 2020.

Note: The trend indicators for non-targeted metric performance show changes to the number reported from previous period and is not a measure of performance.

Corporate governance report continued

2. Purpose, values and culture continued

Boards must be clear on the impacts of decisions on stakeholders and must be adequately informed about their views

➔ Read about how the Board is kept informed of stakeholder views on pages 66 to 69

Stakeholder engagement

Throughout the year, the Board has been kept informed of the views of the company's stakeholders, including its regulators, suppliers, investors and government. The company's Chairman and Chief Executive Officer regularly attend meetings with government bodies such as Ofwat, the Department for Environment, Food and Rural Affairs, the Environment Agency and Drinking Water Inspectorate.

The Chief Executive Officer also regularly attends meetings and other events with Water UK in respect of matters relevant to the water sector as a whole.

Further information about stakeholder engagement can be found on pages 46 to 50 and as part of the company's section 172(1) Statement on pages 66 to 69.

Employee engagement

In line with the UK Corporate Governance Code, as well as the Board's duty under section 172(1) to consider the interests of the company's workforce and to support the Board in its monitoring and assessing of culture, the Board appointed Kevin McCullough as an independent non-executive director with the remit of communicating the views of the company's workforce (as defined in the

UK Corporate Governance Code) to the Board. The scope of this role includes:

- Obtaining and communicating to the Board the views of the company's workforce in respect of matters, including pay and conditions; health, safety and wellbeing; working environment and culture. This enables the Board to give appropriate consideration of the interests of the workforce. Communication methods include: regular meetings with the company's workforce representatives, the HR Director, Head of Communications and Head of Health, Safety, Security & Wellbeing; attendance at workforce events; and visits to operational sites and offices.
- Providing regular reports to the Board.
- At least annually, meeting with the Chair of the Remuneration Committee to enable the committee to take into account the conditions of the workforce when setting executive remuneration policy (in accordance with the UK Corporate Governance Code).

In addition, during the year, the Chief Executive Officer carried out weekly 'town hall' meetings via tele- and video-conferencing facilities with all employees invited to attend and ask any questions they may have.

Board activities

→ Read more about our people on pages 56 to 59

Area	What was reviewed and considered?	Link to purpose
Business strategy The company's plan to deliver over the 2020–25 period and beyond.	The Board considered the impact of changes to the company's design and delivery of capital projects to improve the resilience of its assets as well as a move toward more proactive maintenance. In addition, the Board approved a revised execution plan to deliver the company's business plan.	Protect Sustain
The environment The company's impact on the environment.	The Board approved the company's environmental ambition, including a commitment to 'net zero' carbon by 2030.	Protect
Our customers The company's delivery for our customers.	The Board reviewed and monitored the steps taken by the company in response to the COVID-19 pandemic, including customers in financial difficulty as well as those who are vulnerable.	Enhance Sustain
Our finances The company's ability to continue to operate as a going concern and deliver its strategy.	In May 2020, the company obtained £825m of funding via the issue of a 'Green' bond, which seeks to provide funding for projects connected with improving and sustaining the environment.	Protect Sustain
Our people The health and safety and wellbeing of our workforce.	The Board reviewed the company's health, safety, security and wellbeing transformation programme, which seeks to further embed a 'health and safety' culture within the organisation.	Enhance

Key:

Our purpose is to provide water for life to:

enhance health and wellbeing

protect and improve the environment

sustain the economy

Case Study

Outlining our Environment Plan

Creating a resilient water future for customers in the South East

Zero

Pollution incidents by 2040

Net zero

Operational Greenhouse Gas Emissions by 2030

Our vision is clear; we want to create a resilient future for our customers in the South East

The challenges which face us in delivering it are to transform our operational performance, always improving, while in parallel, demonstrating to our customers, regulators and other stakeholders that we can justify confidence in our ability to deliver.

The environment, and our role in protecting and enhancing it, are at the core of these challenges but we must go further to realise our ambition. The underpinning context is the financial limitation placed on us by the challenging Final Determination made by our regulator Ofwat, the realities of climate change and the changing expectations of our customers, regulators, and partners as a result of the COVID-19 pandemic.

Our executive and the Board have discussed how we focus on critical environmental issues so that we maximise the opportunities, learn efficiently from the experience of others, and identify where we want to lead the agenda. The steps we have agreed to take to realise our ambition focus around three core themes:

Simplicity – implementing practical plans and measurable activity to improve pollutions performance and compliance, focus on embedding natural capital approaches to planning, development of our plans to achieve net zero by 2030 and a focus on our flagship Target 100 water usage reduction programme.

Transformation – delivering a small and carefully chosen number of bold, ambitious programmes which differentiate Southern Water as an environment custodian, such as our Water for Life Hampshire programme; and

Capability – building, from Board level down, a cadre of skilled and committed leaders and expert practitioners.

The Board approved our Environment Plan in March 2021.

➔ Read more on our long-term ambitions on pages 54 to 55

➔ Read more on our purpose on pages 2 to 3





Corporate governance report continued

3

Effectiveness

The regulated company has an effective board with full responsibility for all aspects of the regulated company's business for the long term.

“ Boards should continually evaluate themselves in terms of their composition and capabilities in order to ensure continued effective leadership ”

Keith Lough
30 June 2021

An evaluation should consider the balance of skills, experience, independence and knowledge, and diversity

Board evaluation

In line with the UK Corporate Governance Code and the Ofwat Principles, there is an annual evaluation of the Board in terms of its performance and effectiveness. During 2020–21 an external evaluation of the Board took place facilitated by Stanton Marris.

In accordance with listed company best practice, Southern Water conducts an externally-facilitated Board evaluation once every three years.

2019–20	2020–21	2021–22
Internal evaluation	External evaluation	Internal evaluation

Progress against last year's evaluation

The internal evaluation indicated a few areas for improvement, including areas for development of the recently-joined Board members and changes to the structure of Board meetings and Board reports.

Good progress has been made in all areas identified and this can be seen by the outcomes of the externally-facilitated Board evaluation conducted in late 2020.

Evaluation of the Board

As previously indicated, the annual evaluation of the Board was externally facilitated by Stanton Marris, who had previously supported a session with the Board on risk and strategy, but who otherwise have no connection with the company. The evaluation was based on interviews with each of the Board members, key senior managers and representatives of the company's shareholders and parent company. In addition, the evaluator used their experience from having worked with the Board members previously to support their observations. The review also took account of the requirements of both Ofwat's Board leadership, transparency and governance principles and of the UK Corporate Governance Code.

Following the completion of the evaluation, the outcomes and suggested actions were presented to the Board in December 2020. These outcomes and suggestions are summarised on page 180.

The Board also conducted an evaluation of the Chairman, led by the senior independent non-executive director. The feedback from the review by the senior independent non-executive director and from the non-executive directors consulted as part of this process was positive. In addition, a number of suggestions were made to further improve the structure and strategic focus of Board meetings.

Step 1 – Preparation

A review of a number of sets of Board papers and other background information about the company, including its most recent annual report.



Step 2 – Observations

The reviewer had previously worked with the Board on risk and strategy, which enabled them to draw on their experiences of seeing the Board at work first-hand.



Step 3 – Interviews

A series of interviews were held with all of the Board members – non-executives, Chairman and executives – as well as a number of senior managers who work closely with the Board. In addition, interviews were held with representatives of the three main shareholders and with the Chair of the Board of Greensands Holdings Limited.



Step 4 – Consultation

The evaluation was overseen by the Chairman and Company Secretary and the findings discussed with them.



Step 5 – Outcomes

A number of observations and suggestions were presented to the Board. These are summarised on page 180.

Corporate governance report continued

3. Effectiveness continued

Evaluation outcomes

Overall, the evaluation showed that the Board has come a long way in the past two to three years and the current Chairman's leadership has been instrumental in accelerating progress. It was noted that the necessity of conducting meetings remotely rather than face-to-face was something of an impediment, but that this was due to the exceptional circumstances of the year. It was recommended that the Board should hold a workshop to address the findings of the review. The Board evaluation focused on a number of key areas, identified below.

2020–21 areas of assessment	Commentary and actions
Is the Board a proper Board, not a mere rubber stamp?	The Board provides challenge and holds the organisation to account. It offers a high quality of questioning and intellectual engagement with issues.
Does the Board tackle the right issues?	It was noted that while the Board's agenda has become more focused, more could be done to define a more strategic agenda. However, at the same time, it was acknowledged that it was inevitable that the Board must continue to deal with some operational and more day-to-day business given the highly regulated environment.
Is the relationship between the Board and executive right?	It was considered that the Board has given strong support to the executive in facing a number of difficult years and challenges.
Are the Board roles and individual roles clearly defined?	Formal definitions of the roles are clear and committees deal effectively with much business prior to it coming to the Board. It was suggested that the Board should consider whether more can be done to delegate business to the committees.
Does the Board have the right skills, experience?	The Board brings a strong range of experience and backgrounds. It was suggested that the Board should consider how to build on the evident current 'non-executive' skills.
Does the Board have the right culture, allowing challenge and debate?	The Board was viewed as well able to debate in an intelligent way and provide challenge, although noting that remote meetings can make free-flowing debate somewhat difficult. It was suggested that the Board hold an in-person workshop for a more open and strategic debate once COVID-19 restrictions allow.
Does the Board get the right information?	The quality of papers and information was viewed as generally high, but that further discipline needed to be applied in terms of paper lengths. A 'decision cover sheet' was introduced to improve focus.

Board development and training

The Board also has access to professional development provided by external bodies and by the company's professional advisers.

In his annual appraisal of the non-executive directors, the Chairman considered any specific training and development needs for the non-executive directors. Individually, the Board members also carry out their own training and development, such as by attending relevant seminars and workshops, in order to ensure that their knowledge is kept up to date.



Corporate governance report continued

3. Effectiveness continued

Nomination Committee Report

Message from the Chair



This has been a busy year for the Nomination Committee, as whilst there has only been one appointment to the Board in June 2020, the Board undertook its externally facilitated evaluation, in which the Nomination Committee was heavily involved.

As part of our application of good corporate governance practice, the Board carries out an externally facilitated Board evaluation once every three years. The Nomination Committee led in terms of the process of selecting an independent evaluator and reviewing the proposed scope and methodology. Following the completion of the evaluation in December 2020, the Nomination Committee also reviewed the output and recommendations. The committee also reviewed the output of the review of the Chairman carried out by the non-executive directors. The committee will continue to track the agreed actions and arrange their implementation over the next year.

In addition to its role in terms of the Board evaluation, a great deal of focus was also placed on reviewing the composition of our Board and senior management to ensure that they have the right balance of skills, experience and diversity. As part of this, the committee also considered succession planning both in terms of short-term need should it arise and in terms of longer term requirements, as it is crucial to be able to fill both immediate requirements due to illness or resignations as well as to have a more strategic view as to the requirements of the business over the long term and what skills and experience the Board and the company's senior management will require.

Keith Lough
Chair of the Nomination Committee
30 June 2021

Committee membership



Keith Lough
Chair
Attendance 2/2



Paul Sheffield
Committee member
Attendance 2/2



Sara Sulaiman
Committee member
Attendance 2/2

Areas of focus this year:

- Board and executive composition and succession planning.
- The externally facilitated Board evaluation.

Priorities for 2021–22:

- Implementing the recommendations of the externally facilitated Board evaluation.

Our role is to ensure an effective Board

Introduction

The Nomination Committee is responsible for reviewing the structure, size and composition of the Board and, based on the results of this review, for assessing the balance in terms of independence, skills, experience, expertise and diversity on the Board and making appropriate recommendations based on this assessment. The committee leads the process for identifying and nominating candidates to fill independent non-executive director vacancies. Read more about the process on pages 184 to 185.



Corporate governance report continued

3. Effectiveness continued

Board appointment process

In the ordinary course of events, the Nomination Committee would lead the appointment process for a new independent non-executive director based on criteria for skills, experience and knowledge determined as a result of the committee's review of the Board's composition. The committee, usually assisted by an external search firm with no connection to the business, would draw up a role specification and then lead the hunt for appropriate candidates, who would be whittled down to the preferred candidate through a series of meetings between Board members and the candidate(s).

When the committee was satisfied with its preferred choice, it would then recommend the appointment to the Board for approval. Following Board approval, the proposed appointment would also be referred to Southern Water's parent company, Greensands Holdings Limited, for approval as a reserved matter. The candidate is also required to meet with Ofwat under the provisions of the Board leadership, transparency and governance principles. Once the candidate had met with Ofwat and, subject to receipt of the approvals by the Southern Water and Greensands boards, the individual would be appointed as a director on the terms published at [southernwater.co.uk/our-story/our-governance/appointment-of-non-executive-directors](https://www.southernwater.co.uk/our-story/our-governance/appointment-of-non-executive-directors).

The Board, as a whole, supported by the Nomination Committee, appoints those individuals nominated by investors under the terms of the Subscription and Shareholders' Agreement. These candidates are, as with the independent non-executive directors, required to meet with Ofwat prior to appointment.

The current Chair would not chair the committee if it was considering the succession of the Chair.

Director induction

On appointment to the Board, induction coverage is agreed with each appointee and then an appropriate comprehensive and individualised induction is provided. This will include access to, and time with, the Executive Leadership Team and other key staff, information on the company structure, the regulatory framework of our business, customer service and the operation of assets, strategic plans, financial reports, business plans and our governance framework and holding group structure. In addition, the appointee will meet with the company's external advisers as appropriate. The appointee will also be afforded the opportunity to visit the company's sites.

Board diversity

It is necessary to ensure that there are diverse views in any decision-making body in order to make sure that proposals come under sufficient scrutiny and challenge and that decisions are informed from a broad range of perspectives.

Diversity and different perspectives facilitate innovation, which is crucial for any business. Accordingly, the composition of the Board is made up of individuals from a diverse range of backgrounds, industries and professions to encourage a diverse range of perspectives. In addition, a Board must also reflect the communities and other stakeholders served by that business and there should be representation of different genders and of different ages, ethnic and social groups.

The Board continues to be supportive of greater representation of those historically under-represented in senior leadership positions and seeks to, as a minimum, meet the expectation applicable to listed companies that at least 25% of Board members are female. As at 31 March 2021, four out of 11 (36%) directors were female.

Approach to succession planning

A considered and thorough assessment of the skills and expertise currently on the Board and what will be required going forward is crucial for the long-term resilience of an organisation. As such, the Board, assisted by the Nomination Committee, has reviewed its current array of skills and expertise as well as what is required in order to ensure that the Board continues to be effective.

Conflicts of interest and time commitments

In order to function as an effective Board, directors must be free of conflicts between the interests of the company and their own interests, or, where such conflicts are unavoidable, appropriate mitigations must be in place. Directors are required to declare any external interests that they or persons closely connected to them might have which could, reasonably, conflict with the interests of Southern Water. Under its Articles of Association, the Board of Southern Water is not permitted to authorise conflicts of interest.

The Board is aware of the potential for conflicts of interest in respect of the directors nominated by the investors and closely monitors this. As statutory directors, these individuals must manage any conflicts arising from their position in accordance with the provisions of the Companies Act 2006.

It is accepted that most directors will also have appointments on other boards (or similar bodies) or, in the case of non-executives, potentially also have full-time executive positions in other companies.

This is no bad thing in and of itself, as it allows for a breadth of experience and enables Southern Water to take advantage of perspectives and expertise from other industries and sectors. However, the director must be able to devote sufficient time to their role at Southern Water and be able to discharge their duties effectively and therefore the number of external appointments of each director is monitored. Under their terms of appointment, independent non-executive directors are expected to devote at least 24 days per year to their role at Southern Water.

The Board is satisfied that all directors were able to devote sufficient time and attention to their role at Southern Water throughout the year.

- ➔ Read more about the **Board's skills and experience** on pages 148 to 153
- ➔ Read more about our **Gender Pay Gap report** on pages 56 to 59

Corporate governance report continued

4

Transparency and accountability

The board's leadership and approach to transparency and governance engenders trust in the regulated company and ensures accountability for their actions.

“ In order to be trusted, companies must be transparent in terms of the financial and non-financial information they provide to their stakeholders and this information, where appropriate, should be subject to rigorous assurance by both internal and external assurers ”

Malcolm Cooper
30 June 2021

One of the most important roles of the Board is to ensure that the company is transparent in terms of its performance through the information that it provides to markets and key stakeholders, including, in Southern Water's case, its customers and its regulators.

The disclosures in the financial statements and other documents and publications are key to ensuring this transparency and with it, that the company is accountable. However, these documents only have value if the information contained within them can be relied upon by their readers. Accordingly, the Audit Committee plays a significant role in providing such assurance that the information is correct and accurate.

The committee is supported in its work by both internal and external auditors who can give independent assurance of the information presented by management.

This transparency should also extend to the market and environment in which the company operates and with it, the risks it faces, what risks it is willing to accept and how it mitigates risk. Therefore, companies require a clear picture of the risk landscape in which they operate as well as agreement on what level and type of risk the Board is willing to accept as the company goes about its operations.

Audit Committee Report

Message from the Chair



This has been my first full year as Chair of the Audit Committee, having been appointed in December 2019. In addition to its core role in ensuring that the financial reports and information published by the company is accurate, transparent and meets appropriate accounting and other standards, a key area of focus has been on the assurance of the company's non-financial information, such as that supplied to its regulators. In particular, this has included monitoring and reviewing the company's progress in respect of the Section 19 Undertakings given to Ofwat as part of the settlement reached in 2019.

Furthermore, the Audit Committee has provided support to the company's cultural change programme through its monitoring of areas such as Speak Up and Internal Audit as well as providing support to the company's strategy through its monitoring and review of the plans for the Western Area to address water resources in the region.

Malcolm Cooper
Chair of the Audit Committee
30 June 2021

Committee membership



Malcolm Cooper
Chair
Attendance 4/4



Rosemary Boot
Committee member
Attendance: 4/4



Mike Putnam
Committee member
Attendance: 4/4



Sara Sulaiman
Committee member
Attendance: 4/4

Areas of focus this year:

- Annual and interim financial statements
- Non-financial assurance
- Section 19 Undertakings progress
- Western Area – assurance
- Audit tender for the 2021–22 year end

Priorities for 2021–22:

- Audit and corporate governance reform following the Kingman, Brydon and Competition and Markets Authority reports.

Corporate governance report continued

4. Transparency and accountability continued

Introduction

The work of the Audit Committee is focused on the monitoring and review of the company's internal controls in respect of its financial and non-financial data, as well as the controls put in place to address risk within the business in areas such as legal and regulatory compliance and information governance and information security. The committee also oversees the relationship with the company's external auditor and oversees the work of the company's internal audit function.

Much of the committee's attention is focused on the company's annual and interim financial statements, including reviewing, assessing and recommending to the Board related areas including any relevant judgments and accounting treatments, going concern and long-term viability statement and 'fair, balanced and understandable' assessments, as well as on reviewing and assessing the company's non-financial reports such as the Annual Performance Report.

Throughout 2020–21, the committee received regular reports from the Head of Group Accounts, Group Treasurer, Head of Internal Audit and the company's external financial and non-financial assurers and auditors. The Chief Executive Officer, Chief Financial Officer, Director of Risk & Compliance and the company's external financial and non-financial audit partners are all regular attendees at meetings of the Audit Committee. The committee also has access, as appropriate, to external professional advisers.

The committee is comprised of a majority of independent non-executive directors. No executive directors or the Chairman of the Board may be members of the committee, and at least one member of the committee must have recent and relevant financial experience, and at least one member must also have competence in accounting and/or auditing. The Chair of the Risk Committee is also a member of the Audit Committee.

Work of the Audit Committee during the year

Throughout the year, the committee received regular updates on financial reporting, risk, internal audit and the company's regulatory framework. An area of focus continues to be the company's performance in improving its internal controls and reporting in respect of non-financial information.

During the year the work of the Audit Committee focused on the following key areas:

- The company's annual and interim financial statements and going concern and viability statements
- Non-financial regulatory reporting and improvements in processes and controls, including oversight of external assurance
- Internal controls
- Corporate governance matters
- Reviewing and monitoring the proposed refinancing activities
- Internal audit reports and plans
- Oversight of internal and external audit, including an assessment of the effectiveness of the external auditor
- Compliance with the company's legal and regulatory obligations in relation to financial and non-financial reporting
- Water and wastewater regulatory compliance
- Speak Up
- The undertakings given to Ofwat as part of the regulatory settlement
- The assurance of the proposals in respect of the Western Area
- The improvements identified as being required in respect of GSS payments
- The Environment Agency prosecution and the associated accounting considerations
- The level of non-audit fees paid to the external audit firm.

Financial statements

The Audit Committee received and reviewed the financial statements, including the key areas of judgment and estimation uncertainty set out in note 2, and the external audit report from Deloitte regarding the year-end financial statements, considering any items of significant judgment that have been made and comments on the control environment. There were no significant issues raised by Deloitte. The company continues to take steps to address the matters raised by Deloitte's audit and the committee will monitor progress.

Revenue

There were no changes to treatment of revenue recognition in the year, nor to the underlying system for estimating the measured income accrual.

However, it was necessary to apply a degree of additional judgment this year, when considering the element of revenue unbilled at March 2021, to take account of the impact of COVID-19 on consumption.

How this issue was addressed

There was a significant reduction in non-household revenues during the year, which was expected to be largely offset by an increase in household consumption. Much of the household consumption, in particular for the second half year during the lockdowns, remained unbilled at year-end as a result of the switch of the direct debit customers to a single annual meter reading. As a result it was necessary to apply an additional manual judgment to the accrual calculation to reflect this.

Impairment of trade receivables

The company's policy for providing for bad debt based on customer segments and the age of outstanding debt has not changed in the year and the methodology used last year was applied, on a consistent basis, to calculate the base underlying provision charge for the full year accounts.

How this issue was addressed

As at the year end March 2020 and interim report for September 2020, an additional level of judgment was applied to the provision to recognise the impact of the COVID-19 pandemic on the likely recoverability of the outstanding debt. This additional level of judgment followed the same approach used previously in considering the performance of cash collection against each segment, and most importantly those with the worst cash collection performance, with the underlying expectation from the company's model.

Provisions and contingent liabilities

The investigations and proceedings issued by the Environment Agency into wastewater compliance and reporting matters are ongoing. There has been little change regarding these matters. The next Court hearing may take place in July 2021.

How this issue was addressed

As the accounts were finalised and approved by the Board on 30 June 2021, the position regarding provisioning for these matters will remain the same as that reported at March 2020.

Havant Thicket

The signing of the Bulk Supply Agreement with Portsmouth Water in respect of the Havant Thicket reservoir required the Committee to consider its accounting treatment. The contract includes a commitment for a series of fixed capacity charge payments covering the cost of construction to be made over a period of 80 years. There will be additional payments based on the volume of water received.

How this issue was addressed

The details of the contract were reviewed and it was concluded that the agreement does not entitle Southern Water to control of the reservoir or meet the definition of a finance lease. However, a liability has arisen in respect of the fixed capacity charge payments due under the contract, which was recorded as a liability on the balance sheet for March 2021 with a corresponding intangible asset for the right to draw water.

Viability statement

Last year the company's viability assessment was over 10 years through to 2030. In total eight of the water and sewerage companies used this look out period, with the other two using a seven-year view.

How this issue was addressed

The committee reviewed the company's viability assessment and agreed for this to be made for the period to 2030 for this year. Please see page 140 for our statement.

➔ Read more about performance commitments on pages 74 to 99

Corporate governance report continued

4. Transparency and accountability continued

Our Ofwat performance commitments

The company has an external non-financial assurer to independently assure its non-financial reporting to Ofwat and that there is a robust system of internal controls in place for non-financial regulatory reporting, such that information in the Annual Performance Report fairly represents the company's progress and delivery of its promises. The assurer attends meetings of the Audit Committee and reports formally the results of its assurance.

Section 19 Undertakings

As part of the regulatory settlement reached with Ofwat in 2019–20, the company agreed to certain undertakings to implement improvements in the business in areas such as culture and robustness of non-financial reporting, as well as to recompense current and former customers. The Audit Committee is responsible for monitoring and reviewing the controls and assurance put in place by management in respect of these undertakings and receives regular reports from management about the progress against the agreed action plans and from the company's external assurers in respect of such progress.

Internal controls

The committee keeps under review the internal financial controls systems of the company that identify, assess, manage and monitor financial risks along with other internal control and risk management systems and, accordingly, receives regular reports from both Internal Audit, external audit and any external assurers appointed by the company to review any particular areas of concern.

The committee receives a regular report of any incidents of fraud or bribery, including the actions taken to investigate and respond to the incidents and information on potential incidents of wrongdoing under investigation.

The committee is provided with updates on matters identified via the company's Speak Up policy. There were no material incidents reported via Speak Up during the year.

Oversight of internal audit and external audit

The Audit Committee is responsible for overseeing both the work of the Internal Audit function and for the management of the relationship with the external auditor and external non-financial assurer. The committee reviews the performance of external auditors on an annual basis to ensure that they remain effective.

In accordance with best practice, the committee held discussions with both the internal and external auditors and the external non-financial assurers in the absence of management and the Audit Committee will continue this practice.

Internal audit

The Head of Internal Audit and the team report on a day-to-day basis to management on the effectiveness of the company's systems of internal controls and the adequacy of these systems to manage business risk and to safeguard the company's assets and resources.

The committee received regular reports throughout the year from Internal Audit in respect of its work during the year in accordance with the internal audit plan agreed with the committee at the beginning of the year. The reports from Internal Audit are a material element of the assurance received by the committee on the company's controls. If changes are required to internal audit action dates for medium and high actions, the action owners are required to attend the committee and explain why such changes are required and to seek the committee's approval.

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

Fair, balanced and understandable

At the request of the Board, the committee has considered whether, in its opinion, this Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and whether it provides the information necessary for shareholders to assess the company's position, performance, business model and strategy.

Step 1 – Developing key themes

The initial themes and structure for the Annual Report are developed, taking into account feedback from Ofwat and other stakeholders as well as a ‘best practice’ review.

**Step 2 – Drafting content**

Subject matter experts are identified to provide the detailed information used to draft the content for each section of the Annual Report.

**Step 3 – Review**

The draft content is reviewed by the subject matter experts, the project team, legal team and members of the Executive Leadership Team.

**Step 4 – Assessment**

The content of the report is reviewed to determine which statements are ‘positive’ and which are ‘negative’. These are then extracted and provided to the Audit Committee organised by section and/or subject for it to review the key areas of the report for fairness, balance and understandability.

**Step 5 – Decision**

Based on the content provided to it as well as their own reading of the draft Annual Report, the Audit Committee members make their decision whether or not to advise the Board that the Annual Report, taken as a whole, is fair, balanced and understandable.

**Risk**

The Audit Committee is responsible for supporting the Risk Committee’s work in overseeing and challenging the effectiveness of Southern Water’s approach to risk management. This includes responsibility for monitoring the effectiveness of the company’s systems of internal controls and for endorsing an internal audit plan that is informed by principal risk exposures, including overseeing targeted reviews of key risk and control areas.

The committee is also responsible for maintaining an assurance landscape that has integrity, independence and reliability.

External auditor

Deloitte LLP was appointed as the company’s auditor for the year ended 31 March 2012, following a tendering process carried out in 2011. The current audit partner, Anthony Matthews, rotated onto the audit for the 2016–17 annual report and 2020–21 will be his last year as our audit partner.

The Audit Committee reviews the external auditor’s effectiveness each year, seeking views from the committee and management via a questionnaire, and would report to the Board any concerns over the continuation of the appointment.

The committee undertakes an annual review of the external auditor’s independence and objectivity within the context of the applicable regulatory requirements and professional standards. This includes an assessment of the impact of any non-audit work carried out by the audit firm on the auditor’s independence and objectivity. In the committee’s view the external auditor met these criteria. The committee also monitored the ratio of audit fees to non-audit fees and approved non-audit services and fees paid to Deloitte during 2020–21.

Details of the amounts paid to Deloitte for these services are provided in note 6 to the financial statements.

In accordance with listed company practice, the external audit contract will be put to tender at least every 10 years. A tender process would also be initiated 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, although the Board is mindful of non-audit services currently being undertaken by other potential external audit providers. After a tendering exercise carried out during the year, Deloitte was re-appointed as the external auditor for the financial year ending 31 March 2022.

Corporate governance report continued

4. Transparency and accountability continued

Risk Committee Report

Message from the Chair



The Risk Committee continues to develop its remit and activities, having been established in 2018 to ensure that appropriate and sufficient focus is given to risk within the company.

We continue to recognise the importance of effective risk and resilience management, and champion its use within the company.

One of the key areas of focus for the committee this year has been the continued transformation of our approach to risk management. This has included the development of a new risk taxonomy to improve the presentation and understanding of the most significant risks faced by the company. The Board has also revised its risk appetite in line with the new risk taxonomy. We have also revised the risk impact criteria to be more reflective of our business operations.

The continued impact of the COVID-19 pandemic and its impact on the company's operations demonstrates the necessity for organisations, and in particular those engaged in supplying essential services, to be resilient and still capable of delivering even under the most difficult of circumstances. The company responded well to the challenges faced by COVID-19 and as the pandemic has evolved, we do not plan to make any immediate material changes to the approach that we will be taking to the pandemic. However the situation could change at any time and there can be no assurance that the COVID-19 pandemic will not have a material adverse impact on the future of the Company.

The committee has continued to monitor and assess the efficacy of health and safety within the organisation, including reports on steps taken in response to tragic events at Avonmouth in December 2020 experienced by Wessex Water.

Mike Putnam
Chair of the Risk Committee
30 June 2021

Committee membership



Mike Putnam
Chair
Attendance: 3/3



Gillian Guy
Committee member
Attendance: 3/3



Kevin McCullough
Committee member
Attendance: 3/3



Malcolm Cooper
Committee member
Attendance: 3/3



Marykay Fuller
Non-Executive Director
Attendance: 1/1

Areas of focus this year:

- Development of the new risk taxonomy.
- Reassessment of the company's risk appetite and tolerance to ensure that it is appropriate.
- Health and safety, including employee wellbeing.

Priorities for 2021–22:

- Continuing to embed the new risk taxonomy within the organisation.
- Employee wellbeing and mental health.

Introduction

The work of the Risk Committee is focused on advising the Board on its overall risk appetite, tolerance and strategy as well as overseeing and advising the Board on current risk exposures and future risk strategy. Risk remains a matter for the Board as a whole. The committee is also responsible for advising the Board on the impact of risk on Southern Water's resilience. The committee also advises the Board on how the company's resilience strategy should address risk.

The committee additionally reviews, advises on and makes recommendations in respect of health, safety, security and wellbeing.

Throughout the year, the committee received regular reports from the Director of Risk & Compliance, the Head of Risk & Assurance, and the Head of Health and Safety. The Chief Executive Officer, Chief Financial Officer, Director of Risk & Compliance, Head of Risk & Assurance and Head of Health, Safety, Security & Wellbeing are all regular attendees at meetings of the Risk Committee. The committee also has access, as appropriate, to external professional advisers.

The committee is comprised of a majority of independent non-executive directors. The Chair of the Audit Committee is also a member of the Risk Committee and, to ensure no gaps in the remits of the two committees, the Chair of the Risk Committee is a member of the Audit Committee.

Risk

Throughout the year the committee received reports on significant risks faced by the company and the appropriateness of controls and mitigation measures in respect of such risks. As part of this, the committee carries out 'deep dives' into particular areas of risk. During the year this has included COVID-19 and IT and cyber security.

A focus for the year in this area has been in discussing, developing and challenging management's transformation of its approach to enterprise risk management.

This has included the development of a new risk taxonomy to improve the presentation and understanding of the most significant risks faced by the company. The committee reviewed changes to risk appetite in line with the new risk taxonomy, ahead of discussions at the Board. The Risk Committee has also revised the risk impact criteria to be more reflective of our business operations.

The agreement of the new risk taxonomy, makes the presentation of the company's principal risks clearer, more relevant and, in doing so, makes risk management more effective within the organisation. Following these changes, the committee has noted a marked improvement in the discussions regarding risk.

In addition, the improvements to our risk appetite, risk taxonomy and risk impact criteria ensure that a consistent approach is taken with respect to risk throughout the company. In part this has been necessitated by the significant changes in thinking required on the part of the company in the development of its execution plan for the 2020–25 period, which required a change in terms of the level and types of risk to be taken by the company to ensure delivery. A key aspect of this is the need to deliver a highly ambitious plan (and, ultimately, it is hoped, significant improvements for customers), but not, in doing so, act in a manner that is inappropriate from a risk perspective. The risk analysis presented to the committee on the execution plan provided a clear indication of the risk position of the company and supported an active debate on the subject, which was then taken forward to wider discussions at the Board.

Resilience

The committee was a key participant in the development of the company's Resilience Action Plan and received regular reports on the actions set out in the plan during 2020–21. The COVID-19 pandemic starkly highlighted the need for companies to ensure that they are resilient and capable of maintaining operations even under the most unusual circumstances. The committee noted the good progress on resilience by the company during the year as well as the obvious effectiveness of the company's business continuity plans demonstrated by the shift to materially different ways of working following the first national lockdown in March 2020 without significant impact on the company's ability to continue to deliver essential services.

Health, safety, security and wellbeing

The committee receives regular reports from the Head of Health, Safety, Security and Wellbeing. In addition to information about relevant key performance indicators and metrics, the committee carries out 'deep dives' on particular topics and areas. During 2020–21, this has included reviewing the impact of COVID-19 on working practices and the tragic incident at Avonmouth in December 2020, which killed four people working at a Wessex Water site. In terms of the latter, the committee received updates about the initial view in terms of the cause(s) of the incident as well as the immediate and subsequent steps undertaken by Southern Water in response to the risks posed by working on such sites.

In addition, the committee has monitored the company's health, safety, security and wellbeing transformation strategy, which seeks to improve assurance, reporting rates and embed health and safety further into the organisation's culture.

➔ Read more about our **health and safety risks** on page 135

➔ Read more about our **Risk Management and Principal Risks** on pages 118 to 139

Directors' remuneration report

Remuneration Committee Report

Chairman's Annual Statement



I am pleased to present the Remuneration Committee's report for the year to 31 March 2021.

The purpose of the Remuneration Committee is to put in place the incentive and retention structures that allow Southern Water to drive performance delivery and improvement across a broad and balanced set of outcomes. These outcomes look to deliver for our customers, the environment and our shareholders.

Summary of the year

2020–21 has been an extraordinary year as the company has continued to deliver throughout the global pandemic. Throughout the year the committee had taken into consideration the views of customers, stakeholders and has consulted with its shareholders on its remuneration policies and practices. The application of these has been governed by the Remuneration Committee, reporting to the Board.

Throughout the year the Remuneration Committee reviewed Remuneration policy, Committee Terms of Reference and satisfied itself on their application. It also sought the opinion of PWC Remuneration Consultants on a number of remuneration matters.

Membership of the Committee remains a majority of independent non-executive directors.

Remuneration Outcomes for the 2020–21 Year

During this extraordinary year in the history of the company, Southern Water has successfully operated throughout the pandemic, with a significant increase in demand, and has successfully delivered and improved its essential service. The operation of the core purpose of the company has underpinned the health and wellbeing of millions of customers within the communities it serves throughout this difficult period.

The company has worked hard to support those customers who through no fault of their own have found themselves vulnerable and unable or struggling to pay, and to support this the Remuneration Committee removed any incentive linked to the pursuit of bad debt.

The team has never worked harder and has delivered a good underlying operational performance improvement across a broad and balanced set of outcomes. There is, of course, always space for improvement but what is clear is that the company is emerging as a stronger and more agile business and existing performance trajectories in areas of apparent weakness such as pollution have already significantly improved.

During this period the company did not furlough any employee, took no government support and achieved its highest Colleague Engagement scores.

The KPIs and targets for the year were very stretching and made further so by the global pandemic. The committee set out at the beginning of the year that it would consider applying its discretion, within the rules of the scheme, where it felt that the bonus outcome was significantly impacted by COVID-19. The committee did apply its discretion to the range applicable to the cash flow KPI, where it was felt that a number of mitigating factors related to bad debt and non-household income did negatively impact an otherwise strong performance. No other adjustments were made. As such a bonus of 63.33% of maximum was awarded for all levels of the company. Individuals can earn a small amount above or below this based on their personal performance.

Under the rules of the scheme, bonus awarded to executives is paid into a 'Deferred Incentive & Retention Pool' and normally no more than 50% of that pool is paid in year. All deferred elements are subject to malus and clawback clauses.

Looking ahead to 2021–22

The arrangements for the coming year will continue to comply with the code on executive remuneration and at least 50% of variable pay will be directly linked to customer outcomes.

Many of the performance areas targeted by the KPIs in last year's scheme are seen as important long term indicators. Accordingly, it was deemed appropriate to maintain the principal structure of the scheme for this next year to ensure targeted improvements are truly embedded. We anticipate wider changes for 2022–23.

The Remuneration Committee remains committed to ensuring that we maintain a well-designed, forward-looking bonus scheme that is flexible to the needs of all stakeholders

Paul Sheffield

Chair of the Remuneration Committee

30 June 2021

Directors' remuneration report continued

Remuneration Committee Report continued

Committee membership (in year)



Paul Sheffield
Chair

Attendance 4/4



Rosemary Boot
Committee Member

Attendance 4/4



Sara Sulaiman
Committee Member

Attendance 4/4

Areas of focus this year:

- Management corporate objectives outturn
- Management corporate objectives targets
- Management corporate objectives
- CEO Executive personal objectives outturn
- Gender Pay Gap
- COVID-19 impact
- Remuneration Policy review

Priorities for 2021–22:

- Review of bonus targets for 2022–23
- Gender Pay Gap
- Diversity

Introduction

This report details the activities of the Remuneration Committee for the period to 31 March 2021. 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 Accounting Guidance (RAG) 3.12 and, where relevant for a non-listed company, has taken into account the requirements of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

The Remuneration Committee of Southern Water

The Remuneration Committee has the responsibility for setting the remuneration policy and structure of the executive directors and senior management. It is also responsible for setting the remuneration of the Chairman. The committee has defined terms of reference, which are published at [southernwater.co.uk/board-committee-terms-of-reference](https://www.southernwater.co.uk/board-committee-terms-of-reference).

We recognise that the independent non-executive directors have an important role to play in determining and challenging remuneration policy and practice. In order to reflect this, the independent non-executive directors are a majority on the committee and neither executive directors nor the Chairman are permitted to be members of the committee.

Following his appointment as a non-executive director with the remit for communicating the views of the workforce to the Board, Kevin McCullough has now been appointed to the committee.

Only committee members are entitled to attend meetings, with the Managing Director (accountable for People) and the Chief Executive Officer and Chief Financial Officer attending by invitation. The Company Secretariat acts as secretary to the committee.

No attendee participates in discussions regarding their own remuneration.

Remuneration at a glance

Key objectives

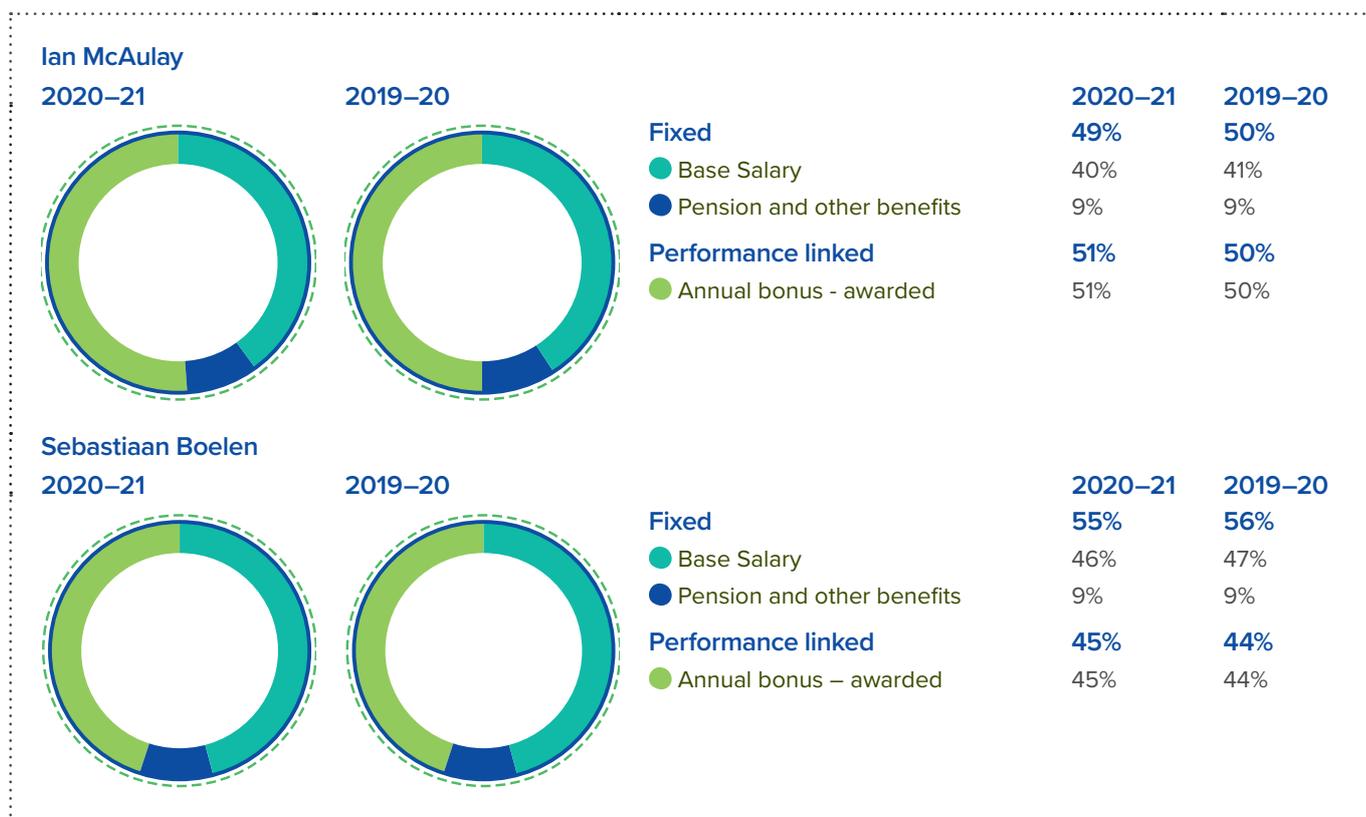
Providing transparent alignment between performance-related pay and quality customer outcomes

Governance, risk management and rigorous application

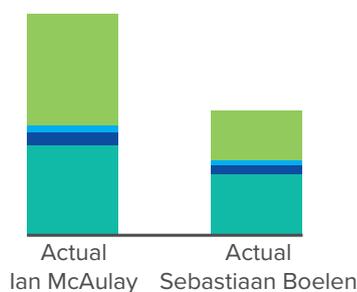
Applying stretching targets linked to customer outcomes

Executive directors' remuneration policy

Elements of executive directors' pay



Single total figure of remuneration for executive directors for year ended 31 March 2021



Ian McAulay

Bonus award	£550.9
Benefits	£18.2
Pension	£78.3
Salary	£435.0

Sebastian Boelen

Bonus award	£290.8
Benefits	£14.4
Pension	£45.0
Salary	£300.0

Directors' remuneration report continued

Remuneration Committee Report continued

Remuneration policy applicable in year (unaudited)

Purpose

This remuneration policy applies to all Southern Water employees. The Board of Directors has adopted the remuneration policy at the recommendation of the Remuneration Committee. This policy applies to remuneration earned from 1 April 2020 to 31 March 2021. This was updated in March 2021 to add clarity to a small number of points.

Providing transparent alignment between performance-related pay and quality customer outcomes

The policy reflects the Board's commitment to being open and transparent in respect of executive pay. In line with the expectations set out in Ofwat's 'Putting the sector back in balance' the Board has also committed during the year to ensuring that performance-related executive pay has a clear alignment to delivering stretching performance improvement, which is in the interests of customers as well as providing sustained and long-term value creation for shareholders and other stakeholders by:

- setting stretching performance targets that are based on the performance ambitions set out in our business plan
- ensuring that targets and metrics have a substantial and demonstrable link to stretching performance delivery and quality outcomes that align with the interests of customers
- transparently reporting how performance-related executive pay is linked to the underlying performance of the company
- embedding behavioural competence built around company values to underpin the cultural change and instil a way of working that will increase employee engagement and therefore productivity
- ensuring employees feel encouraged to create sustainable results and that a clear link exists between customers, shareholders and employees' interests
- ensuring that performance payments do not compromise employees' compliance with the Ofwat Section 19 requirements
- aligning pay to the market-median position, recognising the need, from time to time, to implement specific arrangements for certain individuals

- ensuring employees are offered a competitive and market median-aligned remuneration package, which balances the fixed and variable remuneration components according to job role
- ensuring that Southern Water is able to attract, develop and retain high-performing and motivated employees in a competitive market.

The table on page 201 summarises the elements of our executive directors' remuneration package and our policy for each item.

Governance, risk management and rigorous application

The Board applies sound and effective risk management principles to ensure that the policy is rigorously monitored and applied through:

- the application of good corporate governance by taking into account regulatory requirements and, among others, the UK Corporate Governance Code and any corporate governance principles issued by its regulator, Ofwat, from time to time
- a stringent governance structure for setting relevant and stretching goals, which are aligned to customer outcomes, and communicating these goals to employees
- clear alignment with our business strategy, company values, priorities and long-term goals
- the Remuneration Committee consists of two independent non-executive directors and one non-executive director and no executive directors, which avoids any conflicts of interest and aligns the principle of protection of customers and the interests of investors
- a commitment to the transparent reporting of executive pay within our Annual Report and Financial Statements, and any other channels as appropriate in accordance with legal and regulatory requirements, including the Ofwat Board leadership, transparency and governance principles
- a commitment to transparently report any changes to the policy, including the underlying reasons, within the Annual Report and financial statements, and any other channels as appropriate
- an annual review of the constitution and terms of reference of the Remuneration Committee to maintain its operational effectiveness and publishing these on our website for transparency
- ensuring the ongoing effectiveness of the Board and its committees through regular external and independent evaluation.

Applying stretching targets linked to customer outcomes

The Board sets stretching bonus targets linked to outcomes for customers that require stretching performance. The Board is committed to setting more than 50% of bonus targets that are linked to these outcomes. For 2020–21 these included customer outcomes such as ODIs, C-Mex, D-Mex, efficiency of service delivery, service through people as well as treating the environment as our customer.

Customers will also benefit from the value metrics, which will drive the long-term financial resilience of the organisation and capture the financial consequences of delivering for our customers, aligned with the needs of our shareholders. For 2020–21, these included outcomes such as Totex and net operating cash flow.

All metrics were used throughout the organisation so that all company employees are incentivised to achieve stretching levels of customer service. More detail can be found on pages 74 to 99 of this report.

Executive remuneration components

Executive remuneration comprises both fixed and variable elements with the four remuneration components detailed as follows:

- Fixed remuneration (including fixed supplements)
- Performance-based remuneration (variable percentage of salary)
- Pension schemes, where applicable
- Other benefits in kind (e.g. car allowance and private medical cover).

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 and is frequently benchmarked against industry peer groups.

The performance-based remuneration motivates and rewards those employees who significantly contribute to sustainable results, perform according to set expectations for the individual in question, strengthen long-term delivery of quality outcomes for customers and generate income and shareholder value.

The Board of Directors has determined a maximum percentage of performance-based remuneration relative to the fixed salary remuneration for the executive management positions. The table below shows the maximum limit on variable remuneration (excluding any pension allowance) for the CEO and CFO for 2020–21. The maximum percentages are made up of customer metrics and value metrics as follows:

	CEO	CFO
Customer metrics range and maximum:	0% – 100%	0% – 80%
Value metrics range and maximum:	0% – 100%	0% – 75%
Total maximum variable remuneration	0% – 200%	0% – 155%

Performance-based remuneration is disbursed as a cash bonus. The total of any executive bonus earned during the year is added to the individual's bonus pool carried over from prior years. Each year, 50% of the pool is paid out in cash, with the remaining 50% deferred and retained as the bonus pool for future years. Rules of the scheme include bonus recovery provisions, which allow for the possibility of a reduction or clawback of bonuses already earned, or those deferred, to incentivise sustained, long-term executive performance.

Executive directors are covered by an insured four times salary 'death in service' lump sum benefit and a contribution to a personal pension arrangement. The CEO receives an 18% of base salary contribution rate and the CFO receives 15%. Where retirement savings have exceeded the Lifetime Allowance (as defined by HMRC for their circumstances) the employer contribution may instead be taken as a pay supplement, subject to the relevant tax and National Insurance deductions.

The policy is that remuneration should be market-competitive relative to other comparable companies, with a significant proportion being performance-related. The performance-related element is only paid out if stretching targets are achieved that benefit both customers and shareholders. In setting the remuneration policy for executive directors, the committee 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. Attracting and retaining first class leadership is vital to the long-term success of the company.

Directors' remuneration report continued

Remuneration Committee Report continued

In particular, the committee is kept informed on a regular basis of the following, which it uses to set executive remuneration policy:

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

An investor representative non-executive director sits on the committee and is closely involved in setting remuneration levels, monitoring the performance of the executive directors, agreeing payments and approving any changes to executive reward packages. This involvement ensures that shareholders play a key part in shaping remuneration policy and decisions. Along with the independent non-executive directors they ensure that the link between pay and performance is closely managed.

To ensure that our remuneration practices remain competitive, the committee periodically calls upon experienced specialist consultants. During the year, the committee also received some guidance and market practice information from external, independent advisers, PwC.

Remuneration components

Element of remuneration	Purpose and link to strategy	Policy and approach	Maximum opportunity 2020–21
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>	<p>Reviewed annually with changes effective from 1 July if applicable.</p> <ul style="list-style-type: none"> • 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. • 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.</p>

Element of remuneration	Purpose and link to strategy	Policy and approach	Maximum opportunity 2020–21
Incentive and Retention Plan	<p>Drives and rewards performance against stretching financial, customer and operational KPIs, which are directly linked to business strategy.</p> <p>It is also structured to provide retention incentives to executives.</p>	<ul style="list-style-type: none"> • Details of the operation of the plan are shown on page 202. • Performance metrics and targets are established annually by the Committee, making sure they are sufficiently stretching while also recognising the nature and risk profile of the company. • Where applicable, between 0% and 85% of the opportunity available for each measure is created for achieving a threshold target. 90%-100% is awarded for achieving the actual target, with stretch targets creating between 95% and 150% for achieving outstanding performance. • The Committee has discretion to amend or withdraw payments based on the consideration of other factors which could significantly affect business performance. • Awards made under the plan are disclosed on pages 203 to 207. 	<p>200% of salary for the CEO</p> <p>155% of salary for the CFO</p>
Pension	<p>Defined contribution scheme minimises the risk to the company associated with defined benefit pension plans.</p>	<ul style="list-style-type: none"> • A company contribution into a defined contribution scheme, and/or • A cash allowance in lieu of pension. 	<p>CEO 18% of salary</p> <p>CFO 15% of salary</p>
Other benefits	<p>Provides market competitive benefits.</p>	<p>May consist of:</p> <ul style="list-style-type: none"> • Car allowance • Health cover • Disturbance or relocation allowances. 	<p>Based on individual circumstances</p>

Notes to the policy table

Directors' pay

Executive directors who served during the 2020–21 year are shown below:

Ian McAulay Chief Executive Officer
 Sebastiaan Boelen Chief Financial Officer

Details are given on page 204 of the amounts paid to them in the year ended 31 March 2021.

Directors' remuneration report continued

Remuneration Committee Report continued

Operation of the Incentive and Retention Plan

The Incentive and Retention Plan operates as follows:

1. **Annual Contribution:** Each year, participants have the opportunity to earn an annual bonus contribution based on performance against targets pre-determined by the Board. This is then added to the 'bonus pool'.
2. **Annual Pay-out:** Each year, following the Annual Contribution, 50% of the total amount in the 'bonus pool' is paid out to participants in cash.
3. **Deferred value:** Each year, the remaining 50% of the 'bonus pool' is carried forward. These deferred amounts will therefore roll over to the subsequent years.
4. **Repeat:** The following year, the process repeats, and continues for an indefinite period of time. This serves to increase the retention incentive and also give the Remuneration Committee a long-term view of sustainable outcomes for the company, customers and shareholders.

Measures used in the Incentive and Retention Plan

During the year, the Remuneration Committee identified and operated both customer and value performance measures in the Incentive and Retention Plan. The Customer performance measures for 2020–21 were focused on issues that affect customers such as:

- Customer satisfaction, as measured by our C-MeX performance
- Delivery of our business plan commitments, as measured by our in-year ODI performance
- A number of other measures aimed at reducing our operating costs, which ultimately helps us to reduce bills for customers.
- Creating an Environment plan, which was approved by the Board in March 2021, which includes measurable milestones that underpin deliverable metrics as agreed with the Board, including progress towards net-zero.

Value metrics for 2020–21 included a number of KPIs, all of which underpinned performance improvement.

An executive leaving the company will only be eligible for release of any deferred incentives if they are deemed as a 'good leaver' and meets specific targets prior to departure.

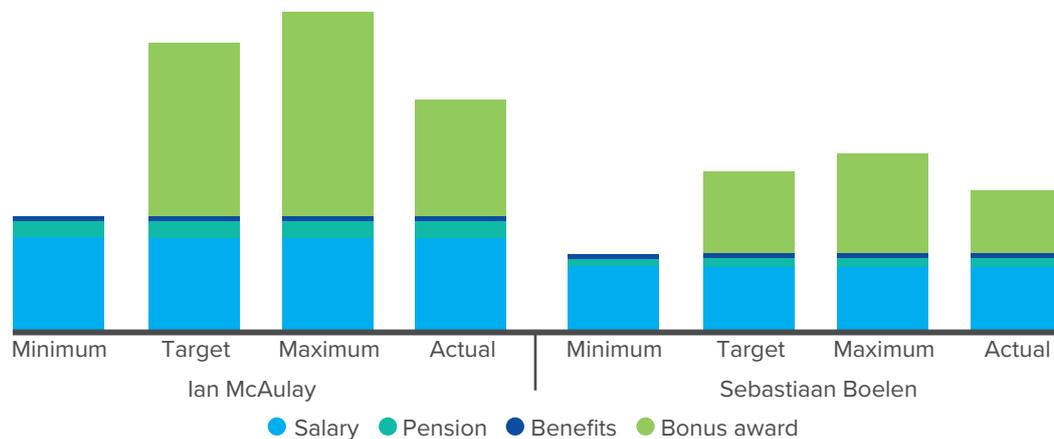
An individual is usually deemed to be a 'good leaver' if they leave the company in the following circumstances:

- Retirement
- Redundancy
- Disability
- Death
- Other circumstances which the committee deems appropriate.

Remuneration scenarios for 2020–21

The following chart sets out the remuneration scenarios payable to the executive directors for various levels of performance as well as the actual remuneration for 2020–21.

Remuneration scenarios and actual for 2020–21



Ian McAulay

	Minimum	Target	Maximum	Actual
Bonus award	£ -	£807,686	£957,000	£550,900
Benefits	£18,249	£18,249	£18,249	£18,249
Pension	£78,300	£78,300	£78,300	£78,300
Salary	£435,000	£435,000	£435,000	£435,000

Sebastiaan Boelen

	Minimum	Target	Maximum	Actual
Bonus award	£ -	£382,620	£465,000	£290,800
Benefits	£14,361	£14,361	£14,361	£14,361
Pension	£45,000	£45,000	£45,000	£45,000
Salary	£300,000	£300,000	£300,000	£300,000

Directors' remuneration report continued

Remuneration Committee Report continued

Notice periods for joiners and leavers

The table below sets out the contractual notice periods for the executive directors. 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, pension and car allowance is payable.

	Notice period
Ian McAulay, CEO	12 months by either party
Sebastiaan Boelen, CFO	Six months by either party

Annual remuneration report

Single figure of remuneration for 2020–21 (audited)

Details of the remuneration received by the executive directors are shown below. The figures shown are the amounts paid or awarded for each of these financial years. Base salary is generally reviewed in July each year and so the amounts reported for base salary reflect a part-year effect of any pay award granted.

£'000		Base salary paid	Benefits	Annual Bonus/ Incentive and Retention Plan ¹	Total	Pension related benefit	Total including pension
Ian McAulay	2020–21	435.0	18.2	550.9	1,004.1	78.3	1,082.4
	2019–20	435.0	17.3	538.1	990.4	78.3	1,068.7
Sebastiaan Boelen	2020–21	300.0	14.4	290.8	605.2	45.0	650.2
	2019–20	290.5	12.8	277.0	580.3	43.6	623.9

¹ The amount reported is added to the bonus pool for the year as shown in the table under Incentive and Retention Plan on page 207. That table also provides details of payments made from the bonus pool and that carried forward to future years.

Notes to the single figure of remuneration (unaudited)

Base salary

The base salary for Ian McAulay was reviewed on 1 July 2020 and, as in previous years, at Ian's request (which was supported by the Board), remained unchanged from the 1 July 2018 level of £435,000. The base salary for Sebastiaan Boelen was reviewed on 1 July 2020 and remained unchanged at £300,000 per annum. Salary was paid monthly via PAYE.

Incentive and Retention Plan (customer and value metrics)

The performance measures agreed by the Committee for 2020–21 were:

- In-year ODIs – delivery of performance commitments
- ODIs RIF (minus C-Mex and D-Mex) – total AMP forecast position
- Retail cost to serve (retail Totex), excluding bad debt – efficient delivery of the operational promises made to customers as part of our business plan
- C-MeX – incentivises excellent customer experience for residential customers across the retail and wholesale parts of the value chain
- D-MeX – incentivises excellent customer experience for developer services (new connections) customers
- Environment – building our future environmental plan
- Gallup Q12 people rating – colleague engagement
- Health, Safety & Wellbeing – ensuring our employees are kept safe and healthy at work
- Totex (Wholesale Totex) – total expenditure within plan
- Progress against PR19 Maturity Assessment – progress against the commitments agreed with Ofwat to ensure we robustly manage performance to avoid further regulatory breaches
- Net operating cash flow – cash generation

The performance for 2020–21 was assessed by the committee in May 2021. Details of the maximum bonus achievable, targets and outturn percentage for each executive director are shown in the tables below.

CEO	Maximum bonus achievable	Outturn %	Outturn as a % of salary
Customer targets	100%	39.20%	39.20%
Value targets	100%	87.45%	87.45%
Total outturn as a percentage of salary			126.65%

CFO	Maximum bonus achievable	Outturn %	Outturn as a % of salary
Customer targets	80%	39.20%	31.36%
Value targets	75%	87.45%	65.58%
Total outturn as a percentage of salary			96.94%

Directors' remuneration report continued

Remuneration Committee Report continued

The overall bonus awarded across the business of 63.33% is the weighted average of the customer and value target performance shown above. The outturn as a percentage of salary is calculated by multiplying the maximum bonus achievable by the outturn percentage.

Incentive and Retention Plan 2020–21	2020–21	Threshold performance level	Target performance level	Stretch performance level	Performance for the year ¹	CEO Weighting (% of salary)	CFO Weighting (% of salary)	CEO Pay-out (% of salary)	CFO Pay-out (% of salary)
In-year ODIs	Performance	£16.8m	£16.0m	£12.8m	£39.65m	30.0%	24.0%	0.00%	0.00%
	Bonus percentage	25%	100%	150%					
ODIs RIF (minus C-Mex and D-Mex)	Performance	£83.0m	£74.7m	£66.4m	£74.35m	10.0%	8.0%	10.20%	8.16%
	Bonus percentage	75%	100%	150%					
Retail cost to serve (Retail Totex), excluding Bad Debt	Performance	£52.5m	£48.3m	£44.1m	£43.1m	15.0%	12.0%	18.00%	14.40%
	Bonus percentage	80%	100%	120%					
C-MeX	Performance	15th	14th	13th	16th	20.0%	16.0%	0.00%	0.00%
	Bonus percentage	75%	100%	120%					
D-MeX	Performance	13th	11th	9th	15th	10.0%	8.0%	0.00%	0.00%
	Bonus percentage	75%	100%	120%					
Environment	Performance	n/a	Plan agreed	n/a	Plan agreed	5.0%	4.0%	5.00%	4.00%
	Bonus percentage	0%	100%	0%					
Gallup Q12 Colleague Engagement	Performance	3.79	3.81	3.85	3.89	5.0%	4.0%	6.00%	4.80%
	Bonus percentage	80%	100%	120%					
Health, Safety & Wellbeing	Performance	90%	95%	100%	78%	5.0%	4.0%	0.00%	0.00%
	Bonus percentage	80%	100%	120%					
Totex (Wholesale Totex)	Performance	£728.2m	£662.0m	£595.8m	£694.43m	50.0%	37.5%	45.10%	33.82%
	Bonus percentage	80%	100%	150%					
Progress against PR19 Maturity Assessment ²	Performance	Some progress	Satisfactory progress	Excellent progress	Satisfactory progress	25.0%	18.75%	22.35%	16.76%
	Bonus percentage	85%	90%	95%					
Net operating cash flow	Performance	(£1.3m)	(£0.4m)	(£0.1m)	(£9.7m)	25.0%	18.75%	0.00%	0.00%
	Bonus percentage	80%	100%	150%					
Total								106.65%	81.94%
Adjustment applied to Net operating cash flow of £8.4m recognising COVID-19-related costs ³								20.00%	15.00%
Total awarded								126.65%	96.94%

1 Where the performance for the year has been based on the latest forecast position available at the time, any subsequent changes to the final outcome position will be adjusted for in the following performance year and in accordance with the IRP scheme rules.

2 This KPI comprises two elements – Progress against PR19 Maturity Assessment (10% maximum) and progress against S19 undertakings (15% maximum). The outturn achieved was 90% of max (9%) in respect of PR19 Maturity Assessment and 89% of max (13.35%) for S19 undertakings.

3 Having reflected on the overall performance of the company and taking into account the views of shareholders, the Board applied a discretionary adjustment to net operating cash flow, recognising the significant impact of COVID-19 on various cash collection issues.

CEO bonus distribution



CFO bonus distribution



- Operating costs
- Environment
- Preparation for 2020–2025
- Cash performance
- Performance commitments
- Customer service
- Employee engagement
- Health, Safety and Wellbeing

The threshold, target and stretch bonus percentages shown reflect the level of bonus award for achievement of the threshold, target and stretch performance levels for each metric.

Incentive and Retention Plan Contribution 2020–21	(a) Bonus pool brought forward (£'000)	(b) Bonus awarded in year (£'000)	(c) Bonus paid out (£'000) (50%)	(d) Bonus pool carried forward (£'000) (50%)
Ian McAulay	476.3	550.9	513.6	513.6
Sebastian Boelen	157.2	290.8	224.0	224.0

The amounts paid out (c) and carried forward (d) are each calculated as $((a) + (b)) \div 2$.

Pension contributions

The pension contribution for the Executive Directors is set out in the table below:

Pension	Salary received (£'000)	Pension contribution as a % of base salary	Cash allowance in lieu of pension (£'000)	Pension contribution to scheme (£'000)	Total Pension related benefit (£'000)
Ian McAulay	435.0	18%	74.3	4.0	78.3
Sebastian Boelen	300.0	15%	34.2	10.8	45.0

Following the closure of the company's defined benefit pension scheme to future accrual and the introduction of a new defined contribution scheme for the company's workforce, the Remuneration Committee reviewed the pension contribution payable to the executives. In doing so, the Remuneration Committee also considered the expectation in Provision 38 of the UK Corporate Governance Code that the pension contributions payable to the executive directors are aligned to that of the workforce. Accordingly, it was agreed that from 1 April 2020, the employer pension contributions offering for new executive director appointments would be aligned to the 'all employee' rate of 11%.

Non-executive director fees for the year (audited)

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

The Board as a whole is responsible for setting the level of non-executive director fees and in doing so receives input from the Remuneration Committee.

Directors' remuneration report continued

Remuneration Committee Report continued

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

£'000	2020–21			2019–20		
	Fees	Other	Total	Fees	Other	Total
Keith Lough (Chairman) (appointed 1 August 2019)	275.0	7.7	282.7	183.3	2.4	185.7
Paul Sheffield (Senior independent non-executive director; acting chairman between 1 April and 31 July 2019)	70.0	0.0	70.0	130.0	5.3	135.3
Rosemary Boot (Independent non-executive director)	50.0	0.2	50.2	59.6	1.7	61.3
Mike Putnam (Independent non-executive director)	60.0	1.4	61.4	57.5	4.0	61.5
Dame Gillian Guy DBE (Independent non-executive director)	50.0	0.0	50.0	50.0	0.0	50.0
Kevin McCullough (Independent non-executive director) (From 18 July 2019)	65.0	2.3	67.3	36.7	1.3	38.0
Malcolm Cooper (Independent non-executive director) (From 23 December 2019)	65.0	0.8	65.8	17.8	0.1	17.9
Marykay Fuller (Greensands Board-nominated non-executive director from 15 June 2020)	47.7	0.4	48.1	–	–	–
Wendy Barnes (Greensands Board-nominated non-executive director until 27 March 2020)	–	–	–	60.0	14.9	74.9
Sara Sulaiman (Investor-nominated non-executive director)	–	–	–	–	–	–

The base fees for the non-executive directors are £50,000, with the exception of Sara Sulaiman, who receives no fee from Southern Water as an investor-nominated non-executive director.

Paul Sheffield was appointed as acting Chairman from 1 April 2019 to 31 July 2019, during which time a fee of £250,000 per annum, prorated as appropriate was paid. Upon the appointment of Keith Lough as Chairman on 1 August 2019, Paul Sheffield's base fee reverted to £50,000 per annum plus the applicable responsibility supplements for his roles as senior independent non-executive director and Chair of the Remuneration Committee.

In May 2019, the Remuneration Committee reviewed the fees payable to the non-executive directors and assessed these against practice within both the sector and elsewhere using benchmarking data supplied by PwC. Following this assessment, responsibility payments were reviewed and the Remuneration Committee agreed that it was appropriate to keep base fees unchanged. The table below provides details of the applicable responsibility payments.

Responsibility supplement	Current Chair and date appointed	Responsibility supplement	Comments on supplement
Audit Committee Chair	Malcolm Cooper* 23 December 2019	£15,000	Increased from £10,000 with effect from 1 July 2019
Risk Committee Chair	Mike Putnam 1 July 2019	£10,000	Introduced with effect from 1 July 2019
Remuneration Committee Chair	Paul Sheffield 1 April 2015	£10,000	Introduced with effect from 1 October 2018
Senior independent non-executive director	Paul Sheffield 1 July 2015	£10,000	No change from 2019–20
Workforce non-executive director	Kevin McCullough 26 February 2020	£15,000	Role introduced with effect from 26 February 2020
Greensands Board-nominated director	Marykay Fuller** 15 June 2020	£10,000	No change from 2019–20

* Rosemary Boot was Interim Audit Committee Chair from 1 April 2019 to 22 December 2019.

** Wendy Barnes was Greensands Board-nominated director until she resigned from the Board on 27 March 2020.

The other amounts payable to the non-executive directors include taxable expenses incurred in connection with attendance at Board meetings and shareholder events.

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.

Gender pay (unaudited)

Creating an environment to enable a diverse and inclusive workforce will have a positive effect on our organisation and this is a key part of Southern Water's People Strategy. The Gender Pay Gap report produced by the company provides details of the company's focus on this area and we are pleased to see that the median pay gap has reduced this year from 2.4% to -2.0% in favour of female employees. In terms of the median bonus gap, we have seen a small reduction from 26.8% to 24.5% linked to seniority; an area we are addressing via succession planning. These results show a positive change in both pay and bonus gaps, indicating that in general remuneration is applied fairly in our organisation, and we are keen to do more to create an increasingly inclusive organisation.

Using the Deloitte diversity and inclusion model, our executive leadership sponsors have set a goal of a leader-led (level 3 of 4) organisation by the end of 2022 where Engagement, Diversity and Inclusion (ED&I) is part of what we do.

It is acknowledged that there is still more to be done. The company will continue to support the aspirations of its female employees, concentrating on further improvements in the areas of recruitment, talent development and remuneration as well as policies which further support colleagues to achieve a balance of work with family commitments. For more information, see the report on our gender pay gap at southernwater.co.uk/gender-pay-gap.

Directors' remuneration report continued

Remuneration Committee Report continued

It is our policy to eradicate bias

We are committed to creating a diverse and inclusive workforce that represents the communities we serve, and we value the skills that each individual brings to our organisation. Diversity and inclusion is at the heart of a sustainable workforce and is a key focus for Southern Water. We recognise the huge value this brings to our company, both culturally and in increased engagement from our colleagues, so from November 2020, we have appointed an Inclusion and Engagement Partner, allowing us to really focus on this key agenda. In terms of pay, we are committed to narrowing the gender pay gap over time and to ensure that our gender pay gap reporting is open and transparent. We are also looking to improve our data around ethnicity so that we can better measure and improve our approach to diversity in the workplace.

Executive pay gap reporting

From 2020 onwards, the Companies (Miscellaneous Reporting) Regulations 2018 require all publicly-listed companies with more than 250 UK employees to publish the ratio between their CEO's full-time equivalent remuneration and that of employees at the 25th, 50th and 75th percentile when total remuneration is calculated and ranked from highest to lowest.

Although not a listed company, Southern Water has chosen to publish this information in line with our commitment to providing information about pay diversity and fairness within our organisation.

The regulations set out three options for calculating the pay ratio.

- Option A – takes into account all forms of remuneration and payments (pension etc)
- Option B – uses the Gender Pay calculation figures
- Option C – uses some other method

Our ratio has been calculated using 'Option A' as this takes into account full remuneration and is therefore the most comprehensive comparison.

Year	Method	25th Percentile Ratio	50th Percentile Ratio	75th Percentile Ratio
2020	A	27.3:1	22.0:1	17.2:1
2019	A	28.7:1	22.8:1	17.8:1

Implementation of policy for 2021–22 (unaudited)

Base salary

The basic salary for Ian McAulay will remain unchanged for 2020–21. The base salary for Sebastiaan Boelen will be increased by 1% in July 2021.

The revised base salaries for each Executive director are as follows:

Base salary	Base salary for 2020–21 (£'000)	Base salary increase (%)	Base salary from July 2021 (£'000)
Ian McAulay	435.0	0.0	435.0
Sebastiaan Boelen	300.0	1.0	303.0

Incentive and Retention Plan

The Incentive and Retention Plan will be based on performance conditions designed to focus the Executive directors on the areas of key strategic importance for the company. As such the performance conditions will be based on customer objectives that focus on delivering positive outcomes for our customers and other stakeholders and value objectives, which long-term create value for our shareholders and our customers alike.

Bonus potential for 2021–22

The table below shows the maximum bonus potential for the Executive directors in 2021–22.

	CEO		CFO	
	2020–21	2021–22	2020–21	2021–22
Total maximum variable remuneration	200%	200%	155%	155%

We have fully committed to comply with Ofwat’s code of practice for executive remuneration for 2020–25

We made significant steps towards compliance in our 2020-21 Remuneration Policy, which set out:

- our policy to provide transparent alignment between executive performance-related pay and stretching outcomes for all our stakeholders and, substantially, for our customers
- our policy to apply stretching targets linked to customer outcomes
- our policy to apply rigorous application of incentive scheme rules and provide independent governance of remuneration decisions, while taking into consideration risk management principles
- our policy to defer an element of bonus so that performance can be measured over the medium to long term.

Our performance measures for 2021–22 focus on positive outcomes for our customers and other stakeholders

In determining the performance measures for 2021–22, the Remuneration Committee considered the expectation under the Ofwat Principles that the company’s performance-related elements should be linked to stretching delivery for customers, as well as the steps needed to further embed the Ofwat code of practice for executive remuneration. It was agreed that the following measures will be used to assess our performance:

- In year ODIs
- ODIs RIF (minus C-MeX and D-Mex, which are stand-alone targets)
- Retail cost to serve (Retail Totex, including bad debt and velocity)
- C-MeX
- D-MeX
- Environment – delivering a number of critical elements of the plan
- Q12 Colleague Engagement
- Health, Safety, Security and Wellbeing
- Totex (broken down into opex, capex and capital efficiency)
- Progress against WRMP and Resilience Action Plan and the Section 19 undertakings given to Ofwat
- Net operating cash flow

In determining the performance measures, the Remuneration Committee sought to balance the expectations of both the company’s investors in terms of an efficient and well-run company as well as the company’s obligations to its customers and other stakeholders.

Weightings and targets, along with actual performance, will be fully disclosed in the 2021–22 Remuneration Report.

Directors' report

for the year ended 31 March 2021

The Directors of Southern Water Services Limited (registered no. 02366670) present their report and the audited financial statements for the year ended 31 March 2021.

Principal activities

The principal activities of Southern Water Services Limited, herein after referred to as '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 over 2.5 million people and provides wastewater services to over 4.7 million people.

Strategic Report

The information that fulfils the requirement of the Strategic Report can be found in our Annual Report on pages 20 to 143 including the Section 172 (1) Statement on pages 66 to 69.

Future developments

The information regarding future developments of the company can be found in our Annual Report on pages 54 to 55.

Post balance sheet events

There were no significant events after the statement of financial position date.

Results and dividends

The income statement on page 222 shows the company's results and loss for the year. Further details are also available in the Annual Report on pages 104 to 111.

Interim dividends of £70.87 per ordinary share (2020: £126.64 per share), totalling £4.0 million (2020: £7.1 million) were paid during the year to Southern Water Services Group (SWSG). These dividends, along with associated group tax relief of £0.9 million, enable SWSG to pay £4.9 million of the interest totalling £9.5 million due to SWS on an inter-company loan as disclosed in note 15 to the financial statements.

No ordinary interim dividends were paid during the year (2020: £nil). No final dividend has been declared or paid for the year ended 31 March 2021.

Directors and their interests

The directors who held office during the year ended 31 March 2021 and up to the date of signing the financial statements, unless otherwise stated, were as follows (details can be found on pages 148 to 153):

Keith Lough

Chairman

Ian McAulay

(Executive director – Chief Executive Officer)

Sebastian Boelen

(Executive director – Chief Financial Officer)

Paul Sheffield

(Senior independent non-executive director)

Rosemary Boot

(Independent non-executive director)

Malcolm Cooper

(Independent non-executive director)

Gillian Guy

(Independent non-executive director)

Kevin McCullough

(Independent non-executive director)

Michael Putnam

(Independent non-executive director)

Marykay Fuller

(Non-executive director) (Appointed 15 June 2020)

Sara Sulaiman

(Non-executive director)

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

Research and development

The improvement of existing services and processes, together with the identification and development of new technology and innovative 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 charged to the income statement for the year amounted to £0.6 million (2020: £0.5 million).

Financial risk management

The Financial Risk Management Policy is included in the Strategic Report which can be found in the Annual Report on page 129.

Corporate governance

A description of the company's corporate governance arrangements for the purposes of Part 8 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as introduced by regulation 14 of the Companies (Miscellaneous Reporting) Regulations 2018 can be found in the Annual Report on pages 145 to 211.

Employees

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

The company has re-established an Employee Voice group during 2020–21 to facilitate meaningful consultation between company management and employees through elected employee representatives. The group will meet regularly at both a functional and company-wide level.

In 2017, the company introduced the Gallup employee survey, which has continued to be undertaken every six months to help develop management action plans and provide insight into the views of employees. The company also conducts further surveys throughout the year on specific matters, the results of which are reported to management and/or the Board as appropriate.

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

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.

During 2020–21, the company's Executive directors and Executive Leadership Team members as well as individual non-Executive directors initiated monthly 'Company Conversations', using video conferencing, to inform and engage with the company's employees about the company's priorities based on the new business plan 2020–25 as well as to inform and engage with the company's employees about the company's

purpose and values and working arrangements as a result of the pandemic. These sessions also afforded employees an opportunity to put questions to the executive directors and senior leadership about anything regarding the business.

In line with the UK Corporate Governance Code, one of the company's independent non-executive directors, Kevin McCullough, has been given the remit of communicating the views of the company's workforce to the Board.

Further details of the company's employees and the company's engagement activities, as well as how the directors have had regard to employee interests, can be found in the Strategic Report on pages 56 to 59.

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, security 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 employees, customers and members of the public.

The company holds an annual Health and Safety Conference, which this year focused on wellbeing. It attracted people from across the company and its partners to share the latest developments within the health and safety industry. Southern Water is committed to the 'Time for change' programme to raise awareness and understanding of mental health issues.

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

Disabled employees: Applications for employment by disabled persons are always fully considered, bearing in mind the abilities of the applicant concerned. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the company

Directors' report continued

for the year ended 31 March 2021 continued

continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

Speak Up: Employees are actively encouraged to Speak Up if they see things that are not quite right. This helps us work better as a company and fosters a culture where we ensure that we are always doing the right thing for each other, our customers, the environment and other stakeholders.

Engagement with customers, suppliers and others

The company recognises the importance of its suppliers to ensure the company's ability to continue to deliver an essential public service. Further details of the company's engagement with its suppliers during the year can be found on page 62.

Due to the nature of its business and the regulatory framework in which the company operates, engagement with its customers is of key importance. The company undertakes extensive customer engagement activities throughout the year. Further details can be found on page 46.

As a private limited company, Southern Water Services Limited is not required to hold an annual general meeting.

The company, its senior executives and Board regularly engage with the company's regulators, with local and national government as well as with relevant industry groups through meetings and other events.

The company's statement explaining how the directors have had regard to the matters set out in section 172(1)(a) to (f) of the Companies Act 2006, and which provides further detail in respect of how the directors have taken into account the interests of the company's employees, suppliers, customers and others during the year, can be found on pages 66 to 69.

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.

A settlement was agreed with Ofwat in 2019 in respect of our historic wastewater performance and reporting and the company is being prosecuted by the Environment Agency for related matters. Further details are disclosed on pages 30 and 31.

The company's environmental performance for 2020–21 is reported on pages 70 to 73, and 88 to 93. 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.

Streamlined Energy and Carbon Report (SECR)

This section fulfils the requirements of the Companies (Directors Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018.

Information about the company can be found on page 72 of the Annual Report.

Quantification and reporting methodology

The methodology used to calculate operational greenhouse gas emissions for the provision of water and wastewater services follows the GHG Protocol Corporate Reporting Standard.

The water sector employs a bespoke carbon accounting workbook which reflects best practice and is updated every year in order to use the latest emission factors, derived from the UK's GHG Conversion Factors. Version 15 22-02 of the Carbon Accounting Workbook (March 2021) has been utilised to prepare the GHG estimations.

Operational boundary

The reporting boundary covers all of the company's operational services and is congruous with our financial reporting boundary.

Energy use

Area	2020–21 kWh	2019–20 kWh
Electricity	459,873,901	464,073,076
Imported	396,768,099	399,468,630
Self-generated	63,105,802	64,604,446
Gas	2,077,548	2,525,152
Business transport	13,373,597	16,372,496
Total incl. self-generation	475,325,046	482,970,723
Total excl. self-generation	412,219,244	418,366,277

The company's self-generated supply comes from combined heat and power (CHP), solar PV and diesel generation. In addition, the company exported excess electricity to the grid, predominantly renewable energy from the company's 16 CHP installations.

Greenhouse gas emissions

Scope	Description	Included in scope	2020–21 (ktCO ₂ e)	2019–20 (ktCO ₂ e)
1	Direct emissions from activities that the company own or control including combustion of fuel	Gas oil use, Process emissions, Company transport	63.1	69.4
2	Indirect emissions from purchase of electricity (location-based)	Grid electricity	91.4	101.6
	Indirect emissions from purchase of electricity (market-based)	Grid electricity	9.5	60.5
3	Other Indirect emissions	Business travel on public transport/private vehicles, Outsourced activities, Grid electricity transmission and distribution	18.5	20.5
Total Gross emissions for Scope 1 & 2	Location-based approach		154.6	171
	Market-based approach		72.6	130

* Location-based approach uses the average grid emission factor for power from the electricity grid

** Market-based approach uses the carbon intensity of the energy we procure from the electricity grid

Targets

In order to mitigate the company's climate impact it is committed to delivering net zero operational greenhouse gas emissions by 2030 as a water sector. This target was published in March 2019.

Directors' report continued

for the year ended 31 March 2021 continued

Global greenhouse gas and energy intensity metrics

Area	Unit of measurement	2020–21	2019–20
All company (location-based approach)	Tonnes of CO ₂ e from Scope 1 and 2 gross emissions per £100,000 turnover	19.7	19.5
All company (market-based approach)	Tonnes of CO ₂ e from Scope 1 and 2 gross emissions per £100,000 turnover	9.3	14.8
All company energy (incl. self-generation)	kWh/ £100,000 of turnover	60,469	55,008
All company energy (excl. self-generation)	kWh/ £100,000 of turnover	52,422	47,650
Water services	kgCO ₂ e per Megalitre (MI) of water treated (location based approach)	178	201
Water services	kgCO ₂ e per Megalitre (MI) of water treated (market based approach)	37	
Water services (Electricity incl. self-generation)	kWh/MI	718	742
Water services (Electricity excl. self-generation)	kWh/MI	704	727
Water services (Total energy incl. self-generation)	kWh/MI	744	775
Water services (Total energy excl. self-generation)	kWh/MI	730	760
Wastewater services	kgCO ₂ e per Megalitre (MI) of wastewater treated (location-based approach)	241	261
Wastewater services	kgCO ₂ e per Megalitre (MI) of wastewater treated (market-based approach)	141	
Wastewater services (Electricity incl. self- generation)	kWh/MI	623	620
Wastewater services (Electricity excl. self- generation)	kWh/MI	502	500
Wastewater services (Total energy incl. self- generation)	kWh/MI	643	645
Wastewater services (Total energy excl. self- generation)	kWh/MI	523	524

Note: Turnover 2020–21 reported as £784.2 million for use in intensity metrics. This reflects a reduction of £35.6 million due to an Ofwat regulatory settlement.

Energy efficiency action

Southern Water has continued to invest in energy efficiency in 2020–21, building on the work done in AMP6 to identify saving opportunities and enable these across the business. A saving of over 4,000,000 kWh has been realised in the year as a result, with key contributing activities including:

- Improved the manning of our largest water production sites, enabling us to optimise operational processes on site 24/7 and to therefore benefit from improved energy efficiency.
- A new Internal scheme to replace all pumps < 7.5 kW with new efficient pump and motors. This has now become a standard policy across the business.
- £4 million of borehole pump replacement investment has been secured. This investment is to include variable speed drives, along with more efficient pumps and motors.
- Optimisation of process across multiple waste sites, resulting in the reduction of site energy demand.

Assurance statement

This quantification of greenhouse gas emissions and energy usage is checked internally through a governance framework and subsequently audited by independent consultants as part of the company's annual regulatory reporting.

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 2021.

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 20 to 142.
- The potential impact of COVID-19 on the company's operations and financial performance.
- The financial position of the company, its cash flows, liquidity position, covenants and borrowing facilities, which are described in the financial performance review on pages 102 to 111.
- The company has available a combination of cash and committed undrawn bank facilities totalling £714.5 million at 31 March 2021 (2020: £874.3 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.
- New financing totalling £1,125 million (net £1,110.1 million) was raised in 2020–21 by the company's subsidiary Southern Water Services (Finance) Limited. For SWS, under a sustainability framework which ensures proceeds are used for environmental, green, and social purposes, including the repayment of debt issued for the same purpose. The proceeds were used to repay a £350 million bond which matured in March 2021 and will be used to finance the ongoing capital investment programme. This replaces a short-term revolving credit facility of £700.0 million that was in place from 31 March 2020.
- The company obtained a waiver from its Lenders in February 2021 which allows full use of available liquidity, plus the raising of new finance, even in a Trigger Event scenario of a credit rating downgrade or a breach of a trigger debt compliance ratio. The next planned financing activity will in anticipation of a bond maturity on 31 March 2023.
- The company operates in an industry that is currently subject to economic regulation rather than market competition. Ofwat, the economic

Directors' report continued

for the year ended 31 March 2021 continued

regulator, has a statutory obligation to set price limits that it believes will enable the water companies to finance their activities.

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.

Long-term viability statement

In accordance with Provision 31 of the UK Code and Ofwat's Information Notice IN 19/07, the Board has assessed the prospects of the company over a longer period than the 12 months required by the 'Going Concern' provision. Details of its assessment and the associated viability statement can be found on pages 140 to 142 of this report.

Qualifying third party indemnity

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

Directors' responsibilities statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS101 'Reduced Disclosure Framework'. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgments 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 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 it faces.

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. they have taken all the steps that they ought to have taken as a director in order to make themselves 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.

Richard Manning

General Counsel and Company Secretary

30 June 2021

Financial statements



Contents

Income statement	222
Statement of other comprehensive income	223
Statement of financial position	224
Statement of changes in equity	225
Statement of cash flows	226
Notes to the financial statements	227
Independent Auditor's report	266

Income statement

For the year ended 31 March 2021

	Note	2021 £m	2020 £m
Continuing operations			
Revenue	5	784.2	878.0
Amortisation of regulatory settlement	5	35.6	–
Total revenue		819.8	878.0
Other operating income	5	1.7	1.4
Operating costs before charge for bad and doubtful debts, depreciation and amortisation		(360.0)	(373.5)
Charge for bad and doubtful debts		(34.8)	(29.6)
Operating costs before depreciation and amortisation		(394.8)	(403.1)
Depreciation and amortisation	6	(287.9)	(264.0)
Total operating costs		(682.7)	(667.1)
Operating profit	6	138.8	212.3
Operating profit before regulatory settlement		103.2	212.3
Amortisation of regulatory settlement		35.6	–
Operating profit		138.8	212.3
Profit on disposal of fixed assets	6	0.8	0.9
Finance income	9	110.1	41.6
Finance costs	9	(161.7)	(160.8)
Fair value (losses)/gains on derivative financial instruments	9	(444.8)	339.9
Net finance (costs)/income	9	(496.4)	220.7
(Loss)/profit before taxation		(356.8)	433.9
Taxation	10	64.8	(105.2)
(Loss)/profit for the financial year		(292.0)	328.7

The notes on pages 227 to 265 form part of these financial statements.

Statement of other comprehensive income

For the year ended 31 March 2021

	Note	2021 £m	2020 £m
(Loss)/profit for the year		(292.0)	328.7
Other comprehensive (expense)/income:			
Items that cannot be reclassified to profit or loss:			
Actuarial (loss)/gain on pension scheme	24	(70.0)	111.7
Movement on deferred tax relating to retirement benefit obligations	23	13.3	(17.5)
Total other comprehensive (expense)/income for the year, net of tax		(56.7)	94.2
Total comprehensive (expense)/income for the year attributable to the owner of the company		(348.7)	422.9

Statement of financial position

As at 31 March 2021

	Note	2021 £m	2020 £m
Non-current assets			
Intangible assets	12	189.7	42.1
Property, plant and equipment	13	6,445.0	6,325.7
Investments	14	29.2	29.2
Derivative financial instruments	22	68.2	194.3
Other non-current assets	15	130.0	130.0
		6,862.1	6,721.3
Current assets			
Inventories	16	6.3	5.1
Trade and other receivables	17	214.2	273.2
Cash and cash equivalents	32	339.5	129.3
		560.0	407.6
Total assets		7,422.1	7,128.9
Current liabilities			
Trade and other payables	18	(289.5)	(260.8)
Borrowings	19	(34.3)	(713.8)
Lease liabilities	21	(2.5)	(2.2)
Regulatory settlement liability	25	(24.2)	(35.6)
Provision for liabilities	26	(3.9)	(5.1)
		(354.4)	(1,017.5)
Non-current liabilities			
Borrowings	20	(3,993.7)	(2,884.8)
Lease liabilities	21	(27.2)	(28.2)
Derivative financial instruments	22	(1,500.6)	(1,376.4)
Deferred tax liabilities	23	(289.7)	(368.7)
Retirement benefit obligations	24	(116.5)	(62.5)
Regulatory settlement liability	25	(75.6)	(99.9)
Provision for liabilities	26	(4.3)	(4.7)
Other non-current liabilities	27	(159.3)	(32.7)
		(6,166.9)	(4,857.9)
Total liabilities		(6,521.3)	(5,875.4)
Net assets		900.8	1,253.5
Equity			
Called up share capital	28	0.1	0.1
Share premium account	29	46.3	46.3
Non-distributable reserve	30	76.9	60.2
Retained earnings	31	777.5	1,146.9
Total equity		900.8	1,253.5

The financial statements of Southern Water Services Limited (Registered no. 02366670) on pages 220 to 265 were approved by the Board and authorised for issue on 30 June 2021. They were signed on its behalf by:



Sebastiaan Boelen
Chief Financial Officer

Statement of changes in equity

For the year ended 31 March 2021

	Called up share capital (note 28) £m	Share premium account (note 29) £m	Non- distributable reserve (note 30) £m	Retained earnings (note 31) £m	Total £m
Balance at 1 April 2019	0.1	46.3	53.8	737.5	837.7
Profit for the financial year	–	–	7.8	320.9	328.7
Other comprehensive income/(expense) for the year:					
Actuarial gain on pension scheme	–	–	–	111.7	111.7
Movement on deferred tax relating to retirement benefit obligations	–	–	–	(17.5)	(17.5)
Total comprehensive income for the year	–	–	7.8	415.1	422.9
Reserves transfer*	–	–	(1.4)	1.4	–
Equity dividends paid (note 11)	–	–	–	(7.1)	(7.1)
Balance at 31 March 2020	0.1	46.3	60.2	1,146.9	1,253.5
Profit/(loss) for the financial year			18.2	(310.2)	(292.0)
Other comprehensive income/(expense) for the year:					
Actuarial loss on pension scheme	–	–	–	(70.0)	(70.0)
Movement on deferred tax relating to retirement benefit obligations	–	–	–	13.3	13.3
Total comprehensive income/(expense) for the year	–	–	18.2	(366.9)	(348.7)
Reserves transfer*	–	–	(1.5)	1.5	–
Equity dividends paid (note 11)	–	–	–	(4.0)	(4.0)
Balance at 31 March 2021	0.1	46.3	76.9	777.5	900.8

* The non-distributable reserve arose upon adoption of IFRS 15 and relates to deemed revenue on adoption of assets from customers and is being amortised to reserves in line with the depreciation of the related assets.

Statement of cash flows

For the year ended 31 March 2021

	Note	2021 £m	2020 £m
Cash from operations	32	388.2	478.3
Tax paid		(0.9)	(1.7)
Net cash from operating activities		387.3	476.6
Investing activities			
Interest received		106.6	38.5
Purchase of property, plant and equipment		(344.8)	(461.6)
Purchase of intangible assets		(36.9)	(11.8)
Proceeds on disposal of property, plant and equipment		0.5	0.5
Repayments of inter-company loan receivables		39.4	54.4
Net cash used in investing activities		(235.2)	(380.0)
Financing activities			
Equity dividends paid		(4.0)	(7.1)
Interest paid		(152.6)	(258.9)
Preference share dividends		–	(9.0)
Repayment of borrowings		(696.2)	(417.8)
Repayments of principle on leases		(1.8)	(1.5)
Advances on restructure of derivative instruments		–	140.0
Payments on derivative instruments		(194.5)	–
Proceeds of new loans		1,107.2	215.0
Net cash generated from/(used) in financing activities		58.1	(339.3)
Net increase/(decrease) in cash and cash equivalents		210.2	(242.7)
Cash and cash equivalents at beginning of the year		129.3	372.0
Cash and cash equivalents at end of the year		339.5	129.3

Notes to the financial statements

For the year ended 31 March 2021

1 Accounting policies

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

Basis of preparation

Southern Water Services Limited is a company incorporated in the United Kingdom under the Companies Act 2006. The company is a private company limited by shares and is registered in England and Wales. The address of the registered office is given on page 1. The nature of the company's operations and its principal activities are set out in the Strategic Report on pages 22 to 100.

These financial statements have been prepared in accordance with FRS 101, incorporating the Amendments to FRS 101 issued by the FRC in July 2015 and the amendments to Company law made by The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015.

The financial statements have been prepared on a going concern basis under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments and retirement benefit obligations) at fair value through profit and loss or other comprehensive income.

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

Fair value is the price that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the company takes into account the characteristics of the asset or liability as if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement purposes in these financial statements is determined on such a basis, except leasing transactions that are within the scope of IFRS 16 'Leases', and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 'Inventories' or value in use in IAS 36 'Impairment of Assets'.

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

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

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 401 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. The group financial statements of Greensands Holdings Limited are available to the public and can be obtained at southernwater.co.uk/greensands-ownership-of-southern-water.

As permitted by FRS 101, the company has taken advantage of the disclosure exemptions available under that standard in relation to standards not yet effective, financial instruments, fair value measurement, revenue from contracts with customers, leases, presentation of a statement of financial position as at the beginning of the preceding period following a retrospective accounting policy application or restatement, capital management, related party disclosures and impairment of assets. Where required, equivalent disclosures are given in the group financial statements of Greensands Holdings Limited.

The company has elected not to take advantage of the exemption regarding the requirements of IAS 7 'Statement of Cash Flows' in order to align with regulatory reporting requirements and provide additional transparency for users of the financial statements.

Adoption of new and revised accounting and financial reporting standards

There have been no new or revised accounting standards adopted in the current year that had a significant or material impact on the financial statements.

Notes to the financial statements continued

For the year ended 31 March 2021

1 Accounting policies continued

Going concern

The company's business activities, together with the factors likely to affect its future development and position, are set out in the Strategic Report pages 22 to 100.

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 credit ratings and financial risk.

On the basis of their assessment of the company's financial position, the directors 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; further details can be found in the Directors' Report on page 217.

In addition and in accordance with provision C.2.2 of the UK Code and Ofwat's Information Notice IN 19/07, the Board has assessed the prospects of the business over a longer period than the 12 months required by the 'Going Concern' provision.

The Board has selected to conduct this review for the period to March 2030 and full details of the assessment and the viability statement are set out within the Strategic Report on page 140.

Segmental reporting

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

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

Revenue recognition

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

Revenue from the supply of services represents the value of services provided under contracts to the extent that there is a right to consideration and is recorded at the fair value of the consideration due.

The company recognises revenue when it transfers control over a product or service to a customer.

Revenue is recognised when the amount of revenue can be measured reliably, the performance obligation has been satisfied, and it is probable that the economic benefits associated with the transaction will flow to the company. Revenue is not recognised when it is considered probable that economic benefits will not be received. In these circumstances, revenue is only recognised when collectability is reasonably certain. Payments received in advance of revenue recognition are recorded as deferred income.

Water and wastewater services

The company supplies water and wastewater services to customers in Sussex, Kent, Hampshire and the Isle of Wight. The performance obligation is the supply of services over the contractual term and is considered to be satisfied as the customer consumes based on the volume of water supplied. This is the point at which revenue is recognised.

For provisioning purposes, revenues and outstanding arrears are segmented based on customer characteristics. Since the company is under a statutory obligation to provide water and wastewater services to its domestic properties, these services could be provided to customers who are unlikely to pay. Should a group of customers attract a provision rate of 100%, i.e. assessed as not generating economic benefit, revenue would not be recognised. In 2019–20, no segment of customers met this criteria and so revenue relating to the provision of water and wastewater services has been recognised in full.

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. Customer rebates are shown as a reduction in revenue.

New connections and infrastructure charges

Under IFRS 15, the performance obligation is satisfied at the point of provision of the new connection to the network, so fees received in respect of the connection are recognised at this point.

Requisitions

For requisitions of water mains and public sewers, the company has determined that the performance obligation is satisfied at the point of completion of the requisition works and connection of the water main or lateral drain, and the total consideration receivable is recognised in full as revenue at that point.

Diversions

Contributions received in respect of diversions of water mains and sewers are recognised upon completion of the diversion of the water main or sewer.

Adoptions

Adoptions of assets are recognised at fair value of the asset upon adoption, i.e. the point at which control of the asset is obtained, within revenue as an increase to non-distributable reserves.

Provision for impairment of trade receivables

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

This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

The model considers current and forward-looking macroeconomic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment.

Taxation

Taxation in the income statement represents the sum of the tax currently payable and deferred tax.

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

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

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

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

Intangible assets

Intangible assets comprises:

- i. Assets in development.
- ii. Other assets – comprising software, studies and development projects.
- iii. Future right to draw water from Portsmouth Water through the Havant Thicket reservoir scheme.

Intangible assets are measured at cost less subsequent amortisation and any impairment. Amortisation of intangible assets is calculated on a straight-line basis over the estimated useful lives, which are primarily three to 10 years*. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Capitalised development costs are for plant installed on some of our sites to test new processes for performance data and scalability. The data is used to identify innovative and efficient future assets and processes to meet new, higher environmental or quality standards. Development costs capitalised are depreciated over three to five years*.

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

* Amortisation of the Havant Thicket reservoir scheme will be over the period to 2100 and will commence on the earliest of 1 April 2029, the date Southern Water is entitled to receive water, and completion of construction.

Notes to the financial statements continued

For the year ended 31 March 2021

1 Accounting policies continued

Property, plant and equipment

Property, plant and equipment comprises:

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

All property, plant and equipment is stated in the statement of financial position at cost or at deemed cost on transition to FRS 101, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

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

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

Items of property, plant and equipment that are transferred to the company from customers or developers are initially recognised at fair value in accordance with IFRS 15 'Revenue from Contracts with Customers'.

The corresponding credit is recorded as revenue through non-distributable reserves and released to retained earnings over the expected useful lives of the related assets.

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

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

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

	Years
Land and buildings:	
– Land ¹	Not depreciated
– Buildings	10–60
Plant and machinery:	
– Operational structures ²	15–80
– Fixed plant	10–40
Infrastructure assets:	
– Water mains	100–120
– Sewers	80–200
– Reservoirs	200
– Ancillary structures	10–70
Assets under construction ¹ :	Not depreciated
Other:	
– Vehicles, computers and mobile plant	3–10

¹ Freehold land is not depreciated, nor are assets in the course of construction until they are commissioned. Commissioning is deemed to occur when a new works is officially taken over from the contractor, following completion of performance and take-over tests.

² Operational structures are assets used for wastewater and water treatment purposes. These include water tanks and similar assets.

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

Right-of-use assets are depreciated over the shorter period of the lease term and the useful life of the underlying asset. If a lease transfers ownership of the underlying asset or the cost of the right-of-use asset reflects that the company expects to exercise a purchase option, the related right-of-use asset is depreciated over the useful life of the underlying asset.

Impairment of tangible and intangible assets

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

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

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

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

Grants and contributions

Grants and contributions received are treated as either revenue or deferred income in line with IFRS 15 as defined by the nature of the receipt.

Infrastructure receipts associated with new connections are recognised as revenue when they are receivable.

Deemed contributions from the transfer of non-current assets from customers are recognised as revenue through non-distributable reserves and released to retained earnings over the life of the asset.

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

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

Grants and contributions received in respect of diversions of water mains and sewers are treated as deferred income and recognised as revenue upon completion of the diversion.

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

Leases

The company adopted IFRS 16 'Leases' with effect from 1 April 2019.

The company as lessee

The company assesses whether a contract is or contains a lease at inception of the contract. The company recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets (£5,000 or less). For these leases, the company recognises the lease payments as an operating expense on a straight-line basis over the term of the lease, unless another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

Notes to the financial statements continued

For the year ended 31 March 2021

1 Accounting policies continued

Lease payments included in the measurement of the lease liability comprise:

- fixed lease payments
- variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date
- the amount expected to be payable by the lessee under residual value guarantees
- the exercise price of purchase options, if the lessee is reasonably certain to exercise the options
- payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.

The lease liability is presented as a separate line in the statement of financial position.

The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made.

The company remeasures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever:

- The lease term has changed or there is a significant event or change in circumstances resulting in a change in the assessment of exercise of a purchase option, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate.
- The lease payments change due to changes in an index or rate or a change in expected payment under a guaranteed residual value, in which cases the lease liability is remeasured by discounting the revised lease payments using an unchanged discount rate (unless the lease payments change is due to a change in a floating interest rate, in which case a revised discount rate is used).
- A lease contract is modified and the lease modification is not accounted for as a separate lease, in which case the lease liability is remeasured based on the lease term of the modified lease by discounting the revised lease payments using a revised discount rate at the effective date of the modification.

The company did not make any such adjustments during the year.

The right-of-use assets comprise the initial measurement of the corresponding lease, lease payments made at or before the commencement day and any direct initial costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

Right-of-use assets are depreciated over the shorter period of lease term and useful life of the underlying asset. The depreciation starts at the commencement date of the lease.

The right-of-use assets are presented separately from other assets in the notes to the financial statements.

The company applies IAS 36 to determine whether a right-of-use asset is impaired and accounts for any identified impairment loss as described in the 'Property, Plant and Equipment' policy.

As a practical expedient, IFRS 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. The company has used this practical expedient with respect to the maintenance element associated with vehicle leases.

The company as lessor

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 credited to the income statement over the life of the lease.

Non-current asset investments

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

Cash and cash equivalents

Cash and cash equivalents comprise cash and short-term bank deposits.

Inventories

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

Deferred revenue

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

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

Provisions

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

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

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

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

Retirement benefits

SWS operated a defined benefit pension scheme, which closed on 31 March 2020, 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.

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

The pension cost under IAS 19 'Employee Benefits' is assessed in accordance with the advice of a firm of actuaries based on the latest actuarial valuation and assumptions determined by the actuary. The assumptions are based on information supplied to the actuary by the company, supplemented by discussions between the actuary and management. The assumptions are disclosed in note 24.

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

The 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 income statement in the period to which they relate. Differences between contributions actually paid are shown as either accruals or prepayments in the statement of financial position.

Notes to the financial statements continued

For the year ended 31 March 2021

1 Accounting policies continued

Financial instruments

IFRS 9 contains requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) impairment for financial assets and 3) general hedge accounting.

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires companies to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

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

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

Financial assets

(i) Loans receivable

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

(ii) Trade receivables and accrued income

Trade receivables and accrued income are classified as 'held to collect' and measured at fair value on initial recognition. If there is objective evidence that the amount receivable is impaired, it is written down to its recoverable amount, with the irrecoverable amount being recognised as an expense in operating costs.

The company applies an approach permitted by IFRS 9 for estimating expected credit losses on trade receivables. For trade receivables that are assessed not to be impaired individually, expected credit losses are estimated based on company's historical experience of trade receivable write-offs, and forward-looking macroeconomic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment.

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

This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

Impairment of financial assets

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

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

Derecognition of financial assets

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

Financial liabilities

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

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

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

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

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

Derecognition of financial liabilities

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

Derivative financial instruments

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

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

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

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

Embedded derivatives

In accordance with IFRS 9, the company has reviewed all contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard.

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

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

The company did not have any embedded derivatives that were required to be separately accounted for in the current or previous years.

Notes to the financial statements continued

For the year ended 31 March 2021

2 Critical accounting judgments and key sources of estimation uncertainty

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

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

Judgments

Critical judgments, apart from those involving estimations, that are applied in the preparation of the financial statements are discussed below:

Amortisation of regulatory settlement

In 2018–19, an accrual of £135.5 million was recognised for rebates to be made to customers through bills, over the period from 2020 to 2025, as part of a regulatory settlement agreed with Ofwat following its investigation into wastewater treatment compliance, as noted on page 30.

There is no clear accounting standard guidance for the income statement treatment of this regulatory settlement. It was considered whether the settlement should be recognised as an expense; however, given that this is an agreed reduction in customer bills in the future, with a requirement to show this separately on invoicing as required by Ofwat, the most appropriate treatment was concluded to be to treat the invoice reductions as a reduction in revenue in 2018–19. These rebates are now being made and recorded through revenue, and the accrual made in 2018–19 is being unwound on the face of the income statement, also through revenue, in line with the annual profile of the rebates to be made.

Provisions and contingent liabilities

The company evaluates its exposures to contingent liabilities relating to pending litigation or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation. A provision is made when it is judged that it is probable that an obligation exists for which a reliable estimate can be made. Individual matters are considered carefully to assess the likelihood that a pending claim will succeed, or a liability will arise, and the point of recognition for the associated liability.

Matters that either are possible obligations or do not meet the recognition criteria for a provision are disclosed as contingent liabilities in note 33, unless the possibility of transferring economic benefits is remote.

Property, plant and equipment

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

Key sources of estimation uncertainty

The key assumptions about the future and other key sources of estimation uncertainty at the reporting period end that may have a risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year are discussed below:

Provisions

Provisions determined may change in the future due to new developments and as additional information becomes available. Reflecting the inherent uncertainty in this evaluation process, actual costs may be different from the estimated provision. Details of provisions are disclosed in note 26 and the value provided at 31 March 2021 was £8.2 million (2020: £9.8 million). Accordingly, if the amount provided was 50% under or over estimated, then the provision would change by £4.1 million (2020: £4.9 million).

Measured income accrual

The measured income accrual is an estimation of the amount of water and wastewater unbilled at the period end. The accrual is estimated using a defined methodology based upon historical billing and consumption information and the applicable tariff. The calculation is sensitive to estimated consumption for measured customers. Actual consumption may differ from the estimate made, which could impact future operating results positively or negatively. Given the nature of the balance it is not practical to assess how this estimate will change in the next 12 months.

Our sensitivity analysis suggests that the measured accrual would vary by £1.8 million and £5.5 million if consumption estimates were between 1% and 3% above or below those predicted.

Measured accrual sensitivity analysis	31 March 2021	Sensitivity			
Measured accrual balance (£m)	214.5	1%	3%	-1%	-3%
		1.8	5.5	-1.8	-5.5

The value of household billings raised in the year ended 31 March 2021 for consumption in prior years was £245.4 million. The value of these billings was lower than the accrual made at 31 March 2020. The estimation difference was £2.2 million and this has been recognised in the current year's turnover. This difference is well within our view of acceptable tolerances for accounting estimates.

Impairment of trade receivables

The impairment of trade receivables at each reporting date is calculated by segmenting customer debt based on historic debt collection and payment performance, demographic information and the age of debt outstanding. In general for each segment, forecast cash collection rates are estimated using this range of data and other macroeconomic assumptions, which then determines a corresponding provision percentage. This assessment generates an expectation for the level of recovery of the outstanding receivables balance and therefore the lifetime expected credit loss.

The model considers current and forward looking macroeconomic events to the extent that the past response of customers to changes in the economy is built into the expected future cash collection performance for each customer segment. For the year to 31 March 2021, this includes a reflection of the impact of the COVID-19 pandemic to date. Our underlying charge to the income statement on this basis was £26.2 million.

To reflect the continuing significant impact that the COVID-19 pandemic is having on the macroeconomic environment, we have recognised an additional charge of £8.6 million, for the impairment of trade receivables, to the income statement in 2020–21. This is a significant judgment as the overall impact that the pandemic will have on the economy is continuing to evolve.

The value of the provision for doubtful debts as at 31 March 2021 was £253.9 million (2020: £216.4 million). The actual level of receivables collected may differ from the estimated levels of recovery, which could impact future operating results positively or negatively.

Our sensitivity analysis suggests that the impairment provision would vary by £2.3 million and £7.1 million if cash collections estimates were between 1% and 3% above or below those predicted.

Impairment provision sensitivity analysis	31 March 2021	Sensitivity			
Impairment provision estimate (£m)	253.9	1%	3%	-1%	-3%
		2.3	7.1	-2.3	-7.1

Retirement benefit obligations

The company operates a defined benefit scheme as well as a defined contribution scheme. Under IAS 19 'Employee Benefits', the company has recognised an actuarial loss of £70.0 million (2020: gain of £111.7 million).

The pension cost and liabilities under IAS 19 are assessed in accordance with directors' best estimates, using the advice of an independent, qualified actuary and assumptions in the latest actuarial valuation. The assumptions are based on member data supplied to the actuary and market observations for interest rates and inflation, supplemented by discussions between the actuary and management. The mortality assumption uses a scheme-specific calculation based on the CMI 2020 model with a smoothing factor of 7.5 and a 1.25% p.a. allowance for future longevity improvement.

The major assumptions used to measure schemes' liabilities, along with sensitivities to changes in those assumptions and future funding obligations are set out in note 24 of the financial statements.

3 Changes in significant accounting policies

A number of new standards and amendments are effective for periods beginning from 1 January 2020. These changes had no material impact on the company's financial statements.

4 Segmental analysis

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

Notes to the financial statements continued

For the year ended 31 March 2021

5 Income

An analysis of the company's income is as follows:

	2021 £m	2020 £m
Water and sewerage services:		
Household – measured	511.4	544.3
Household – unmeasured	110.6	130.7
Non-household – measured	100.3	140.4
Non-household – unmeasured	4.0	5.1
Total water and sewerage services	726.3	820.5
Bulk supplies	4.5	3.9
Infrastructure charge receipts	5.3	9.7
Trade effluent	7.5	11.2
Cesspools	5.2	5.7
New connections	4.0	4.3
Adoptions (see note (a) below)	18.2	7.8
Other services	13.2	14.9
Total revenue before amortisation of regulatory settlement	784.2	878.0
Amortisation of regulatory settlement (see note (b) below)	35.6	–
Total revenue	819.8	878.0
Other operating income (see note (c) below)	1.7	1.4
Profit on disposal of fixed assets	0.8	0.9
Interest receivable (note 9)	100.6	32.8
Interest revenue from Southern Water Services Group Limited	9.5	8.8
Total income	932.4	921.9

(a) Revenue associated with the adoption of assets from customers is treated as non-distributable upon recognition, and amortised to retained earnings in line with the depreciation of the related assets.

(b) As reported on page 30, the company co-operated with Ofwat in relation to its investigation into the management, operation and performance of our wastewater treatment works.

To ensure that our customers are not disadvantaged as a result of these matters, the company has agreed to make direct customer rebates totalling £135.5 million in forecast outturn prices (£122.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches identified in the investigation. These rebates are now being made and recorded through the water and sewerage services revenue shown above. The provision for these rebates made in the financial statements for 2018–19 is also being released through revenue in line with the annual profile of the rebates to be made.

(c) Other operating income includes the release of deferred grants and contributions relating to non-current assets from the balance sheet, as amortised in line with the useful economic life of the related assets, and rents receivable.

6 Profit for the year

	2021 £m	2020 £m
Profit for the year has been arrived at after charging/(crediting):		
Depreciation on:		
– Owned assets	270.8	247.2
– Leased assets	3.4	3.7
	274.2	250.9
Included within <i>Operating costs</i> : Depreciation and amortisation in the income statement:		
Amortisation of intangible assets	13.7	13.1
Profit on disposal of fixed assets	0.8	0.9
Research and development expenditure	0.6	0.5
Rentals under operating leases (see note (a) below):		
– Properties	0.1	0.2
– Vehicles	1.7	1.1
Employee costs (note 7)	67.6	78.6
Amortisation of grants and contributions (see note 27)	(1.4)	(1.2)
Fees payable to the company's auditor in respect of:		
– Statutory audit of the company's financial statements	0.5	0.5
– Other services pursuant to legislation (see note (b) below)	0.1	0.1
– All other services	0.1	0.1

(a) The company adopted IFRS 16 'Leases' with effect from 1 April 2019. Rentals under operating leases comprise payments on leases that have been assessed as short-term (12 months or less) agreements and leases of low value assets (£5,000 or less) (see note 1 'Accounting policies' for more information on the company's approach to IFRS 16 'Leases').

(b) Other services pursuant to legislation and other non-audit services primarily relate to regulatory assurance fees.

Notes to the financial statements continued

For the year ended 31 March 2021

7 Employee information

	2021 £m	2020 £m
(a) Employee costs (including directors' emoluments):		
Wages and salaries	101.3	105.2
Social security costs	10.9	11.3
Pension costs – Defined contribution	7.7	4.9
– Defined benefit	0.2	7.7
Total employee costs	120.1	129.1
Less: charged as capital expenditure	(52.5)	(50.5)
Charged to the income statement	67.6	78.6

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:

	2021 Number	2020 Number
Operations	1,176	1,169
Customer services	37	98
Corporate centre	925	937
	2,138	2,204

8 Directors' emoluments

	2021 £000	2020 £000
Aggregate emoluments (including benefits in kind)	2,428	2,317

No retirement benefits accrued to directors (2020: nil) under a Southern Water Services Limited defined benefit scheme.

Retirement benefits of £14,833 accrued to directors (2020: £31,075) under a Southern Water Services Limited defined contribution scheme.

Further details can be found in the Directors' remuneration report on pages 194 to 211.

Details of emoluments and benefits for the highest paid director:

	2021 £000	2020 £000
Highest paid director's aggregate emoluments and benefits	1,082	1,069

During the year, the company made contributions of £4,000 (2020: £10,000) to a money purchase pension scheme in respect of the highest paid director's qualifying services.

9 Net finance income/(costs)

	2021 £m	2020 £m
Finance income		
Interest receivable on swap instruments	98.7	31.9
Interest revenue from Southern Water Services Group Limited	9.5	8.8
Deposit income on short-term bank deposits	1.9	0.9
	110.1	41.6
Finance costs		
Interest payable on bank loans	(1.3)	(3.0)
Interest payable on other loans	(2.1)	(7.5)
Interest paid to Southern Water Services (Finance) Ltd	(168.0)	(146.0)
Indexation	(20.5)	(29.3)
Amortisation of issue costs	(1.5)	(1.5)
Amortisation of gilt lock proceeds	0.1	0.1
Amortisation of deferred credits	4.7	4.8
Amortisation of bond premium	0.7	0.7
Interest on lease liabilities	(0.5)	(1.2)
Other finance expense (note 24)	(1.3)	(4.2)
Dividends on preference shares – see note (a) and (b) below	(4.9)	(6.5)
	(194.6)	(193.6)
Amounts capitalised on qualifying assets	32.9	32.8
	(161.7)	(160.8)
Fair value (losses)/gains on derivative financial instruments		
Derivative financial instruments not designated as hedges (note 22)	(444.8)	339.9
Net finance (costs)/income	(496.4)	220.7

The interest revenue from Southern Water Services Group Limited relates to the long-term loan disclosed in note 15.

Borrowing costs included in the cost of qualifying assets during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 4.10% to expenditure on such assets (2020: 3.96%).

Dividends on preference shares

- (a) Dividends due to Class B preference shareholders of £70 per share totalled £4.9 million (2020: £6.2 million). Of this amount £nil was paid during the year (2020: £3.8 million) with £4.9 million accrued at 31 March 2021 (2020: £2.4 million). The cumulative balance sheet liability for unpaid preference share dividends at 31 March 2021 was £7.3 million (2020: £2.4 million).
- (b) The Class A1 and Class A2 preference shares were fully redeemed in the year to 31 March 2020, therefore no dividends were payable on these classes in the year to 31 March 2021 (2020: A1 £0.1 million and A2 £0.2 million).

Notes to the financial statements continued

For the year ended 31 March 2021

10 Taxation

	2021 £m	2020 £m
Current tax:		
Current year	0.9	1.7
Total current tax charge	0.9	1.7
Deferred tax:		
Origination and reversal of timing differences	(65.7)	64.0
Adjustment in respect of prior years	–	(0.8)
Effect of corporation tax rate change	–	40.3
Total deferred tax charge/(credit)	(65.7)	103.5
Total tax charge/(credit) on profit/(loss)	(64.8)	105.2

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

	2021 £m	2020 £m
Profit/(loss) before tax	(356.8)	433.9
Tax at the UK corporation tax rate of 19% (2020: 19%)	(67.8)	82.4
Permanent differences	3.0	2.2
Group relief received for nil payment	–	(11.4)
Differences between current and deferred tax rates	–	(7.5)
Impact of tax rate changes	–	40.3
Adjustment in respect of prior years:		
Deferred tax	–	(0.8)
Total tax charge/(credit) for year	(64.8)	105.2

Factors that may affect future tax charges:

In the March 2021 Budget it was announced that legislation will be introduced in Finance Bill 2021 to increase the main rate of UK corporation tax from 19% to 25%, effective 1 April 2023. As substantive enactment is after the balance sheet date, deferred tax balances as at 31 March 2021 continue to be measured at a rate of 19%. If the amended tax rate had been used, the deferred tax liability would have been £91.7m higher.

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.

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

	2021 £m	2020 £m
Deferred tax		
Arising on income and expenses recognised in other comprehensive income:		
Tax charge/(credit) relating to retirement benefit obligations	(13.3)	19.0
Deferred tax movement due to rate change	–	(1.5)
Total deferred tax charge/(credit) recognised in other comprehensive income/(expense)	(13.3)	17.5

11 Dividends

	2021 £m	2020 £m
Dividends available for distribution to investors in the ultimate parent company:		
Current year interim dividend	–	–
Dividends not available for distribution to investors in the ultimate parent company:		
Current year interim dividend of £37.95 per share	2.1	–
Current year interim dividend of £32.92 per share	1.9	–
Current year interim dividend of £126.64 per share	–	7.1
	4.0	7.1

The interim dividends of £4.0 million are paid to Southern Water Services Group Limited (SWSG). These dividends, along with associated group tax relief of £0.9 million, enable SWSG to pay £4.9 million of the interest of £9.5 million due to Southern Water Services Limited on an inter-company loan as disclosed in note 14. These transactions are illustrated in the diagram on page 117 of the Annual Report.

No additional interim or final dividend has been declared for the year ended 31 March 2021 (2020: interim additional – £nil, final – £nil).

12 Intangible assets

	Externally generated		
	Assets in development £m	Other £m	Total £m
Cost			
At 1 April 2020	18.4	119.3	137.7
Additions	161.3	–	161.3
Transfers	(25.8)	25.8	–
At 31 March 2021	153.9	145.1	299.0
Amortisation			
At 1 April 2020	–	95.6	95.6
Charge for the year	–	13.7	13.7
At 31 March 2021	–	109.3	109.3
Net book amount			
At 31 March 2021	153.9	35.8	189.7
At 31 March 2020	18.4	23.7	42.1

The company does not currently have any internally-generated intangible assets.

Included within additions above is £1.0 million of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing Costs'. The cumulative net book value of the borrowing costs capitalised amount to £1.6 million (2020: £1.5 million).

Additions in the year also includes £131.1 million relating to the right to draw water from the capacity of Portsmouth Water Limited under a bulk supply agreement. A liability relating to the contractual obligation to make future payments to Portsmouth Water Limited in return for this right has also been recognised in other long-term liabilities. The right to draw water commences on 1 April 2029 and any water received will be subject to a volumetric charge and expensed at that time.

Other intangible assets include software, studies and development projects.

Notes to the financial statements continued

For the year ended 31 March 2021

13 Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Infra-structure assets £m	Assets under construction £m	Other £m	Total £m
Cost						
At 1 April 2020	1,570.9	3,369.4	2,780.1	922.9	647.9	9,291.2
Additions	–	–	–	393.5	–	393.5
Transfers	26.5	323.7	108.3	(534.2)	75.7	–
Disposals	–	(9.0)	(0.5)	–	(9.0)	(18.5)
At 31 March 2021	1,597.4	3,684.1	2,887.9	782.2	714.6	9,666.2
Depreciation						
At 1 April 2020	803.3	1,510.9	176.0	–	475.3	2,965.5
Charge for the year	41.8	144.4	33.2	–	54.8	274.2
Disposals	–	(9.0)	(0.5)	–	(9.0)	(18.5)
At 31 March 2021	845.1	1,646.3	208.7	–	521.1	3,221.2
Net book amount						
At 31 March 2021	752.3	2,037.8	2,679.2	782.2	193.5	6,445.0
At 31 March 2020	767.6	1,858.5	2,604.1	922.9	172.6	6,325.7

Freehold land is stated at a cost of £51.7 million at 31 March 2021 and 31 March 2020 and is not depreciated.

The company's interests in land and buildings are almost entirely freehold.

Included within additions above is £31.9 million (2020: £32.3 million) of interest that has been capitalised on qualifying assets in accordance with IAS 23 'Borrowing costs'. The cumulative net book value of the borrowing costs capitalised amount to £239.2 million (2020: £216.9 million).

Leased assets

Right-of-use assets included in the table above are as follows:

	Land and buildings £m	Infra-structure assets £m	Other £m	Total £m
Net book amount at 31 March 2020	28.9	–	3.5	32.4
Additions	–	–	1.1	1.1
Transfers	(11.7)	11.7	–	–
Depreciation charge for the year	(1.4)	(0.3)	(1.6)	(3.3)
Net book amount at 31 March 2021	15.8	11.4	3.0	30.1

14 Investments

	2021 £m	2020 £m
Shares in subsidiary Southern Water Services (Finance) Limited		
At the beginning and end of the year	29.2	29.2

The company has the following direct investments in subsidiary undertakings at 31 March 2021:

	Registered Office	Class of share capital	Activity
Southern Water Services (Finance) Ltd (SWSF)	Ugland House, PO Box 309, George Town, Grand Cayman	Ordinary (100%)	To raise debt finance
Southern Water Executive Pension Scheme Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant
Southern Water Pension Trustees Limited	Southern House, Yeoman Road, Worthing	Ordinary (100%)	Dormant

SWSF is tax resident in the UK for tax purposes. The directors are satisfied that the carrying value of the investment in SWSF is supported by the underlying assets and activities of SWSF.

The company is currently in the process of transferring the assets and liabilities of SWSF to a UK company within the group with the aim of closing SWSF by the end 31 March 2022.

15 Other non-current assets

	2021 £m	2020 £m
Non-current receivables		
Amounts owed by group undertakings	130.0	130.0

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

16 Inventories

	2021 £m	2020 £m
Raw materials	4.3	4.3
Work in progress	2.0	0.8
	6.3	5.1

17 Trade and other receivables

	2021 £m	2020 £m
Trade receivables	334.4	315.9
Provision for impairment	(247.5)	(213.3)
Net trade receivables	86.9	102.6
Loan to Southern Water Services (Finance) Limited	16.9	56.3
Amounts owed by other group undertakings	10.7	4.8
VAT recoverable	11.0	10.2
Other amounts receivable	7.3	7.7
Net accrued income	64.7	77.3
Prepayments	16.7	14.3
	214.2	273.2

Trade receivables comprise balances from contracts with customers where the company has performed some or all of its contractual obligations.

Amounts owed by group undertakings are unsecured, interest-free and settled regularly. All entities are wholly owned within the group.

Accrued income as at 31 March 2021 includes water and sewerage income not yet billed of £55.2 million (2020: £62.4 million).

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

Provision for impairment

Movements on the impairment provision were as follows:

	2021 £m	2020 £m
At 1 April	(216.4)	(188.7)
Impairment charge	(34.8)	(29.6)
Amounts written (back)/off during the year	(2.7)	1.9
At 31 March	(253.9)	(216.4)

Notes to the financial statements continued

For the year ended 31 March 2021

17 Trade and other receivables continued

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

The company does not include in revenue and trade receivables those accounts that are deemed irrecoverable.

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

	2021 £m	2020 £m
Current	0.1	–
1–2 years	0.1	0.1
2–3 years	0.2	0.1
3–4 years	0.6	0.1
More than 4 years	14.5	2.4
	15.5	2.7

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

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

	2021 £m	2020 £m
Current	72.7	76.8
1–2 years	45.5	44.4
2–3 years	37.4	38.9
3–4 years	33.9	33.8
More than 4 years	103.6	90.6
	293.1	284.5

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

At 31 March 2021	Gross £m	Provision £m	Net £m
Accrued income – not due	71.1	(6.4)	64.7
Trade receivables			
Not due	25.8	–	25.8
Overdue and not specifically provided	293.1	(232.0)	61.1
Overdue and specifically provided	15.5	(15.5)	–
	405.5	(253.9)	151.6

At 31 March 2020	Gross £m	Provision £m	Net £m
Accrued income – not due	80.4	(3.1)	77.3
Trade receivables			
Not due	28.7	–	28.7
Overdue and not specifically provided	284.5	(210.6)	73.9
Overdue and specifically provided	2.7	(2.7)	–
	396.3	(216.4)	179.9

18 Trade and other payables

	2021 £m	2020 £m
Trade payables	32.4	30.5
Amounts owed to group undertakings	51.8	27.7
Capital creditors and capital accruals	100.5	104.2
Taxation and social security	4.0	2.8
Accruals	71.0	65.0
Deferred revenue	29.8	30.6
	289.5	260.8

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

All amounts owed to group undertakings due within one year are unsecured, interest-free and repayable on demand. All entities are wholly owned within the group.

Included in deferred revenue above are contract liabilities from contracts with customers where some or all of the performance obligations of the company have not yet been fulfilled of £1.3 million (2020: £0.3 million)

19 Current borrowings

	2021 £m	2020 £m
Unamortised debt issuance costs (note 20 (iii))	(1.5)	(1.5)
Bond premium deferred	0.7	0.7
Deferred gilt lock proceeds (note 20 (iv))	0.1	0.1
Deferred proceeds	4.7	4.7
Revolving credit facility	–	330.0
Class A £350m – 5.010% fixed rate 2021	–	349.5
Other loans from subsidiary SWSF (note (i) below)	30.3	30.3
Current borrowings excluding lease liabilities	34.3	713.8
Lease liabilities	2.5	2.2
Total current borrowings including lease liabilities	36.8	716.0

The Class A £350 million bond was repaid on 31 March 2021.

- (i) The loan from SWSF 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 2021

20 Non-current borrowings

	Note	2021 £m	2020 £m
Loans from subsidiary Southern Water Services (Finance) Limited:			
Class A £350m – 6.202% fixed rate 2029	20(ii)	348.8	348.7
Class A £150m – 3.716% index linked 2034	20(ii)	247.7	243.7
Class A £35m – 3.716% index linked 2034	20(ii)	57.7	56.8
Class A £350m – 6.650% fixed rate 2026	20(ii)	349.1	349.0
Class A £150m – 3.826% index linked 2023	20(ii)	247.7	243.7
Class A £350m – 5.010% fixed rate 2021	20(ii)	–	349.5
Class A £150m – 5.010% fixed rate 2041	20(ii)	147.2	147.1
Class A £200m – 4.510% fixed rate 2052	20(ii)	197.3	197.2
Class A £300m – 5.135% fixed rate 2056	20(ii)	292.8	292.7
Class A £375m – 2.385% fixed rate 2028	20(ii)	370.2	–
Class A £450m – 3.010% fixed rate 2037	20(ii)	443.5	–
Class A £300m – 1.626% fixed rate 2027	20(ii)	294.3	–
Class A £175m – 2.790% fixed rate 2031	20(ii)	174.1	174.0
Class A £75m – 2.970% fixed rate 2036	20(ii)	74.6	74.6
Artesian £165m – 4.086% index linked 2033	20(ii)	272.6	268.2
Artesian £156.5m – 3.645% index linked 2032	20(ii)	252.2	248.2
Total Class A debt from Southern Water Services (Finance) Limited		3,769.8	2,993.4
Unamortised debt issuance costs	20(iii)	(10.0)	(11.5)
Bond premium deferred		7.5	8.2
Deferred gilt lock proceeds	20(iv)	4.5	4.6
Deferred proceeds	20(v)	76.3	81.1
Other loans from Southern Water Services (Finance) Limited	20(vi)	30.3	30.3
Total loans and other borrowings from Southern Water Services (Finance) Limited		3,878.4	3,106.1
Revolving credit facility – LIBOR plus margin	20(vii)	–	330.0
Class A £60m – 0.000% index linked 2025	20(viii)	44.1	51.7
Class A £40m – 0.000% index linked 2026	20(viii)	35.7	41.0
Class B Preference shares	20(ix)	69.8	69.8
Lease liabilities	21	29.7	30.4
Total borrowings		4,057.7	3,629.0
Included in:			
Current liabilities			
Borrowings	19	34.3	713.8
Lease liabilities	21	2.5	2.2
		36.8	716.0
Non-current liabilities			
Borrowings		3,993.7	2,884.8
Lease liabilities	21	27.2	28.2
		4,020.9	2,913.0

These loans (excluding the preference shares) are guaranteed and secured pursuant to a guarantee and security agreement (the Security Agreement). The agreement is over the entire property, assets, rights and undertakings of each of SWS, Southern Water Services (Finance) Limited (SWSF), SWS Holdings Limited, and SWS Group Holdings Limited. In the case of SWS, this is to the extent permitted by the Water Industry Act 1991 and Licence.

Notes in respect of the specific instruments above:

- (i) 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 a margin of 0.01% or 0.001%. Therefore each individual back-to-back inter-company loan has been separately disclosed.
- (ii) Fixed rate borrowings are recognised net of issue costs and discounts on issue and are carried at amortised cost using the effective interest rate method.

The value of the capital and interest elements of the index-linked loans is linked to movements in inflation. The increase in the capital value of index-linked loans during the year of £20.5 million (2020: £29.3 million) has been taken to the income statement as part of finance costs.

- (iii) Unamortised debt issuance costs represent issue fees paid to SWSF that are not otherwise accounted for within the amortised cost of specific loans. Where these costs are attributable to a specific instrument they are being amortised over the life of that instrument. The remaining costs are being amortised over the weighted average life of the loans advanced at the time the costs were incurred. As at 31 March 2021 unamortised debt issuance costs amounted to £10.0 million of which £1.5 million represents the short-term amount which is disclosed separately in note 19.
- (iv) Prior to the issue of the Class A £300 million bond in the year to 31 March 2008, SWSF entered into a gilt lock agreement, resulting in the receipt of £6.3 million, which was advanced to SWS along with the proceeds of the bond issue. The proceeds have been deferred in the financial statements of SWS and are being released to the income statement over the life of the loan.
- (v) 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.
- (vi) The loan from SWSF 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.
- (vii) Revolving credit facility drawdowns accrue interest at LIBOR plus an applicable margin between 0.30% and 0.70%, determined by reference to the credit rating of the company.
- (viii) The Class A £60 million loan is index linked with an interest rate of 0.00% until August 2025.
The Class A £40 million loan is index linked with an interest rate of 0.00% until May 2026.
- (ix) The Class B preference shares are redeemable at the option of SWS at any time.

The shares, which do not carry voting rights, were issued on 23 July 2003 and are redeemable at their nominal value plus the share premium paid on 31 March 2038 or, at the company's option, anytime earlier. The shares were issued at £1,000 per share. Shareholders are entitled to receive dividends at £70 per share.

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

On 11 December 2019, the company redeemed 20,831 of its Class B preference shares at nominal value plus the premium on issue, including settlement for fixed dividends due to that date. No dividends were paid to the shareholders in the year and at 31 March 2021 the cumulative accrual for unpaid dividends due was £7.3 million (2020: £2.4 million).

Notes to the financial statements continued

For the year ended 31 March 2021

20 Non-current borrowings continued

	2021 £m	2020 £m
The maturity profile of borrowings disclosed within this note is given below:		
Borrowings excluding leases:		
Between one and two years	251.7	4.0
Between two and five years	12.1	255.8
After five years	3,729.9	2,625.0
	3,993.7	2,884.8
On demand or within one year	34.3	713.8
	4,028.0	3,598.6
Leases:		
Between one and two years	2.9	2.2
Between two and five years	5.8	6.2
After five years	18.5	19.8
	27.2	28.2
On demand or within one year	2.5	2.2
	29.7	30.4
Borrowings including leases:		
Between one and two years	254.6	6.2
Between two and five years	17.9	262.0
After five years	3,748.4	2,644.8
	4,020.9	2,913.0
On demand or within one year	36.8	716.0
	4,057.7	3,629.0

The company leases various offices and vehicles and has a lease on its outfall pipes.

Vehicle leases have terms of between four and five years. Leases on office buildings have terms of between 15 and 99 years from commencement date. The outfall lease had an initial term of 99 years and commenced on 1 April 1997.

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

All lease obligations are denominated in sterling.

The fair value of the company's lease obligations is approximately equal to their carrying amount.

Interest rates are fixed at the contract date. All leases (except outfalls (see note 21)) are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

The company's lease obligations are secured by the lessors' rights over the leased assets disclosed in note 13.

21 Leases

This note provides information for leases where the company is a lessee.

i) Amounts recognised in the statement of financial position

The statement of financial position shows the following amounts relating to leases:

	2021 £m	2020 £m
Right of use assets within 'Property, plant and equipment':		
Buildings	15.8	28.9
Infrastructure	11.4	–
Other	2.9	3.5
	30.1	32.4
Lease liabilities		
Current	2.5	2.2
Non-current	27.2	28.2
	29.7	30.4

Additions to the right-of-use assets during the financial year to 31 March 2021 were £1.1 million (2020: £33.2 million).

ii) Amounts recognised in the income statement

The income statement shows the following amounts relating to leases:

	Year to 31 March 2021 £m	Year to 31 March 2020 £m
Depreciation charge of right-of-use assets		
Buildings and infrastructure	(1.7)	(2.0)
Other	(1.7)	(1.7)
	(3.4)	(3.7)
Interest expense (included in finance costs)	(0.5)	(1.2)
Expense relating to short-term leases (included in operating costs)	(1.8)	(1.3)

iii) Amounts recognised in the statement of cash flows

	Year to 31 March 2021 £m	Year to 31 March 2020 £m
Total cash outflow for leases	(1.8)	(1.5)

Notes to the financial statements continued

For the year ended 31 March 2021

21 Leases continued

iv) The company's leasing activities and how these are accounted for

The company leases various offices and vehicles.

Rental contracts are typically made for fixed periods, but may have extension options.

Contracts may contain both lease and non-lease components. For leases of vehicles for which the company is a lessee, it has elected not to separate lease and non-lease components and instead accounts for these as a single lease component.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowing purposes.

Leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the company.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease payments included in the measurement of the lease liability comprise (where applicable):

- fixed lease payments
- variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date
- the amount expected to be payable by the lessee under residual value guarantees
- the exercise price of purchase options, if the lessee is reasonably certain to exercise the options
- payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.

Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, the lessee's incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

The company has a lease on its outfall pipes which contains variable lease payments. These payments will increase by RPI every 10 years. The next review date is on 1 April 2022 and the lease expires on 31 March 2096.

Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability
- any lease payments made at or before the commencement date less any lease incentives received
- any initial direct costs
- restoration costs.

Right-of-use assets are generally depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. If the company is reasonably certain to exercise a purchase option, the right-of-use asset is depreciated over the underlying asset's useful life.

Payments associated with short-term leases of equipment and vehicles and all leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less. Low-value assets comprise assets less than £5,000.

22 Derivative financial instruments

Categories of financial instruments at fair value

	2021 £m	2020 £m
Derivative assets carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	68.2	194.3
Total derivative financial assets	68.2	194.3
Derivative liabilities carried at fair value through profit or loss (FVTPL):		
Interest rate swaps – not hedge accounted	(1,500.6)	(1,376.4)
Total derivative financial liabilities	(1,500.6)	(1,376.4)

	2021 £m	2020 £m
Changes in value of financial instruments at fair value		
Profit for the year has been arrived at after crediting/(charging):		
Financial assets at fair value		
Designated as FVTPL	(159.0)	148.1
Financial liabilities at fair value		
Designated as FVTPL	(285.8)	191.8
Fair value (losses)/gains on derivative financial instruments	(444.8)	339.9

The fair values of derivative instruments (interest rate swaps) at the reporting date are determined using quoted prices adjusted for credit risk and are stated net of the deferred fair values mentioned above.

The regulatory framework, under which revenues and the RCV are indexed, exposes the company to inflation risk. The company enters into inflation-linked derivative financial instruments to manage its exposure to that risk.

Under interest rate swap contracts, the company agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the company to mitigate inflation risk on issued fixed rate debt held.

Notes to the financial statements continued

For the year ended 31 March 2021

23 Deferred tax liabilities

Deferred tax is provided as follows:

	Accelerated tax depreciation £m	Revaluation of financial instruments £m	Retirement benefit obligations £m	Other – timing differences £m	Total £m
At 1 April 2019	511.0	(227.8)	(31.7)	(3.8)	247.7
(Credit)/charge to income statement	(3.7)	65.3	2.7	(0.3)	64.0
Prior year adjustment:					
– Charge/(credit) to income statement	1.0	–	(1.8)	–	(0.8)
– Credit to other comprehensive income	–	–	19.0	–	19.0
Effect of change in tax rate:					
– Income statement	59.8	(19.1)	0.1	(0.5)	40.3
– Other comprehensive income	–	–	(1.5)	–	(1.5)
At 1 April 2020	568.1	(181.6)	(13.2)	(4.6)	368.7
Charge/(credit) to income statement	10.6	(80.2)	3.7	0.2	(65.7)
Prior year adjustment:					
– Charge/(credit) to income statement	0.2	–	–	(0.2)	–
– Charge to other comprehensive income	–	–	(13.3)	–	(13.3)
At 31 March 2021	578.9	(261.8)	(22.8)	(4.6)	289.7

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

	2021 £m	2020 £m
Deferred tax liabilities	578.9	568.1
Deferred tax assets	(289.2)	(199.4)
	289.7	368.7

24 Retirement benefit obligations

The deficit associated with retirement benefit obligations has increased to £116.5 million (2020: £62.5 million). The main reason for the increase in the deficit over the year is principally due to the increase in the assumed rate of future price inflation, which results in higher projected future benefit payments, together with the decrease in AA corporate bond yields, which leads to a lower discount rate and therefore higher liabilities. These effects have been offset to a lesser extent by company contributions, higher than assumed investment returns and lower than assumed inflationary increases during the year.

Pension schemes operated

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

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

The Scheme closed to accrual with effect from 31 March 2020.

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

As part of the company's interactions with both the Trustees and when required The Pensions Regulator, the company looks to agree a long-term funding and risk management strategy for the pension liability. Following on from regular dialogue with the Trustees, and discussions and correspondence with The Pensions Regulator regarding the deficit, the Board agreed a long-term funding solution for the scheme in 2018.

The main risks of the scheme are as follows:

a) Asset volatility:

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

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

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

b) Changes in bond yields:

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

c) Life expectancy

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

d) Inflation risk

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

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

Contributions made to the defined contribution scheme for the year ended 31 March 2021 amounted to £7.7 million (2020: £4.9 million). At the balance sheet date, £1.1 million of contributions were outstanding for payment and were paid on 7 April 2021 (2020: £nil outstanding at the balance sheet date).

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 2019 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:

	2019 SWPS % per annum (p.a.)
Return on investments: pre-retirement	FI Gilt curve
Return on investments: post-retirement (pensioner/non-pensioner)	+ 65 bps
Salary growth	2.50%
Pension increases on the excess over guaranteed minimum pensions (where capped at 5% p.a.)	3.00%

The term 'FI Gilt curve' refers to the generally available fixed interest gilt yield curve agreed by the Trustees and the company for the purposes of the 2019 actuarial valuation.

The assets of the scheme had a market value of £755.6 million at 31 March 2019. This was sufficient to cover 76% of the scheme's benefits. The weighted average duration of the scheme liabilities is 16.5 years.

Notes to the financial statements continued

For the year ended 31 March 2021

24 Retirement benefit obligations continued

The timing and quantum of future contributions in relation to the deficit were agreed with the Trustees and Pensions Regulator. These contributions will be dependent on future levels of RPI, but, if market breakeven rates are borne out at 31 March 2019, the expected base deficit contributions will be paid annually and total £177.2 million over the period from 1 April 2021 to 1 April 2029. The first payment was made in November 2018.

Expected employer contributions to the defined benefit scheme for 2021–22 are £18.1 million under the current Schedule of Contributions.

IAS 19 – assumptions, asset, liability and reserves disclosures

The company has employed an independent actuary to approximately update this valuation, allowing for differences between the actuarial assumptions used by the scheme for funding purposes and those adopted by the company to measure the scheme's liabilities in the financial statements, as well as adjusting for benefit accrual and benefits paid by the scheme.

The major assumptions used by the actuary are set out in the table below:

	2021 % p.a.	2020 % p.a.
Price inflation (RPI)	3.15	2.50
Price inflation (CPI)		
– RPI less 0.8%		1.70
– RPI less 1% pa up to 2030	2.15	
– Equal to RPI after 2030	3.15	
Rate of increase in salaries (no longer applicable following cessation of accrual)	N/A	2.40
Rate of increase of pensions in payment:		
– MIS* members only***	2.15	1.70
– Old section** members only***	3.15	2.50
– New section and ex FSLP (RPI max 5%***)	3.05	2.50
– Post 5 April 1988 GMP (CPI max 3%***)	1.90	1.60
– All sections post-31 March 2013 service (RPI max 2.5%***)	2.15	1.90
Rate of increase for deferred pensions:		
– MIS* members only***	2.15	1.70
– Old section** members only***	3.15	2.50
– New section and ex FSLP (RPI max 5%***)	3.05	2.50
– Post 5 April 1988 GMP (CPI max 3%***)	1.90	1.60
– All sections post-31 March 2013 service (RPI max 2.5%***)	2.15	1.90
Discount rate	2.15	2.40

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

** For this section the Trustee will endeavour to meet any indexation of excess pension above the 5% per annum cap on increases that apply to other sections of the scheme.

*** Pension increase assumptions allow for caps and floors, where appropriate, based on a statistical model (the Black Scholes model).

Assumptions regarding future mortality experience are set based on advice, published statistics and experience. The base mortality tables are unchanged from 2020 and reflect the best estimate basis from the Trustees' 2019 Actuarial Funding Valuation. Improvements rates have been updated to use the most recently available CMI model (CMI 2020), using the same smoothing factor of 7.5 and long-term improvement rate of 1.25% as used in 2020, as assuming greater improvements is not considered appropriate in light of the ongoing COVID-19 pandemic.

	2021 Years	2020 Years
Assumed future life expectancy at age 65		
Currently aged 45:		
Male	24.3	24.4
Female	26.4	26.4
Currently aged 65:		
Male	23.0	23.0
Female	24.9	24.9

The assets and liabilities in the scheme and the expected rates of return at 31 March 2021 and 31 March 2020 were:

	Value at 2021 £m	Value at 2020 £m
Equities	197.1	176.0
Government bonds	173.1	239.7
Non-government bonds	367.3	343.5
Cash	34.0	18.4
Total market value of plan assets	771.5	777.6
Total value of plan liabilities	(888.0)	(840.1)
Accrued deficit in the plan	(116.5)	(62.5)
Related deferred tax asset	22.8	13.2
Net retirement benefit obligations	(93.7)	(49.3)

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

The government bond and cash allocation set out above includes £180.3 million held in a Liability Driven Investment (LDI) portfolio to mitigate interest rate risks arising from the liabilities.

	2021 £m	2020 £m
Reconciliation of the present value of the scheme liabilities		
At 1 April	840.1	942.5
Current service cost	–	6.4
Past service cost	0.2	–
Interest expense	19.3	22.2
Member contributions	–	0.3
Experience gain on liabilities	(15.8)	(27.2)
Actuarial loss/(gain) on liabilities:		
– Due to changes in demographic assumptions	0.2	12.7
– Due to changes in financial assumptions	114.1	(78.2)
Benefits paid	(70.1)	(39.9)
Curtailement	–	1.3
Scheme liabilities at 31 March	888.0	840.1

Notes to the financial statements continued

For the year ended 31 March 2021

24 Retirement benefit obligations continued

Sensitivity analysis of the scheme liabilities

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

	Change in assumption	Impact on scheme liabilities (£m)
Discount rate	+ 0.1% p.a.	(14.0)
	– 0.1% p.a.	14.5
Price inflation (RPI measure)*	+ 0.1% p.a.	11.3
	– 0.1% p.a.	(11.0)
Mortality	+ 1 year	37.6
	– 1 year	(36.0)

* These movements have been calculated assuming that changes in the inflation assumption affect all inflation linked assumptions.

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

	2021 £m	2020 £m
Reconciliation of the value of the scheme assets		
At 1 April	777.6	755.8
Interest income	18.0	18.0
Gain on assets above interest	28.5	19.0
Employer contributions	17.5	24.4
Member contributions	–	0.3
Benefits paid	(70.1)	(39.9)
Bid value of scheme assets at 31 March	771.5	777.6

The total return on scheme assets was £46.5 million (2020: return of £37.0 million).

	2021 £m	2020 £m
Total cost recognised as an expense		
Current service cost	–	6.4
Past service cost	0.2	–
Curtailement	–	1.3
Net interest cost	1.3	4.2
Total income statement expense before deduction for tax	1.5	11.9

	2021 £m	2020 £m
Analysis of the amounts recognised in other comprehensive income		
Gain due to liability experience	(15.8)	(27.2)
Loss due to changes in demographic assumptions	0.2	12.7
Loss/(gain) due to changes in financial assumptions	114.1	(78.2)
Return on plan assets greater than discount rate	(28.5)	(19.0)
Total loss/(gain) recognised in OCI before adjustment for tax	70.0	(111.7)

The cumulative amount of actuarial losses recognised in other comprehensive income is £237.7 million (2020: £167.7 million).

	2021 £m	2020 £m
Analysis of the movement in the scheme deficit during the year		
Deficit in the scheme at 1 April	(62.5)	(186.7)
Employer's contributions	17.5	24.4
Employer's current service cost	–	(6.4)
Employer's past service cost	(0.2)	–
Curtailment	–	(1.3)
Financing charge	(1.3)	(4.2)
Actuarial (loss)/gain	(70.0)	111.7
Deficit in the scheme at end of year	(116.5)	(62.5)

25 Regulatory settlement liability

	2021 £m	2020 £m
At 1 April	135.5	138.5
Settlements in year	(35.7)	(3.0)
At 31 March	99.8	135.5

Included in:	2021 £m	2020 £m
Current liabilities	24.2	35.6
Non-current liabilities	75.6	99.9
	99.8	135.5

In 2018–19, Ofwat concluded its investigation in relation to the management, operation and performance of the company's wastewater treatment works. That investigation resulted in Ofwat taking enforcement action. Ofwat issued Southern Water with a financial penalty amounting to £3.0 million as published on its website. To ensure that customers are not disadvantaged as a result of these matters, the company has agreed to make direct customer rebates totalling £135.5 million in outturn prices (£122.9 million in 2017–18 prices) over the period 2020–25. This reflects the seriousness of the breaches identified in the investigation and these amounts have been provided for in the financial statements for 2018–19. These rebates are now being made and the provision is being released through revenue in line with the annual profile. The company has given a number of formal undertakings to Ofwat in relation to the numerous measures that have been put in place and are being put in place to ensure that the issues identified in the investigation have ceased and cannot be repeated.

Notes to the financial statements continued

For the year ended 31 March 2021

26 Provisions for liabilities

	Environmental obligations £m	Other £m	Total £m
Balance 1 April 2019	6.6	–	6.6
Utilised in year	(1.0)	–	(1.0)
Increase in year	0.2	4.0	4.2
Balance at 31 March 2020	5.8	4.0	9.8
Balance 1 April 2020	5.8	4.0	9.8
Utilised in year	(0.8)	(1.5)	(2.3)
Increase in year	0.7	–	0.7
Balance at 31 March 2021	5.7	2.5	8.2

Included in:	2021 £m	2020 £m
Current liabilities	3.9	5.1
Non-current liabilities	4.3	4.7
	8.2	9.8

The environmental provision relates to management's best estimate for the decommissioning of abandoned sites and environmental commitments made for ecology work following the South Hampshire abstraction inquiry for the period up to 2030. No reimbursement is expected.

Other provisions includes £1.5 million (2020: £3.0 million) relating to the payment of compensation for missed appointments under our Guaranteed Standards of Service scheme and represent management's best estimate of the likely value of payments to be made. Payments of £1.5 million were made over the course of the year.

Environment Agency

Like other wastewater operators, in the normal course of operations, the company occasionally faces Environment Agency investigations. The company has been subject to a detailed investigation regarding permit breaches at some of its wastewater treatment works in two locations during the period 2010–15. In February 2020, the agency presented 51 charges before the court and the company entered guilty pleas to these charges. The company will continue to be open and transparent and is committed to working with the agency to ensure a swift conclusion to the case.

The Board, supported by external legal advice, has concluded that it is not yet possible to make a reliable overall estimate for the obligation that will arise from this prosecution, notwithstanding the company's guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, the Board does recognise that there will be a minimum liability associated with the charges before the court and, having reviewed the latest information, has maintained the provision of £1.0 million, recognised in the accounts for 2019–20, reflecting a minimum amount as indicated in the sentencing guidelines and an allowance for legal costs.

The court has a very broad discretion to assess the level of the fine and the provision is not intended to indicate or predict any particular level. When considering the above, it is noted that there are disputed levels of culpability and environmental harm. The sentencing guidelines are very wide and there is a requirement for the court to examine the financial circumstances of the organisation in the round. The next court hearing may take place in July 2021. The Board will continue to review the level of provision made as more information becomes available.

The company is also committed to assisting the Environment Agency with its separate investigation into sampling compliance and reporting issues 2010 and 2017 (inclusive). The Board, supported by external legal advice, has again and for similar reasons concluded that it is not yet possible to make a reliable estimate of the financial obligation that will arise from this separate investigation but will also keep this under review.

The Board has taken these investigations extremely seriously and has continued to monitor and support the work of the Risk and Compliance directorate, which continues to deliver a programme of improvements to the company's non-financial regulatory reporting, including the collection, verification, reporting and assurance of data.

27 Other non-current liabilities

	Grants & contributions £m	Deferred Revenue £m	Contractual obligations £m	Total £m
Balance at 1 April 2020	19.6	13.1	–	32.7
Increase in year	3.8	–	124.6	128.4
Released to income statement	(1.4)	(0.4)	–	(1.8)
Balance at 31 March 2021	22.0	12.7	124.6	159.3

Grants and contributions relate to property, plant and equipment.

Deferred revenue of £12.7 million (2020: £13.1 million) relates to the proceeds from the sale of income rights relating to aerial masts and sites owned by SWS. The income will be credited to the income statement evenly over the life of the lease.

Contractual obligations of £124.6 million relate to a liability to make future payments to Portsmouth Water Limited, giving Southern Water the right to draw water from the capacity of Portsmouth Water Limited under a bulk supply agreement. The right to draw water commences on 1 April 2029 and any water received will be subject to a volumetric charge and expensed at that time.

28 Called up share capital

	2021 £m	2020 £m
Equity shares		
Authorised		
46,050,000 ordinary shares of £1 each	46.1	46.1
Allotted and fully paid		
56,000 ordinary shares of £1 each	0.1	0.1
Non-equity shares		
Issued		
Preference shares		
69,829 (2020: 69,829) Class B shares of £1 each	0.1	0.1

The redeemable preference shares are presented as a liability (see note 20) at an amount of £69.8 million including share premium of £69.7 million and, accordingly, are excluded from called up share capital in the balance sheet. The total statutory company share premium of £116.0 million includes ordinary share premium of £46.3 million.

29 Share premium account

	2021 £m	2020 £m
Equity share premium		
Balance at 1 April and at 31 March	46.3	46.3

Notes to the financial statements continued

For the year ended 31 March 2021

30 Non-distributable reserve

	£m
Balance at 1 April 2019	53.8
Profit for the financial year	7.8
Transfer to retained earnings	(1.4)
Balance at 1 April 2020	60.2
Profit for the financial year	18.2
Transfer to retained earnings	(1.5)
Balance at 31 March 2021	76.9

Non-distributable reserves comprise the value of sewer adoptions previously recognised at fair value, deferred and amortised to the income statement over the life of the related assets. Under IFRS 15 the company recognises the fair value upon adoption, i.e. the point at which control of the asset is obtained, through profit and loss to non-distributable reserves. This reserve is released to retained earnings in line with the amortisation of the related assets.

31 Retained earnings

	£m
Balance at 1 April 2019	737.5
Equity dividends paid	(7.1)
Profit for the financial year	320.9
Other comprehensive income for the year	94.2
Transfer from non-distributable reserve	1.4
Balance at 1 April 2020	1,146.9
Equity dividends paid	(4.0)
Loss for the financial year	(310.2)
Other comprehensive loss for the year	(56.7)
Transfer from non-distributable reserve	1.5
Balance at 31 March 2021	777.5

32 Notes to the statement of cash flows

	2021 £m	2020 £m
Operating profit	138.8	212.3
Adjustments for:		
Fair value of sewer adoptions	(18.2)	(7.8)
Depreciation of property, plant and equipment	274.2	250.9
Amortisation of intangible assets	13.7	13.1
Receipt of grants and contributions	3.8	6.8
Difference between pension charge and cash contributions	(17.3)	(16.7)
Amortisation of grants and contributions	(1.4)	(1.2)
Operating cash flows before movements in working capital	393.6	457.4
Increase in inventories	(1.2)	(0.3)
Decrease in receivables	22.2	7.9
Increase in payables	10.9	13.1
Decrease in regulatory settlement liability	(35.7)	(3.0)
(Decrease)/increase in provisions	(1.6)	3.2
Cash from operations	388.2	478.3
Tax paid	(0.9)	(1.7)
Net cash from operating activities	387.3	476.6

	2021 £m	2020 £m
Cash and cash equivalents		
Cash and bank balances	339.5	129.3

Cash and cash equivalents comprise cash and short-term bank deposits. The carrying amount of these assets is equal to their fair value.

The table below details changes in liabilities arising from financing activities, including both cash and non-cash changes. Liabilities arising from financing activities are those for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities.

	At 1 April 2020 £m	Cash flow changes £m	Fair value adjust- ments £m	New leases £m	Other non-cash changes £m	At 31 March 2021 £m
Analysis of net debt (including changes in liabilities from financing activities)						
Cash and cash equivalents	129.3	210.2	–	–	–	339.5
Net liabilities from financing activities:						
Term facilities/index linked loans (note 20)	(422.7)	346.2	(3.3)	–	–	(79.8)
Loans from subsidiary (note 20)	(3,106.1)	(757.2)	(19.1)	–	4.0	(3,878.4)
Lease liabilities (note 20, 21)	(30.4)	1.8	–	(1.1)	–	(29.7)
Redeemable preference shares (note 20)	(69.8)	–	–	–	–	(69.8)
Net interest rate swaps (note 22)	(1,182.1)	194.5	(444.8)	–	–	(1,432.4)
Total liabilities from financing activities	(4,811.1)	(214.7)	(467.2)	(1.1)	4.0	(5,490.1)
Net debt	(4,681.8)	(4.5)	(467.2)	(1.1)	4.0	(5,150.6)

Other non-cash changes to loans from subsidiary of £4.0 million relate to the amortisation of loan issue costs, bond premium, gilt lock proceeds and deferred proceeds.

	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m	Total £m
Balances at 31 March 2021 comprise:					
Cash and cash equivalents	–	339.5	–	–	339.5
Derivative financial instruments	68.2	–	–	(1,500.6)	(1,432.4)
Unamortised debt issuance costs	–	–	1.5	8.5	10.0
Gilt lock proceeds	–	–	(0.1)	(4.4)	(4.5)
Borrowings due within one year	–	–	(35.7)	–	(35.7)
Borrowings due after one year	–	–	–	(3,997.8)	(3,997.8)
Leases	–	–	(2.5)	(27.2)	(29.7)
Net debt	68.2	339.5	(36.8)	(5,521.5)	(5,150.6)

Borrowings due within one year relate to amounts that are repayable on demand or within 12 months of the balance sheet date (see note 20).

Notes to the financial statements continued

For the year ended 31 March 2021

33 Contingent liabilities

Companies of the size and scale of Southern Water Services Limited are sometimes subject to a number of claims, disputes and potential litigation. The significant ones currently include ongoing investigations by regulatory bodies (the EA and DWI) as well as a potential claim in respect of property search income. The directors consider that, where a liability is probable, and where it is possible to be estimated reasonably, an appropriate position has been taken in reflecting such items in these financial statements. Separate consideration of the EA investigations is set out in note 26.

Following the South Hampshire abstraction inquiry, Southern Water Services Limited has committed to undertake certain environmental work on the Rivers Itchen and Test and Candover Stream between 2018 and 2030. A provision was made in the accounts of 2018–19 in relation to costs of the ecology work associated with this agreement and further details are disclosed in note 26 to the accounts. Certain compensatory costs may become due in the future, subject to conditions at that time and the impact of the ecology work undertaken. These have not been provided for and could increase the obligation by approximately £1.2 million.

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 Services Limited's valuation.

The company had no contingent liabilities for capital claims at the year-end (2020: £nil).

34 Financial commitments

(a) Capital commitments are as follows:

	2021 £m	2020 £m
Contracted for but not provided for in respect of contracts placed in respect of property, plant and equipment	518.0	301.3
Contracted for but not provided for in respect of contracts placed in respect of intangible assets	15.5	10.7

(b) The company as lessee

	2021 £m	2020 £m
Lease payments under operating leases recognised as an expense in the year	1.8	1.3

As at 31 March 2021 and 2020, the company had no outstanding commitments for future minimum lease payments under non-cancellable operating leases in respect of vehicles and land and buildings.

Operating leases are charged to the income statement over the lease term and comprise short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets (£5,000 or less).

35 Related party transactions and ultimate controlling party

The immediate parent undertaking is SWS Holdings Limited.

The ultimate parent company and ultimate controlling party is Greensands Holdings Limited (GSH), a company incorporated in Jersey, which is the parent undertaking and controlling party of the smallest, largest and only group to consolidate these financial statements. Copies of the consolidated financial statements may be obtained from the registered office of GSH at Southern House, Yeoman Road, Worthing, BN13 3NX, or from the Southern Water website.

The largest shareholder in GSH as at 31 March 2021 is an institutional investment company advised by JP Morgan Asset Management owning 31.24%.

The company has taken advantage of the exemption under FRS 101 'Reduced Disclosure Framework' in not disclosing details of transactions with other companies which are 100% wholly owned. Equivalent disclosures are given in the group financial statements of GSH.

36 Post balance sheet events

There were no significant events after the statement of financial position date.

Independent Auditor's report

to the members of Southern Water Services Limited

Report on the audit of the financial statements

1. Opinion

In our opinion the financial statements of Southern Water Services Limited (the 'company'):

- give a true and fair view of the state of the company's affairs as at 31 March 2021 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the income statement;
- the statement of other comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- the statement of cash flows; and
- the related notes 1 to 36.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including Financial Reporting Standard 101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

2. Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

3. Summary of our audit approach

Key audit matters

The key audit matters that we identified in the current year were:

- Litigation and claims associated with the wastewater plants;
- Provision for impairment of trade receivables;
- Revenue recognition - estimating unbilled household revenue; and
- Classification of costs between operating and capital expenditure.

Within this report, key audit matters are identified as follows:

- ! Newly identified
- ⬆ Increased level of risk
- ↔ Similar level of risk
- ⬇ Decreased level of risk

3. Summary of our audit approach

Materiality	The materiality that we used in the current year was £11.8m which was determined on the basis of 3% of the forecast EBITDA and comprise 2.8% of the actual EBITDA as of 31 March 2021.
Scoping	Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.
Significant changes in our approach	We have used a different basis to determine materiality. EBITDA was used this year as this excludes the volatility of financial instruments and one-off items in the year which distort core performance.

4. Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- Obtained an understanding of relevant controls related to the management assessment of the going concern;
- Obtained third party confirmation for the group's borrowing facilities available, including drawn and undrawn amounts;
- Assessed the reasonableness of the cash flows projections and the appropriateness of the sensitivities performed by management;
- Performed integrity checks of management's going concern model, including checking for mathematical and clerical accuracy;
- Recalculated debt covenants and assessed compliance over the forecasted period, including consideration of the waiver from its Lenders in February 2021 which allows full use of available liquidity, plus the raising of new finance, even in a Trigger Event scenario of a credit rating downgrade or a breach of a trigger debt compliance ratio;
- Assessed consistency of the forecasted cash flows with the forecasts prepared for the goodwill and investments impairment models;
- Evaluated management's stress tests and performed independent sensitivity scenarios tests; and
- Assessed the appropriateness of the disclosures over going concern included within the financial statements in view of the latest guidance from the FRC.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Independent Auditor's report continued

to the members of Southern Water Services Limited

5. Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

5.1 Litigation and claims associated with the wastewater plants

Key audit matter description



Consistent with the 31 March 2020 audit the company continues to be under investigation from the Environment Agency ('EA') in respect of two significant matters.

The first relates to permit breaches at wastewater treatment works during the period 2010-2015. In February 2020 the EA presented 51 charges before the court and the company has entered guilty pleas to these charges.

Management was not able to make a reliable overall estimate of the financial obligation that will arise from this EA prosecution, notwithstanding the guilty pleas and the Sentencing Council's Guidelines for Environmental Offences. However, recognising that there will be a minimum liability associated with the permit breaches management have therefore recognised a provision of £1m for the 51 cases in the prior year financial statements, reflecting a minimum amount as indicated by the Sentencing Guidelines and an allowance for legal costs. There were no significant developments in the prosecution process that would enable a reliable overall estimate to be determined. The next court hearing may take place in July 2021. As such, management continue to recognise the provision of £1m in the current year financial statements.

The second separate investigation is into sampling is ongoing. Management, supported by legal advice, have concluded that it is not yet possible to make a reliable estimate of the financial obligation providing reasons in the disclosure to the financial statements.

We have identified a potential risk of bias in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance.

Further details are included within the Audit Committee report on pages 176-177, critical accounting estimates and judgements note (note 2) and in note 25 to the financial statements.

How the scope of our audit responded to the key audit matter



We have:

- obtained an understanding of the relevant controls over the litigation and claims process;
- assessed relevant recent correspondence with the EA;
- performed enquiries of management regarding the status and views on the EA investigation and the charges announced;
- read Board minutes and considered the Board's assessment in relation to quantifying the risk of penalty, if any, arising from the EA investigations;
- evaluated the competence, capabilities and objectivity of external lawyers, performed enquiries and read documentation received to understand their views and position in regards to the EA investigation and charges;
- assessed whether there are any industry or legal precedents that are applicable in forming the judgements applied;
- challenged management on the provisioning basis assessing the determination of a probable outflow against precedent cases and advice from legal counsel, accounting approach for the EA liability, impact of the EA provision assumption on the going concern assessment and disclosures in the financial statements; and
- assessed the completeness and accuracy of the disclosures made by the company in respect of the regulatory matters.

Key observations



We are satisfied that the treatment of the EA investigations reflects the best available evidence at the time of issuing the financial statements and consider that the disclosures in the financial statements are appropriate.

5.2 Provision for impairment of trade receivables

Key audit matter description



At 31 March 2021 the company held a bad debt provision of £253.9m (2020: £216.4m) and accrued a bad debt charge during the year of £34.8m (including £8.6m estimate in relation to Covid-19 impact) that represents 4.6% of the company's revenue (2020: £29.6m and 3.6% of revenue).

The company has a significant domestic customer base and due to regulations is not allowed to interrupt water supply, including in the event of non-payment. A proportion of the company's customers do not or cannot pay their bills, which results in the need for a provision to be made for non-payment of the customer balance.

The bad debt provision is a key area of judgement and is based on assumptions made on the forecast collectability of debts across both invoiced amounts and accrued revenues.

We focused our work on the estimation of the bad debt provision on the following areas:

- Adherence of the management's methodology with the company's policy and IFRS 9;
- The accuracy of customer data included within the aged debt report, specifically whether customer data has been correctly classified based on the age of debt; and
- The reasonableness of the cash collection assumptions made by management, including the impact of Covid-19 while considering third party macro-economic data.

We have identified a potential risk for bias in relation to this audit matter due to its influence on key metrics which management use to monitor and report business performance.

Further details are included within the audit committee report on page 8, critical accounting estimates and judgements note (note 2) and in note 17 to the financial statements.

How the scope of our audit responded to the key audit matter



We have:

- obtained an understanding of the relevant controls within the bad debt estimation process;
- involved an IT specialist to test management's IT system logic and methodology;
- recalculated the system generated bad debt provision using data analytics;
- performed test of details to assess the accuracy of information within the aged debt report to assess whether customer debt is accurately categorised based on information contained within the company's billing cycle;
- assessed whether the final provision has been calculated in line with the policy of the company and considered the requirements of IFRS 9 Financial Instruments;
- challenged management's bad debt policy and methodology specifically on whether the recoverability assumptions are reflective of current cash collection rates and whether the final provision is in line with industry peers;
- assessed the cash collection performance in the year against management's budgets;
- analysed post balance sheet cash collection and direct debit cancellation trends;
- assessed whether the increase in bad debt due to Covid-19 is supported by macroeconomic metrics and forecasts and assessed contradictory evidence, including water industry reports; and
- assessed specific provisions and adjustments included in the total provision balance by understanding the rationale for the adjustment including agreement to supporting documentation.

Key observations



We are satisfied that management's methodology for assessing impairment of trade receivables is reasonable and have been applied appropriately to compute the bad debt provision.

Independent Auditor's report continued

to the members of Southern Water Services Limited

5.3 Revenue recognition – estimating unbilled household revenue

Key audit matter description



For customers with meters, the revenue recognised depends upon the volume of water supplied, including an estimate of the sales value of water supplied between the date of the last meter reading and the year end. The total unbilled income accrual for the year to 31 March 2021 is £2154.5m (2020: £241.0m).

The most judgemental area of the estimation of unbilled revenue related to the usage estimate, which is based on historical data and assumptions around consumption patterns. Due to the level of management judgement, the estimation of unbilled household revenue has been identified as a key audit matter. Incorrect estimates of water consumption could lead to overstatement of revenue in the period.

We have identified a potential risk for bias in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance.

Further details are included in the critical accounting estimates and judgements note (note 2) and in note 5 to the financial statements.

How the scope of our audit responded to the key audit matter



We have:

- obtained an understanding of key controls within the unbilled revenue estimation process;
- reperformed management's analysis of the accrued income amount;
- performed a retrospective assessment of the previous year's accrual by comparing bills raised during 2019/20 relating to the 2018/19 accrual to determine the accuracy of management's forecasting;
- tested the accrued income balance by selecting a sample of individual properties and verified historical billing rates for each selection to confirm the appropriateness of the accrual;
- performed substantive testing of manual adjustments applied by management to the period end accrued income balance; and
- involved IT audit specialists to test the accuracy of the system generated reports utilised by management in determining the required accrual.

Key observations



We are satisfied that management's estimates in relation to the recognition of unbilled revenue are appropriate.

5.4 Classification of costs between operating and capital expenditure

Key audit matter description



The company continues to invest significantly in infrastructure renewal and replacement, with property, plant and equipment and intangible asset additions, of £554.8m (2020: £546.2m) in the period that includes £59.5m (2020: £56.5m) of capitalised overheads.

Expenditure incurred to increase the capacity or enhance the network is treated as capital expenditure (“capex”). Expenditure incurred in maintaining the operating capability of the network is expensed in the year in which it is incurred (“opex”). Capital projects can contain a combination of enhancement and maintenance activity which are not distinct and hence the allocation of costs between capital and operating expenditure is inherently judgemental. This risk also includes the inappropriate capitalisation of overheads.

We have identified a potential risk for bias in relation to this audit matter due to its influence on key metrics which management utilise to monitor and report business performance.

Further details are included within critical accounting estimates and judgements note (note 2) and in note 13 to the financial statements.

How the scope of our audit responded to the key audit matter



We have:

- obtained an understanding of the relevant controls surrounding the capitalisation of costs;
- assessed the company's capitalisation policy to determine compliance with IAS 38;
- assessed the application of the capitalisation policy to the costs incurred by selecting a sample and agreeing to third party invoices;
- analysed and considered the changes from the prior year and performed detail audit testing on a sample basis of all the cost centres and agreeing the basis of the calculation to supporting documentation;
- inspected the calculations behind the percentages applied to new cost centres and tested the calculations for accuracy and consistency across the business; and
- tested the accuracy of the overheads' capitalisation by re-performing management's calculation for a sample of cost centres and agreeing key inputs to supporting documentation.

Key observations



We consider that the classification of costs between operating and capital expenditure is appropriate.

Independent Auditor's report continued

to the members of Southern Water Services Limited

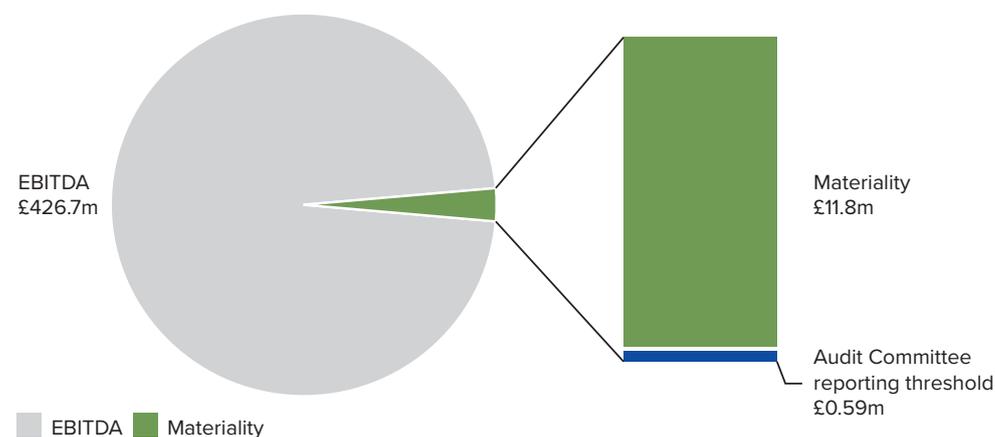
6. Our application of materiality

6.1 Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality	£11.8m (2020: £11.0m).
Basis for determining materiality	3% of EBITDA (2020: 5% of operating profit).
Rationale for the benchmark applied	This year we reassessed our approach and used EBITDA as a basis for determining materiality as this excludes the volatility of one-off items and finance costs in the year which distort core performance and is more aligned with free cash flows.



6.2 Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Performance materiality was set at 60% of materiality for the 2021 audit (2020: 60%). In determining performance materiality, we considered factors including impact of Covid-19 on business operations and account balances, our ability to rely on general IT controls, management's willingness to make process improvements as well as to correct errors identified.

6.3 Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.59m (2020: £0.56m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. An overview of the scope of our audit

7.1 Scoping

Our audit was scoped by obtaining an understanding of the entity and its environment, including internal control, and assessing the risks of material misstatement. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

8. Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained in the annual report.

We have nothing to report in respect of these matters.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

9. Responsibilities of directors

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, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

10. Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Independent Auditor's report continued

to the members of Southern Water Services Limited

11. Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

11.1 Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the company's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- results of our enquiries of management, internal audit and the audit committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the company's documentation of their policies and procedures relating to:
 - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
 - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
 - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations;
- the matters discussed among the audit engagement team and relevant internal specialists, including tax, pensions and IT specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the areas described in our key audit matters. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory frameworks that the company operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act, pensions legislation and tax legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the company's ability to operate or to avoid a material penalty.

11.2 Audit response to risks identified

As a result of performing the above, we identified litigation and claims associated with the wastewater plants, provision for impairment of trade receivables, revenue recognition - estimating unbilled household revenue and classification of costs between operating and capital expenditure related to the potential risk of fraud. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the Audit Committee and external legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Report on other legal and regulatory requirements

12. Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- 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; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Independent Auditor's report continued

to the members of Southern Water Services Limited

13. Matters on which we are required to report by exception

13.1 Adequacy of explanations received and accounting records

- Under the Companies Act 2006 we are required to report to you if, in our opinion:
- we have not received all the information and explanations we require for our audit; or
- 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.

We have nothing to report in respect of these matters.

13.2 Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

We have nothing to report in respect of this matter.

14. Use of our report

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.



Anthony Matthews FCA (Senior statutory auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

30 June 2021



from

**Southern
Water** 

The logo graphic for Southern Water, featuring three stylized, wavy white lines that suggest water or a landscape.

Southern Water
Southern House
Yeoman Road
Worthing
West Sussex
BN13 3NX

Registered no: 02366670

Southernwater.co.uk