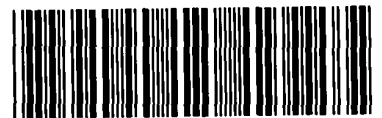


WESSEX WATER SERVICES LTD

Annual Report and Financial Statements 30 June 2017

Registered in England and Wales No. 2366648

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Strategic Report

Introduction

At Wessex Water we thrive on finding new ways to deliver the best levels of service and environmental performance.

We provide some of life's most essential services to millions of people in our area and we constantly look for new ways to deliver these. This year we have been pioneering two new approaches, EnTrade and catchment permitting, both helping us to deliver environmental improvements at the lowest possible cost to our customers.

Finding better ways to deliver often involves working in partnership with others such as farmers, our customers and our regulators. We are very proud that with our great people and by forming strong partnerships with others we have once again achieved both industry leading customer service and environmental performance.

Excellent customer service

Our customers are at the heart of everything we do and we aim to provide an exceptional service experience that is inclusive and accessible to all.

We're one of only 10 companies in the UK to achieve the Institute of Customer Service's ServiceMark with distinction, the highest level of accreditation available to its 500-plus members.

We are one of only two water companies to commit to fixing as many reported leaks as possible within a single day – and this year we raised the bar to 70%.

We are committed to providing excellent quality drinking water and overall compliance in 2016 was 99.95%, and we now generate almost 30% of our total energy needs from the sewage that we process.

Resilience

Our services need to continue to be high quality in the face of both acute shocks and gradual stresses.

This year, by joining up our resources in a water grid we have avoided the need to develop new water resources to meet demand in the next 25 years. The grid also means that more of our customers have the added resilience of an alternative water supply should they need it.

This year we have also built more resilience into our system by helping customers to use water more wisely. We fitted efficient water devices and fixed faulty plumbing in more than 5,000 homes through our Home Check programme.

We are continuing our joint research programme with the University of Bath with whom we launched a water innovation and research centre based at the university. This helps to identify opportunities such as using the natural environment to help protect our rivers, lakes and estuaries.

Affordability

Affordability is important for our customers and therefore for us as we develop our future plans and proposals. Bills need to be affordable for all our customers.

We have kept average household bills flat since last year and have continued to work hard to support customers who are financially vulnerable and have difficulty paying. We are now helping more than 27,000 customers to pay ongoing charges and repay debt, as well as offering additional practical help to reduce water and energy bills.

It is 10 years since we introduced the industry's first social tariff and this year we introduced a new discount for customers receiving Pension Credit.

We provide help when and where it's needed most because we understand that anyone can find themselves vulnerable at any time through illness, unemployment or simply a change in circumstances like a bereavement or divorce.

Engaged communities

As a community business and one of the largest infrastructure investors in the region, it is important to us that individuals, households and community groups are engaged with their local water environment and actively support the delivery of our aims.

We have led the way with ideas like catchment permitting and gone further still by investing in a number of very innovative projects, some of which are industry firsts. In the Poole Harbour catchment we have run the first reverse auctions to encourage farmers to plant cover crops that reduce the amount of harmful nutrients leaking into the water.

Our management of nearly 300 hectares of land designated as Sites of Special Scientific Interest (SSSIs) means that the condition of these vital habitats exceeded government targets. Of our SSSIs, 99.5% were assessed as being in favourable or recovering status.

Wessex Water's Young People's Panel brings the views of young adults into our decision making as we plan our future operations. To our knowledge this is the first 'youth panel' for this age group that a water company has organised. It is an innovative way of engaging young people, whereby we gain their insights and they gain real-life experience of a company, which also helps them develop their future careers. Some of their ideas are already being taken forward by us.

Our work with local schools allows us to showcase the work we do and encourage children to engage with the water environment around them.

Strategic Report (continued)

Our people

It takes great people and great teamwork to provide water and sewerage services to nearly three million customers, 24 hours a day, seven days a week. That's why we encourage and reward our employees for their contribution to achieving our aims.

We seek their ideas and put them into practice, celebrate success at our annual awards and encourage them to go the extra mile with our GEM scheme.

This year we launched our People Programme, a dedicated programme of initiatives to address current and future strategic people priorities in areas including resourcing, talent management, reward and recognition, future working, diversity and employee wellbeing.

Our apprenticeship strategy is proving successful for both the Company and the local community, offering secure employment opportunities across our region.

Financial results

Turnover for 2016-17 increased from £522m to £531m. Profit before tax was £158m (against £157m last year) and we achieved all our key financial targets in the year.

Dividends were declared in accordance with Board policy, which at all times is to preserve our investment grade credit ratings and access to new capital.

We continue to maintain a straightforward corporate structure, pay the expected level of corporation and other taxes and are classed by the HMRC as low risk.

The compliance measures included in the Strategic Report include measures on both a calendar year basis and on a regulatory year basis.

The future

We have now published our updated strategic direction document at www.wessexwater.co.uk/ourstrategy

In it we set out what we aim to deliver for customers, wider society and the environment. We explain our key priorities for the future, based on wide and ongoing conversations with our customers and stakeholders.

We have also set out the strategy by which we will deliver, focusing wherever possible on forming partnerships with others and harnessing market forces where they can help deliver more effectively and efficiently.

Our strategic direction is designed to inform both our water resources plan which runs to 2045, and our business plan proposals for service and environmental improvements to 2025.

This has been a great year for Wessex Water with achievements to be proud of in many areas. We look forward to continuing to innovate to help reduce cost, improve resilience and improve the essential services we provide.

Customers and communities

Introduction

Our customer service vision is very simple. We aim to deliver the highest levels of customer satisfaction, make it easy for customers to deal with us and ultimately build trust and loyalty.

We achieve this by delivering what customers say is really important to them:

- excellent and reliable water and sewerage services at a price they can afford
- a service tailored to meet their individual needs
- choice and flexibility in the way they can communicate and interact with us
- a real person to answer the telephone
- resolving problems quickly and first time
- keeping them informed at all times using their channel of choice
- checking they are happy with the outcome if they have a problem
- compensating without quibble where things go wrong.

We encourage our staff to go the extra mile whenever they can and invite customers to let us know if we have done well or need to improve.

We remain the top performer in the water sector for customer service. This is the second year of Ofwat's new look service incentive mechanism (SIM) and we have again come top of all water and sewerage companies in the satisfaction surveys.

But we can't stand still. We want to become the best of the best, not just the best in the water industry, and we have challenges ahead of us:

- customer expectations continue to rise and they increasingly demand a more personalised and effortless service
- our future customers, the youth of today, will want a very different and increasingly digital customer service experience

Strategic Report (continued)

- some areas of vulnerability are becoming more prevalent in society, such as mental ill health, and our staff need to be properly equipped to support our customers
- as we are very reliable, we are a silent provider to many, so we need to build stronger relationships with our communities.

We are rising to these challenges through our customer excellence programme, which is shortly entering its second year, and are also benefiting from our membership of the Institute of Customer Service.

Customer service

Once again, we topped Ofwat's league table for satisfaction surveys. This is mirrored in our own satisfaction surveys where customers continue to score us highly on satisfaction, first-time resolution, staff conduct and knowledge and effort.

This year we implemented our real time feedback tool, allowing us to seek feedback on our service from more customers than ever. Under the guidance of our customer experience group, we use this information for continuous improvement of policies, processes, systems and training.

In terms of our performance commitments, 96% of our customers rate our service as very good or good. This is slightly below the long-term average and we are working hard to improve this.

Our value for money score has once again improved with 84% of customers rating our service as very good or good value for money. Our overall customer effort score has dipped slightly with 75% of customers saying it takes little or no effort to resolve their query, but the number saying it takes no effort at all has improved to 59%.

Compared with sectors outside water, our net promoter score compares favourably with many of the top household names. Our UK customer satisfaction index score shows we are towards the top of the utility sector and not far away from the top 50 companies across all sectors.

In September, the Consumer Council for Water confirmed that we continue to have the lowest number of complaints in the water industry – we have had no referrals this year to the water ombudsman, WATRS.

Day to day we are widening our use of alternative communication channels while remaining committed to offering personal telephone answering and, most importantly, choice for our customers. We have also extended our opening hours for operational contact and are seeing a growing number of customers opting for self-service, text messaging and Live Chat.

Keeping customers informed when we have problems on our network, such as a burst water main, or when we are fixing a problem at their own home or additional support to customers in vulnerable circumstances and this year they are in touch with more customers than ever before.

We've developed our metered bills so we are now able to provide graphical water use information. This will help customers compare their use over time and identify leakage.

Our billing customer relations staff have been through further training on adopting a more conversational style of writing, designed to make our replies to queries and complaints simpler, easier to understand, more personalised and overall more engaging. This has coincided with additional focus on complaints and root causes and the introduction of an improved two-stage, rather than three-stage, complaints process.

We retained our government Customer Service Excellence award for our approach to customer service and have the best overall package of customer guarantees in the industry. We continue to hold the best practice mark of distinction from the Keep me Posted campaign.

Our operational contact centre has achieved the Institute of Customer Service's ServiceMark with distinction, one of only 10 in the UK to achieve this accolade.

We are about to enter the second year of our customer excellence programme and over the last year we've focused on:

- reviewing customer journeys from the customer's perspective and fixing any problem areas
- improving our communications
- developing better feedback tools and metrics
- improving our self-service offering
- reviewing all our community work
- extending our opening hours

Over this year, projects include a new and improved contact management system, a customer self-service portal and improved signage.

Customer engagement

We engage extensively with our customers and stakeholders, both in our day-to-day business and for specific programmes of work, such as preparation of our five-yearly business plan.

Our challenge group, the Wessex Water Partnership, oversees all our engagement and how it is used. The partnership has met six times and is independently chaired by Dan Rogerson, formerly water minister in the coalition government.

Our engagement strategy – Your say, your future – continues to develop and this year we've conducted major pieces of research to inform our long-term, 25-year vision, obtain customers' views on paying for changes in service levels and their opinions on the resilience of our services.

Strategic Report (continued)

We successfully launched our Young People's Panel of 21 sixth formers recruited from schools and colleges across our region. These are our future customers and it has been invaluable to hear about their priorities for service, their views on our day-to-day service offering now and in the future, and on topics such as resilience, intergenerational fairness and affordability.

Our Have your say online customer panel continues and this year we sought its views on:

- our 25-year vision
- our customer magazine
- experience of drought.

We follow up each survey with a newsletter to participants explaining the findings and what we are doing as a result.

Customers in vulnerable circumstances

Anyone can find themselves vulnerable at any time due to illness, unemployment or simply a change in circumstances like a bereavement or divorce. Because our customers are our priority, we are committed to providing extra care and help when and where it is most needed.

We pride ourselves on treating customers as individuals and tailoring our service to suit their needs, making sure we are inclusive and accessible to all. We have retained the British Standard for inclusive services provision (BS 18477) and the Louder than Words charter mark.

We have made sure staff have the right skills, confidence and awareness to deal with often quite complex situations and strengthened this with specialist training. Alongside Wiltshire Mind, we enhanced our training material for field staff by developing videos to support our Going the Extra Mile (GEM) programme and to help them spot the signs of mental ill health and how to support customers, colleagues, friends and family.

We are also an active member of the British Gas task force aimed at encouraging utilities to become dementia friendly and intend to make all our staff Dementia Friends over the next two years. We hold registers of customers with longer term disabilities or additional needs and, as they are likely to need the same support from their energy provider, we are doing all we can to signpost customers to other utilities. This year we renamed this service Priority Services, in line with energy companies.

Through our assistance programme, tap, we continue to support those who are financially vulnerable. We are now helping more than 27,000 customers to pay ongoing charges and repay debt, while offering practical help to reduce water and energy bills – this represents a 28% increase over the year.

Around 10,000 customers are in receipt of our main social tariff, Assist, which offers discounts of up to 90% off water charges for those in the greatest financial hardship. A further 3,000 pensioners on Pension Credit are receiving a discount of around 20% on their bills.

Our partnerships with the debt advice community are thriving and we continue to believe that holistic advice is vital to help customers get back on track and into sustainable payment – it's never just about water debt. We are also liaising with a growing number of community based organisations outside the debt advice sector and using geographical mapping to help us engage with customers who are traditionally much harder to reach and likely to be some of the most vulnerable.

We have also launched five new projects in hard to reach areas such as deprived housing estates. We continue to support financial capability and money management projects in our communities, funding a further four this year through our Money Matters awards.

Community and education

We are committed to helping customers reduce water usage at home and use numerous methods to help them with their water use, attending summer shows around our region to encourage them to Be Smart about water.

Last year we were at Yeovil Air Day in Somerset inviting people to find out how to save water and money by learning more about our Be Smart love your loo campaign.

We were at the Bournemouth Air Festival answering questions and telling visitors about water saving initiatives in their homes and gardens.

In September we attended Dorset County Show spreading information about our Be Smart switch to a meter programme, as well as environmental initiatives.

Our education advisers continued to visit schools across Bristol, Bath, Somerset, Wiltshire, South Gloucestershire and Dorset, teaching topics ranging from the water cycle to what happens to waste once it has been flushed down the toilet, to students of all ages and to community groups.

The advisers welcomed students to eight education centres across our region where the experience included a guided tour of the works and opportunities for hands-on practical work in or around the education centres.

During the last year, 29,104 students benefited from school visits and trips to water and sewage treatment works.

Our Watermark awards support organisations across our region with their environmental projects.

Last year awards included one to help a Somerset school with its swift nesting box project and another to aid a project to save a rare butterfly – the Duke of Burgundy.

Groups and organisations in Dorset, Wiltshire and Somerset with environmental and wildlife projects in areas along our water supply grid scheme received funding for environmental initiatives through our grid community awards. The awards helped restore a historic pond in Dorchester and supported Wiltshire Bat Group to purchase new monitoring equipment to study a rare species of bat.

Strategic Report (continued)

Market opening

In April 2017, the retail market opened to enable non-household customers to choose their retailer for water services. To meet this challenge we delivered our Open Water programme to ensure we operated effectively, compliantly and on budget in the new market.

This was achieved through a strategy of providing a wholesale service which is 'best for business and right for retail'. This meant continuing to supply excellent water quality, great sewerage standards and industry leading customer service to retailers and their customers.

We were also able to test our approach in the shadow market – a practice run before the official opening – which ran from October 2016 to March 2017.

From 1 April 2017 the non-household customers were transferred to a retail company Water 2 Business Ltd which is owned by Wessex Water Ltd and Bristol Water Holdings Ltd.

Water and sewerage

Our service delivery and investment plans focus on our outcomes; the results of our consultations with customers and other stakeholders.

Highest quality drinking water

We are committed to providing the highest quality drinking water to our customers.

Our overall compliance with drinking water standards in 2016 was 99.95%, marginally below our long-term performance.

In 2016, there were 23 failures out of approximately 34,000 tests, of which 20 were due to domestic plumbing and service pipe issues such as lead pipes, nickel taps and copper plumbing. The remaining three exceedances were related to our own iron water mains.

There was a further reduction in the number of customer contacts about acceptability of water due to the ongoing benefit of our mains rehabilitation work and improved customer communications.

Sewage flooding minimised

Sewage flooding is a rare occurrence but when it does happen it can be devastating – so tackling it remains a key objective.

The number of flooding incidents caused by blockages in public sewers fell further, down to 1.20 incidents per 10,000 properties compared to our target of 1.72.

This was the result of:

- our campaigns about the problems caused by flushing wet wipes down toilets and pouring fat down sinks
- optimising operational maintenance
- the generally dry weather conditions in the region last year.

Members of the public are being misled by advertising and labelling related to certain wet wipes and other products branded as 'flushable'. Following our complaint to the Advertising Standards Authority, it decided that this issue did not sit within its area of enforcement, but the action was successful in raising public awareness.

In 2015, we introduced a new and innovative measure of overall flood risk due to inadequate capacity, which could potentially cause internal or external flooding. Last year we invested £9m to reduce this risk at 99 locations, but we have narrowly missed the target. We expect to complete a large project at Brent Knoll in the first half of 2017-18, which will put us on course to meet the target.

The responsibility for flooding is often complex and we work with local authorities as they produce surface water management plans and sustainable strategies for flood management. We were consulted more than ever before, attending more than 100 liaison meetings. Together with Wiltshire Council and the Environment Agency we are trialling a shared resource to review planning applications in Wiltshire.

We have contributed a further £50k towards the partnership scheme to reduce flooding at Cannington in Somerset and £25k towards a sustainable partnership scheme in Southmead, Bristol.

Resilient services

Our asset management framework continues to help us maintain a truly integrated approach to risk and investment decision making. Last year we were recertified to the international standard for asset management, ISO55001:2014.

During the year we carried out an assessment of the resilience of our business, assets and services. The methodology we use assesses the status of our systems and processes and identifies improvements; it also provides a consistent framework to manage progress. We will carry out the assessment annually.

In 2010, we began work on our biggest ever project, a major integrated water supply grid, and it remains on track for completion in 2018. Once fully operational it will enable us to:

- reduce abstractions from sensitive groundwater sources
- move water more effectively around our region
- ensure future demand is met
- improve the resilience of supplies to customers.

Strategic Report (continued)

All the major pipelines have been laid and work is well advanced on the final parts of the scheme at Black Lane in Blandford and Codford, near Warminster. For the first time ever we have transferred water between our southern and northern resource zones, thus delivering some of the benefits of the scheme in advance of the target date.

This year we have reduced the number of properties supplied by a single source by a further 30,000, ahead of the agreed programme.

On the sewer network our infiltration reduction plans continue to reduce the risk of groundwater entering public and private sewers and drains. We proactively inspected more than 90 km of sewers and permanently sealed 5.2 km of leaking sewers.

Environment

Introduction

Our region has many of the country's finest rivers and streams and we are focused on working with other stakeholders in continuing to protect and improve their condition.

By cutting leakage and managing customer demand and working with communities where there is concern about local effects of abstraction, we have reduced water abstraction.

We have upgraded sewage treatment to avoid adverse effects from contaminants such as ammonia and excessive nutrients. We have reduced the number of pollution incidents from our sewers, usually caused by blockages, and work with the Environment Agency and local councils to address water pollution caused by misconnected domestic plumbing.

Our region is rich in wildlife and has a large number of areas protected by international and national designations. We take our duties towards the environment seriously and are actively reviewing our landholding and integrating this information with our geographic information system to develop land management plans to improve biodiversity.

All projects within our capital investment programme are subject to detailed environmental screening to avoid harming wildlife. We also offer grants to wildlife organisations under our biodiversity action plan partners' programme, which is helping to further our catchment management objectives.

Collaboration and innovation underpin our significant early progress against our challenging environmental outcomes. This has resulted in our industry leading performance.

Improved bathing waters

The only bathing water within our region that is failing to meet the 'satisfactory' standard is at Burnham Jetty. This is a result of tighter directive standards rather than any underlying deterioration in water quality and is why our performance commitment for beaches passing EU bathing standards is reported as 98% against our target of 100%. We have an agreed programme to improve our assets that may affect the Burnham Jetty bathing water.

We completed the National Environmental Programme during the year, achieving 100% performance against target to deliver agreed schemes. Outputs from the programme include:

- constructing a 1,200m³ underground storage tank at Sloway Lane pumping station near Highbridge
- increasing pumping capacity at Blake Gardens in Bridgwater to reduce overflow operation
- proactively investigating misconnections of foul flows that could end up in the River Parrett in Bridgwater
- installing 67 event duration monitors at overflow locations.

We are supporting Litter Free Coast and Sea project officers in both Dorset and Somerset to raise awareness and ownership of bathing water quality and to promote behaviour change campaigns for local residents, tourists and businesses.

Rivers, lakes and estuaries protected

Our programme for this asset management plan period (AMP6) includes the reduction of phosphorus concentration in discharges at 47 sewage treatment works.

During the year, our in-house engineering team began detailed design on the first group of these schemes, with the first few starting construction on site, and also began outline design on the next group.

The National Environment Programme also includes a series of phosphorus technology trials designed to test the performance of new processes to meet future, more stringent targets for phosphorus levels in sewage discharges required by the EU Water Framework Directive.

We have completed four full-scale trials, including a magnetite assisted settlement process, absorptive media reed beds and stretching existing chemical dosing performance on tertiary sand filters and activated sludge plants.

Under this programme we are working with the University of Bath to develop a high-rate algal pond for the removal of phosphorus from sewage effluent. This plant has been constructed at Beckington sewage treatment works and we are currently monitoring its performance.

Tackling leakage and improving water efficiency

We are committed to reducing the amount of treated water that is used unnecessarily or lost through leaks from our pipe network. This maintains the resilience of our services and helps to keep bills affordable. We have maintained leakage at 68 MI/d which is below our agreed target for the year and also met our target of fixing 70% of leaks reported to us in the same day.

Strategic Report (continued)

We completed more than 5,000 free in-home water efficiency checks, fitting devices and sharing behavioural advice, and repaired nearly 4,300 of our customers' leaking pipes free of charge to help reduce their water use.

While we met our target for water saved through water efficiency promotion, average daily water use has increased to 141 litres per person, which is above our target. This was due to the exceptionally dry weather experienced from June through to late autumn.

With the completion of our water supply grid in 2018 we will be operating well below the economic leakage level meaning that, without new ways of working, the cost of reducing leakage further will outweigh the value of the water saved. We will continue to innovate as we seek to meet our target of 66.5 Ml/day by 2020.

Water resources

Overall, 2016-17 was a drier than usual year with 86% of average rainfall across the region.

Resource management actions and rainfall in early 2017 helped improve the resource position and, although reservoirs refilled later in the season than we usually experience, by the end of the year storage stood at 91% of total capacity. Some groundwater levels and river flows were still below average at the end of the year.

Using our performance measure to limit abstraction at our Mere source has resulted in significant reductions in output. In 2016-17 we were able to minimise abstraction between July and November. However, we then had to return to regular abstraction levels to help manage the effects of the dry autumn on the wider resource situation and the need for other source outages as part of our grid investment programme. During the year we used 341Ml against a target of 100Ml and we anticipate this performance will improve later in the AMP once the supply grid is fully commissioned.

Last year was the 41st since we imposed any customer restrictions on water use, such as hosepipe bans. During the year we developed a new draft drought plan setting out how we will respond to periods of drought – public consultation on this plan will take place during 2017-18. We have also started work on developing a new water resources management plan that looks 25 years to the future.

Environmental investigations

Our investment should always be based on sound scientific evidence. By gathering data through investigations we can better understand our impacts and then trial solutions.

In AMP6, we are delivering 45 environmental investigations covering a range of issues:

- the occurrence and removal of hazardous and emerging substances from sewage effluent
- trialling new, sustainable treatment solutions for phosphorus removal
- understanding the ecological impact of our reservoirs and abstractions
- understanding the effect of our sewage treatment works on the nutrient levels within rivers, compared to other sources, at a catchment scale
- trialling techniques to restore and enhance grassland and woodland habitats, improving connectivity for species to disperse.

A number of investigations have been concluded, including one to understand the effects of our assets upstream of and around Taunton on the bathing water quality at Burnham Jetty. This included tracer surveys, complex hydrological modelling of the river system and extensive sampling. The data indicated that there is a limited effect from these assets on bathing water quality, so no further investment is recommended.

This work will feed into our proposals for AMP7 to deliver the most cost effective and sustainable solutions for our customers with the best environmental results.

Wildlife and conservation

In order to develop our performance commitment to assess 100% of our landholding for biodiversity, we have surveyed our key conservation sites extensively over the last five years, resulting in changes to their management. So far, most of our holdings in excess of 10 hectares have been surveyed, amounting to just over 70% of our land area.

In 2015, we appointed a part-time conservation, access and recreation (CAR) officer to help improve these elements of our landholding for the public. The role is to oversee and co-ordinate CAR projects at some of our largest and most visited sites, and those of greatest importance for wildlife and heritage.

Ten new projects have been initiated this year, including the refurbishment of the toilet block at Sutton Bingham reservoir, improving footpaths at Otterhead Lakes and Tucking Mill reservoir, a public bat walk at Backwell Lake and tree surveys and improvement works across a number of sites.

We continue to support wildlife projects funded by our Biodiversity Action Plan Partners Programme up to £80,000 per year and will be supporting four projects in our area between 2015 and 2020.

Our small grants scheme, new for this phase of the programme, has supported three projects this year which have led to:

- the creation of training materials
- improving accuracy of riverfly monitoring
- recruiting volunteers
- constructing brushwood berms to improve river flow
- exploring new ways to control the invasive Himalayan balsam.

Strategic Report (continued)

Reduced carbon footprint

One of our long-term sustainability goals is to be carbon neutral in our operations. Our net greenhouse gas emissions fell to 123 kilotonnes carbon dioxide equivalent in 2016-17.

This was our lowest since 1999-2000 and meant we met our performance commitment for the year. The reduction was the result of work to improve energy efficiency, increase and diversify renewable energy generation and the falling carbon dioxide intensity of UK grid electricity.

Our electricity use continues downwards from its peak in 2007-08, largely through concerted energy efficiency work which is delivering around four gigawatt hours of savings each year. We are also gaining financial benefits by using innovations such as Open Energi's dynamic demand system which enables instantaneous, temporary adjustment of the site's energy use to maintain a balance on the local electricity grid.

Following installation of advanced anaerobic digestion and associated electricity generation at Trowbridge sewage treatment works in 2015-16, we are making good progress with a scheme to improve digestion at Berry Hill, near Bournemouth.

Meanwhile, our operating division GENeco has finalised an agreement with Unilever for a certified supply of biomethane originating from anaerobic digesters at Bristol sewage treatment works.

Innovation

Our environmental investigations programme aims to gather knowledge and data from locations potentially experiencing environmental stress in order to better understand the scale of the issue.

One project, in the Bristol Avon catchment, involves a novel approach to regulating effluent discharges. We have agreed with the Environment Agency a mandatory reduction of 46 tonnes of phosphorus from a group of 24 sites at a cost of £20m less than the traditional approach; each of these in turn has a discretionary stretch target.

This is a more flexible approach than usual, which will allow optimisation of existing treatment and the use of novel processes or additional treatment that has not been over-sized.

Our Eureka programme rewards staff who have proposed projects that save money, improve service to customers, reduce risk and improve the ways we work. In 2016, there were 91 suggestions overall, of which 16 were rewarded and five deemed suitable for wider roll-out.

In addition, we have introduced Directors' challenges where a defined issue is put to the entire Company for ideas.

The first two, which concerned protection of drinking water quality once it is in the distribution network and options to reduce fly nuisance at sewage treatment works, received positive responses.

We carry out regular trials of new products developed by other companies and in 2016-17 these included:

- a hydrogen sulphide resistant product that deals with corrosion in pipes and tunnels
- an epoxy lining system that can be used for sewers more than 300mm in diameter
- a mobile unit that analyses the phosphate content of river water.

We continue to develop better ways to tackle our most pressing environmental and social concerns. One of these, launched this year, is EnTrade – an innovative, market-based method for improving the water environment. EnTrade involves an online platform by which farmers bid for payment to carry out measures such as planting cover crops that reduce the amount of nitrogen that leaches from soil into groundwater. This approach is much more cost-effective than conventional engineered solutions and the first two auctions were comfortably oversubscribed.

The first part of our joint research programme with the University of Bath concluded in 2016-17. The main themes were low energy nutrient recovery from sewage, methods for increasing biogas from sewage sludge digesters, emerging pollutants in waste water, and improved techniques for understanding and comparing the whole life costs of water management.

Meanwhile, the university's Water Innovation Research Centre, formed with our assistance in 2014-15, continues to develop. The last 12 months saw the formation of an advisory board that brings together individuals from industry, regulators and academia, plus the hosting of its first water science and engineering conference and the UK International Water Association's Young Water Professionals event.

Environmental resilience

The resilience of our services to customers is closely tied to the resilience of the wider water catchments in which we operate.

Catchment-based strategies are now a business as usual approach to protecting our service levels; often this means we are able to deal with the source of the problems not the symptoms. We are currently working with farmers at 20 sites to reduce nitrate levels in groundwater sources or to remove pesticide risks from reservoirs.

We are now also taking catchment-based approaches to reducing nitrate run-off into Poole Harbour rather than installing nitrate removal at a sewage treatment works and are finding innovative ways to maximise the benefits achieved at the lowest cost to customers.

We have extended the work we do to promote the more efficient use of water and during the year we visited more than 5,000 homes, fitting water saving devices and offering advice, resulting in a saving of 50 litres per person. The service has had excellent customer feedback and we will be extending its reach during 2017.

Strategic Report (continued)

Employees

Introduction

We aim to be an employer of choice and provide all employees with the opportunity to develop to their full potential and have a rewarding and satisfying career.

We provide our employees with the skills, expertise and professional development they need to perform to the highest level. In return, our employees are highly motivated and engaged and consistently provide outstanding and industry leading levels of customer service.

Our people are of the utmost importance to us and our continued success is built on their commitment, goodwill and performance.

Apprenticeships are a key element of our resourcing strategy to build and maintain a sustainable workforce to meet current and future needs. We are proud that we have recruited a higher percentage of young women into technical apprenticeships compared to the regional and national average in both the engineering and construction sectors – this reflects the work we do to bring young women into our sector.

Promoting and encouraging diversity and inclusion has been a key focus again this year. We firmly believe the diversity of our workforce should reflect the community we serve. We recognise that difference in personal characteristics is positive and brings richness to our work environment that is essential to our continued success.

We continue to develop and implement a range of diversity initiatives and we continue to promote flexible and remote working, together with flexible retirement aimed at easing people into retirement gradually.

Protecting the health, safety and welfare of our staff, contractors and customers remains the highest priority.

Training

Training and development continues to be of integral importance and we have delivered more than 650 courses with an average of three days' development training per employee.

We continue to work in partnership with a number of local colleges and universities to enhance our management development programmes. In partnership with the University of the West of England, we have delivered our accredited Institute of Leadership and Management Level 5 programme, which has been very successful.

As part of our talent and succession planning, we continue to invest in two-day development centres for nominated high potential employees. This led to rotation, secondment and mentoring opportunities providing our people with identified career development opportunities.

Apprentices

We are seeing the benefits of running apprenticeship programmes and have an outstanding retention rate with our apprentices. Over the past year we employed 43 new apprentices with another 42 posts expected to be filled in the next six months.

We have continued to engage our local young people in apprenticeships. We held our second apprenticeship open day in November 2016 to coincide with National Engineering Week and again welcome around 300 visitors to learn more about the company and the career opportunities available to young people in our business.

Taking advantage of our volunteering policy, our apprentices took part in the Brathay Apprenticeship Challenge. Through the challenge, they visited more than 20 schools and careers fairs to promote the concept of apprenticeships to young people. They also designed, resourced and built an outside learning space for St John's Primary School in Trowbridge.

We are proud that 12% of our technical apprentices this year are female – this exceeds the regional and national average in both engineering and construction sectors and is a reflection of the work we do to engage young women into our sector.

We have again worked with our training providers to support local women into engineering events, and ensure our vacancies are promoted to all kinds of young people across our region.

As the government changes the focus of apprenticeships, we will ensure we make best use of the reforms and this year we introduced our first higher level apprenticeship. The Civil Engineering higher level apprenticeship saw four apprentices develop skills and knowledge across our entire Engineering and Construction directorate whilst also studying towards an HNC in Civil Engineering and a NVQ Level 4 in Construction Site Supervision. As the scope of apprenticeships widens, we will continue to offer more Higher Level Apprenticeships and introduce Degree Level Apprenticeships.

Diversity

We value the differences that a diverse workforce brings and are committed to creating and promoting an inclusive workplace for all employees and others who work with us as suppliers, contractors or customers.

We continue to place strong emphasis on promoting diversity and inclusion within the company, ensuring everyone has an equal chance to progress their career with us regardless of age, gender, sexual orientation, ethnicity, disability, cultural background and carer responsibilities.

We have developed and implemented a range of diversity initiatives this year, including policies on hearing loss, facilitated action learning sets for employees to support one another through supported facilitation and coaching.

We hosted a Women in Sustainability networking event to promote and encourage membership within our company and we have been an active member of the Business Disability Forum.

We have promoted our volunteering policy and encouraged staff to volunteer in our community. We continue to promote flexible and remote working together with flexible retirement to ease people into retirement gradually.

Diversity is a key focus within our strategic People Programme, our aim is to reflect the community we serve.

Strategic Report (continued)

Culture

We continue to have a strong, friendly and positive culture and staff enjoy working for us and with each other. We held a staff survey this year and 86% of employees rated us a good company to work for and 77% rated us a great place to work. Our staff engagement was 80%, an increase of 3% from last year. Our employees are important to us and we listen to their feedback.

We want to ensure they continue to feel valued and to make a positive difference to their day-to-day lives. To help us achieve this we have launched a People Programme, a five-year plan to oversee and invest in a series of activities to benefit our employees, to attract and retain highly skilled staff and help build a sustainable workforce for the future.

Health and safety

As a responsible employer it is clear to us that the management of health and safety is critical to our success. Protecting the health, safety and welfare of our staff, contractors and customers remains an established and shared responsibility that is essential to maintaining our reputation.

We continue to develop and embed a strong health, safety and welfare culture in our day-to-day operations that targets zero accidents and supports our aim to be a great place to work in which all employees can work safely and reach their full potential.

We monitor all accidents and incidents reported by employees and the information we collect assists in determining problem areas and allows resources to be allocated to ensure that the situation does not escalate.

During the year we have encouraged staff to report all incidents and especially near misses. Any report that raises significant concerns is subject to additional investigation and where appropriate the situation is rectified or procedures improved.

Position for the 12 months to 31 December 2016:

- 539 incidents reported (an increase of 17% from 2015)
- no fatalities or life changing (permanently disabling) injuries
- no reportable diseases or dangerous occurrences
- 10 incidents were notifiable to the Health and Safety Executive (an increase of three from 2015)
- 230 working days lost through notifiable incidents (a reduction of 40% from 2015)
- no enforcement action from the Health and Safety Executive.

Despite an increase in the overall number of reportable incidents during 2016, overall safety performance was within the Company target.

Lost time incident rate

This includes all reported incidents involving staff that resulted in absence from work of one or more days. In 2016 there was a slight reduction in the number of incidents with 40 lost time incidents. The principal causes of lost time in 2016 were slips, trips and falls and manual handling.

Safety Smart

More than 850 staff attended a Safety Smart day. The day comprised a business update, health and safety presentations and an interactive safety scenario using actors to play out an incident based around a life changing injury sustained after a fall through defective mesh flooring.

Health and safety awards

Our commitment to safety and performance has been recognised by two external safety bodies.

Engineering and Construction were awarded the prestigious Sir George Earle trophy by RoSPA. This is the pinnacle of the RoSPA Awards scheme and is internationally recognised as the premier performance award for occupational health and safety. RoSPA acknowledged our committed and insightful management and the innovative and unique approach to changing behaviour based on expanding the awareness of teams, whilst also engaging and using them as a source of innovation.

Operations were awarded a distinction in the British Safety Council's 2016 International Safety awards with a score of 59 out of 60 and were shortlisted for the Power and Utilities sector award that recognises outstanding performance.

External engagement

To improve awareness and safety at roadworks we have joined the charity SafeWise which has centres at Weymouth, Bournemouth and Devizes. The charity works with schools and young people to educate them about the risks in the home and on the roads, using full scale street scenes.

Staff from Engineering and Construction had been involved with the charity and in particular a focus group involving disabled charities that identified safety improvements for pedestrians around roadworks. In support of speeding issues at roadworks we have produced a hard-hitting video designed to slow down drivers passing roadworks. The video is used at driver awareness sessions run by Dorset and Wiltshire Police for people who have been detected committing a road traffic offence.

Future initiatives

Overall performance is encouraging and remains within target but we continue to look for new ways to improve. We are developing a safety incident and observation app to improve the ease of reporting incidents and near misses as well as trialling a driver behaviour programme. We are also reviewing the Company arrangements for managing the safety of lone and mobile workers and trialling female fit personal protective equipment.

Strategic Report (continued)

Financial performance

Introduction

The UK group structure has remained the same since 2002 with the Company wholly owned by Wessex Water Limited, which in turn is wholly owned by YTL Utilities (UK) Limited. Neither of these entities provide any intra-group funding to the Company with virtually all of the debt raised for the UK group sitting within the Company and all borrowings at market rates provided by financial third parties.

Gearing, as measured by net debt to RCV, stood at 65% at March 2017. On a pensions-adjusted basis, this figure rises slightly over 70%, which the Board still finds an acceptable level.

During the year the Board has continued to pay particular attention to the projected level of the Company's gearing ratio with a view, when declaring dividends, to protect the Company's existing credit ratings at all times. The Board remains committed to maintaining the Company's current level of credit ratings.

The latest actuarial valuation of the Company's pension scheme took place on 30 September 2016. At each triennial valuation the Company agrees with the scheme's trustees a payment recovery plan in respect of any deficit and the Company will do so again with regard to the 2016 valuation, which is still in the process of being finalised. The Company is committed to honouring any special contribution obligations that it signs up to.

We continue to have a healthy liquidity position comprising cash and cash equivalents held on the balance sheet along with undrawn bank facilities giving the Company instant access to funding if needed.

Taxation strategy

The Company adopts a risk averse and cautious approach to tax. The Company seeks to comply with the spirit and letter of UK tax legislation and claims all tax reliefs and allowances that it is entitled to. The Company does not enter into complicated structures nor engages in any aggressive or artificial tax planning, as it does not believe it is the correct thing to do.

Due to the size and complexity of the UK tax system, tax is a complicated area and uncertainties will arise. Consistent with other business areas it seeks external advice when required.

The Company has an open, regular and professional dialogue with HMRC. HMRC renewed its low risk rating for the Company last year for a further three-year period. The Company is keen to maintain this low risk status in the long term. The Company believes that its approach to tax and early engagement with HMRC on any area of uncertainty are significant factors in maintaining this low risk rating.

The current year corporation tax charge was £26.6m, which represented an effective tax rate of 17%. This is lower than the statutory rate of corporation tax of 19.75% due to the availability of tax allowances available to the Company.

In addition to corporation tax, the Company is also liable to a number of other taxes, which represent a cost to the business, including employer National Insurance contributions, business rates, environmental taxes and Insurance Premium Tax.

Financial performance

The second year of the AMP6 price review period saw a slight increase in the profitability of the Company, with operating profit rising by £2.9m from £230.6m to £233.5m. There was an increase in turnover of £9.3m, with a £6.4m increase in operating costs.

Turnover

Turnover increased by £9.3m or 1.8% from £521.8m to £531.1m. The price increase allowed by Ofwat at 1 April 2016 was 1.9% comprising a 0.8% increase from the price review and November 2015 RPI of 1.1%. At 1 April 2017 the price increase was for wholesale revenues to be increased by 0.4% plus November 2016 RPI of 2.2%, and for household retail revenues an increase of 3.4%.

The total turnover increase is very close to the price increase with the impact of economic conditions in the region and the impact of customers switching to meters being broadly neutral.

Total expenses

Total expenses (excluding depreciation and amortisation) increased by £8.8m from £189.3m to £198.1m as the increases in repair costs, site operations, pension costs and EA charges exceeded cost savings made.

Depreciation and amortisation

Depreciation costs decreased by £2.4m, from £101.9m to £99.5m. There was an increase in underlying depreciation from assets capitalised but a profit on sale of the retail customer book at retail market opening was also shown on this line, reducing the total.

Capital investment

In the regulatory year to 31 March 2017 we delivered gross capital expenditure for the second year of the AMP6 programme of £214.0m, which was £13.2m higher than the £200.8m delivered in the previous year.

Interest charges

Interest charges increased from £73.5m last year to £75.7m this year. The £2.2m increase was split between an interest payable increase of £2.2m, a £0.1m increase in interest receivable, and a £0.1m increase in pension related costs.

Strategic Report (continued)

The £2.2m increase in base interest costs was a result an increase in the cost of debt from 3.6% to 4.0% over the year and an increase in net debt over the year from £1,808.8m to £1,914.6m.

There is a prudent mix of debt between fixed rate, index linked and floating rate instruments. At the year-end the debt split was 47% fixed, 37% index linked and 16% floating, with the index linked debt based on either November or March RPI. The maturity of debt is generally long term with £1,675.0m of debt maturing after 2020.

Taxation charge

The corporation tax charge was £25.9m, an increase of £1.3m over £24.6m last year.

The principal reason for the increase was the level of tax credits from prior years, they were unusually high last year at £3.1m, but reduced to a more normal £0.7m this year. The basic tax charge relating to the year reduced by £1.1m from £27.7m to £26.6m.

The normal corporation tax rate reduced from 20.0% last year to 19.75% this year and profit before tax increased by £0.7m.

The Company has a statutory year-end of 30 June and the tax computation is prepared for the 12 months to 30 June each year. Corporation tax is paid quarterly.

Deferred tax has moved significantly from a credit of £34.0m last year to a credit of £18.9m this year, a movement of £15.1m. There is a deferred tax credit in both years because the rate at which deferred tax is calculated has fallen from 20% at June 2015 to 18% at June 2016 and has fallen again to 17% at June 2017. This 2% reduction in the deferred tax rate was a credit of £38.1m last year and the 1% reduction in the deferred tax rate was a credit of £19.1m this year.

Dividends

Wessex Water's dividend policy is to declare dividends consistent with the Company's performance and prudent management of the economic risk of the business. The Board has agreed to ensure that gearing stays at or below 70% in order to maintain its current credit ratings and give the Company continued access to the capital markets.

Cashflow and gearing

Net debt increased by £33.8m from £1,880.8m to £1,914.6m. This comprised:

- earnings before interest and depreciation of £333.0m, less
- cash outflow from capital investment of £176.1m, less
- interest and tax payments of £84.3m, less
- working capital and bond accrual outflow of £14.4m, less
- dividend payments of £92.0m.

Liquidity at year end was £241.4m comprising £91.4m of cash and cash equivalents and £150.0m of facilities not yet drawn down.

The Strategic Report was approved by the Board of Directors on 19 September 2017 and signed on its behalf by:
Mark Watts - Director



Principal Risks

Our industry leading customer and environmental performance has been achieved through a focus on understanding the risks we face and using innovative approaches to mitigate risks and create opportunities to improve the services we provide.

The Company's policy on risk identification and management is subject to annual review by the Board. The identification and management of risk is delivered through a tiered system of groups from operational staff, senior management, Executive Directors and the Wessex Water Services Limited Board. The Board reviews and holds ultimate responsibility for the risk process and for the identification and mitigation of risks.

A risk group meets through the year and submits the current corporate risk register and summary report every six months to the Risk Management Advisory Group made up of the Executive Directors. This group scrutinises and challenges the risks included in the register and identifies any additional work it thinks is necessary to better classify the risk or explore other mitigation methods which may be available. Any significant new risks are reported to the Advisory Group and to the Board as they arise.

The Chief Executive submits an annual risk review paper to the Board for its review and agreement. This paper details the risk review process, identifies the current principal risks (listed below) to the business and the mitigation measures in place. It also records the status of emergent risks that have been identified.

Since the last annual review, the Board has agreed the removal of one principal risk relating to the industry's preparedness for retail non-household market opening now that the market has opened, and the combination of two principal risks of digital security and IS business resilience into a single risk of digital resilience.

The Board also agreed the addition of a principal risk reflecting the ability to attract skilled resources. Risk scores have generally remained static as mitigation works have balanced out a general increasing trend of risk.

- 1) **Government/regulatory action.** Market uncertainties reflecting the Brexit vote, general election and the format of the next (PR19) price control are all reflected in this risk. Relationships with politicians and regulators are maintained so that the Company's views about the effect of any proposed legislative changes on the Company and its customers are heard.
- 2) **Major pollution incident.** Recent fines in the industry are now regularly exceeding £1m per incident, with a maximum fine to date of £20m. Significant effort is made to prevent such an incident occurring through staff adherence to Company processes and procedures. Local emergency plans are in place to protect the local environment at key installations.
- 3) **Insider threat.** Considerable damage could be done to the Company's reputation by a rogue or radicalised employee or contractor. References are obtained for all new starters, whether permanent or contract. DBS checks are undertaken for all new permanent and fixed-term staff and for agency staff working in sensitive areas of the business.
- 4) **Health and safety incident.** Serious injury or death of a staff member or third party could expose the company to prosecution under health and safety legislation and the Corporate Manslaughter Act. As expected, the changes to the sentencing guidelines has resulted in an increase in recent prosecution fines for larger organisations which have, in some cases, been greater than £2m. Health and safety is of paramount importance to us with processes and procedures implemented through staff training and regularly monitored to maintain compliance and to protect people from harm. Our 'Take 5 to Check 5' initiative has been launched during the year and our health and safety approach has been recognised through national awards.
- 5) **Availability of new finance.** The bond markets are used extensively to fund new investment. The current economic climate post Brexit vote has shown the volatility of these markets. The relationship with bond markets and rating agencies will be maintained and the Board will continue to ensure that the Company operates within prudent financial parameters. This annual review includes our long-term viability statement which includes modelling the main financial risks.
- 6) **Resourcing and skills.** There is already a recognised short-fall in STEM skills (Science, Technology, Engineering and Maths), which is compounded by the uncertainty from the Brexit vote and heightened in our region by the impact of the Hinkley Point C programme. It is expected that this situation will become worse and we have initiated a People Programme to help mitigate this risk.
- 7) **Unfit water.** Significant effort is made to prevent a major failure of process or contamination of the water supply. We have completed a major exercise in documenting and updating our methodology for drinking water safety plans in liaison with the Drinking Water Inspectorate. Risk assessments are now being formally reviewed at the monthly water risk meeting and issues escalated to the Risk Group.
- 8) **Outcome delivery incentive failure.** As part of the move to risk-based regulation Ofwat has introduced performance commitments for the period 2015-2020. Many of these measures are company specific but some are cross-company measures with stretch targets. As well as reputational risk there are also financial penalties and rewards that can be incurred which will apply in the period 2020-2025.
- 9) **Digital resilience.** Most activities undertaken by the business are reliant on the availability of IT services and facilities and the company continues to examine ways in which IT resilience can be maintained and, where appropriate, improved. The Security Service has identified the growing threat of cyber-attack or industrial espionage as a high risk to both businesses and utilities. The company also holds and processes large quantities of data which are considered sensitive within the meaning of the Data Protection Act. Failure to process and protect the data in the prescribed manner is an offence. The quarterly Information Security Forum maintains the focus on mitigating this risk.
- 10) **Anti-competitive behaviour.** With the opening of the non-household retail market the risk of not complying with competition law is at its highest. We have setup a competition team that meets monthly to consider emergent issues and risks and appropriate actions. Management and staff have completed a training programme and further mitigation is being implemented to address this risk.

Principal Risks (continued)

While the corporate risk register holds 80-100 risks at any time, the principal risks are those that the Board consider could have a material impact on the capability of the business to perform its functions. All these risks are subject to active mitigation strategies and the Board considers that the Company is taking appropriate action to mitigate the severity and likelihood of those risks to an acceptable level. Many other areas which would be expected as standard areas for consideration, such as fraud, have been assessed and determined to be risks which are well controlled with current mitigations.

Board of Directors

Executive Directors

Colin Skellett – Chief Executive

A chartered chemist and engineer by training, he has worked in the water industry for more than 40 years, holding a number of positions in the management and control of both water supply and sewage treatment.

He joined Wessex Water in 1974 and was appointed its Chief Executive in 1988. Colin oversaw the move from the public to the private sector and the transformation of Wessex Water into a highly rated UK plc. Colin was awarded an OBE for services to business and WaterAid in the 2012 Queen's Birthday Honours and has an Honorary Doctorate in Engineering from the University of the West of England. He was Chairman of the West of England Local Enterprise Partnership until January 2016.

Mark Watts – Director of Finance

A qualified treasurer, Mark spent eight years in international banking before joining the treasury department of Wessex Water in 1991. He was appointed Treasury Manager in 1994 before becoming Treasurer in 1999.

Mark is highly experienced in raising finance, from both the capital markets and the banking sector, as well as having a long history in dealing with various corporate finance issues. He was appointed Finance Director and Treasurer on 16 March 2010.

Andy Pymer – Managing Director

A chartered civil engineer turned economist, Andy has more than 25 years' experience in the water sector, holding roles both overseas and in the UK. He was appointed Managing Director in 2016 having previously been Director of Regulation and Customer Services.

Andy is also co-Chair of Wessex Water's joint venture billing provider, Pelican Business Services, and Chair of Wessex WaterAid, which has raised more than £1.5m for the charity over the past 10 years.

James Rider – Chief Operating Officer

James is a Fellow of the Chartered Institute of Water and Environmental Management with more than 25 years' experience in the water industry. He started as a technician engineer in 1990 and has since held a wide range of roles within operations, engineering and construction, information and technology and billing and customer services.

Non-Executive Directors - Independent

Gillian Camm – Senior Independent Director

Appointed in November 2011 and Chair of the Wessex Corporate Responsibility Committee. Deputy Lieutenant Gloucestershire, vice president Quartet Community Foundation, member Society of Merchant Venturers, Chair of Leadership Foundation for Higher Education.

Huw Davies FCA

Appointed in September 2014 and Chair of Pension Trustees and Audit Committee. Former chief financial officer of Wates Group Ltd, non-executive director of J Murphy Ltd, and Chair of I CAN the children charity for speech, language and communication needs.

Fiona Reynolds DBE

Appointed in August 2012 and chair of the Futures Panel. Master of Emmanuel College, Cambridge from September 2013. Other non-executive roles include Chair of the Cathedrals Fabric Commission for England, Chair of the Green Alliance and Non-Executive member of the John Lewis Partnership Corporate Responsibility Committee. Director-General of the National Trust from 2001 to 2012.

Richard Keys

Appointed in 2016. Chartered accountant, former partner and head of PwC's global accounting consulting group. Currently, non-executive director, NATS Holdings Limited; non-executive director, member of the Departmental Board, The Department for International Development; non-executive director Merrill Lynch International; recently retired as non-executive director Sainsbury's Bank plc.

Board of Directors (continued)

Non-Executive Directors - Shareholder

Francis Yeoh CBE (Charman)

Managing Director of YTL Corporation Berhad, Malaysia since 1988. A founder member of the Malaysia Business Council, member of Malaysia's Capital Markets Advisory Council and Independent Non- Executive Director of The Hong Kong and Shanghai Banking Corporation Limited. Director since May 2002.

Hong Yeoh

Director of YTL Corporation Berhad, Malaysia since 1985, Executive Director of YTL Power International Berhad. Responsible for YTL Group's utilities and construction divisions. Director since May 2002. Chairman of Remuneration Committee.

Mark Yeoh

Executive Director responsible for the YTL hotels and resorts division. Graduated from King's College, University of London with an LLB (Hons) and was subsequently called to the Bar at Gray's Inn, London in 1988. He joined the YTL Group in 1989 and serves on the Board of YTL Corporation Berhad, YTL Power International Berhad, YTL Land & Development Berhad, YTL Cement Berhad and Wessex Water Limited. Director since October 2003.

Hann Yeoh

Non-Executive Director of Wessex Water since August 2012. Executive Director of YTL Power Generation Sdn Bhd (wholly-owned subsidiary of YTL Power International Berhad) and part of the business development team of YTL Power International Berhad. He also sits on the Board of YTL PowerSeraya Pte Limited in Singapore and is a graduate of Oxford University with a Master of Engineering in Engineering Science.

David Barclay

Former Vice Chairman of Dresdner Kleinwort and Non- Executive Deputy Chairman of John Lewis plc. Senior Independent Director of Wates Group Limited. Deputy Chairman of the Board of the British Library. Appointed 1 November 2005.

Governance Report

Introduction

Wessex Water is committed to high standards of corporate governance. Under Condition F of its Instrument of Appointment as a water and sewerage undertaker (the "Licence") Wessex Water is required to conduct its water and sewerage business as if it were the Company's sole business as a public limited company. The Licence also requires Wessex Water to have particular regard to the UK Corporate Governance Code as approved for the purposes of the Listings Rules of the Financial Services Authority (the "Code"). The Code is not a rigid set of rules and provides general principles of best practice. The Code is made up of "Main Principles", "Supporting Principles" and "Code Provisions". The Code Provisions are subordinate to the Principles. Whilst the Code is generally regarded as embodying best practice in UK Corporate Governance, its main focus is the relationship between a listed company and its shareholders. Wessex Water has a single shareholder and, accordingly, it is able to address some issues more directly and completely than it could if it were a listed company.

The Company's focus is on complying with the Principles and spirit of the Code in its particular context as a private limited company with a single shareholder. In practice, the Company complies with the Code Principles and Code Provisions with only very limited exceptions. In those few areas where we have decided not to follow the precise requirements of the Code we explain why, and how good governance is nevertheless achieved.

The following parts of this Governance Report explain how good governance is at the heart of the Company's business and underpins the Company's relationships with its customers, shareholder, and other stakeholders. The Board regards it as fundamental to the long-term success of the Company to provide excellent customer service and satisfaction. Governance arrangements are kept under constant review. We continue to reflect best practice and maintain our position as the leading water and sewerage company for customer service and satisfaction. We have set out our commitment to best practice in our Code of Practice for Corporate Governance a copy of which is available on our website.

We believe that our governance arrangements ensure that we continue to operate effectively and efficiently to the benefit of our customers, shareholder, and other stakeholders with clear accountability for decision making.

Governance Structures - The Board

The affairs of the Company are ultimately the responsibility of the Board, which controls and directs the undertaking of the regulated water and sewerage business.

The Board annually reviews and approves the Company's Organisation and Control Arrangements (O&CA) which set out the framework for control of the Company's affairs. The O&CA also specify requirements for the competency of members of the Board and its Committees, for effective management of the Company and for the granting of delegated powers and authorisations.

The principal duties of the Board, the matters reserved for its decision and the terms of reference of its Committees are fully documented and copies are available on our website. Matters reserved to the Board include strategy, charges, material changes to the Company's management and control structure, Board appointments, approval of material contracts, risk management, health and safety policies, disposal of material assets, approval of the annual operating budgets, employee pension arrangements, significant changes in accounting policies and defence and settlement of material litigation.

There are no matters specifically reserved to the shareholder. In practice the Board operates (and has operated continuously for more than a decade) without the requirement for shareholder resolutions. As part of its responsibility for the management of risk, the Board has determined criteria which control the extent of dividends paid and consequently the financial gearing of the Company. As with all Board decision making, these criteria were determined with the active involvement of the Independent Non-Executive Directors.

There are four Executive Directors. During the year there were four Independent Non-Executive Directors, exceeding by one the requirements of Condition P of the Licence. Four further Non-Executive Directors are appointed by the Company's sole shareholder, plus an alternate director. The shareholder also appoints the chair.

This balance on the Board ensures a high level of engagement and dialogue with the Company's customers and shareholder. In this way, the Company complies with and exceeds the principles and spirit of the Code without the need for compliance with certain specific Code Provisions (including those in relation to the use of an annual general meeting to communicate with investors and encourage participation) which are not relevant to a company with a single shareholder.

The Non-Executive Directors scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. The Independent Non-Executive Directors, led by the Senior Independent Director form or participate in the various Company Committees, assess the integrity of financial information and whether financial controls and systems of risk management are robust and defensible, determine appropriate levels of remuneration for Executive Directors, assisting in appointing and, if necessary, removing Executive Directors, and assisting in succession planning.

Governance Report (continued)

The Board ensures that Directors (and in particular the Independent Non-Executive Directors) have access to independent professional advice at the Company's expense where they judge it necessary to discharge their responsibilities as Directors. The Board also ensures that the Committees are provided with sufficient resources to undertake their duties.

The Company arranges appropriate Directors' and Officers' insurance against the usual legal risks faced through holding office.

If Directors have concerns about the running of the Company or a proposed action which cannot be resolved, they are encouraged to ensure that their concerns are recorded in the Board minutes and the Independent Non-Executive Directors are encouraged, on resignation, to provide a written statement to the Chairman highlighting any such concerns.

Due to the Company having a single shareholder, the Code provisions in relation to Directors being subject to annual election by shareholders are of limited relevance and not applied.

The Company complied with the Code's Main Principles and Supporting Principles as to the composition of the Board. Moreover, the Company exceeded the requirements of the Code (designed for listed rather than privately held companies) by having no fewer than four Non-Executive Directors, during the reporting year who are directors or employees of the Malaysian holding company, thus enabling effective dialogue with the shareholder.

While the Board has a majority of Non-Executive Directors, it does not have a majority of Independent Non-Executive Directors as envisaged by the relevant Code Provision. The Ofwat Board Leadership, Transparency and Governance Principles are based on the Code, which applies to UK listed companies. The principal purpose of the Code is to ensure that the interests of a company's members are protected and represented at board level. The preface to the Code states that: "the function should be to help boards discharge their duties in the best interests of their companies." The preamble to the Ofwat Principles states that: "any departures from the [Ofwat] principles should be by exception in the spirit of corporate governance for listed companies." In the context of a privately held company with a 100 percent shareholder, we consider it to be in accordance with good corporate governance practice for there to be a significant number, if not a majority, of shareholder representatives on the Board. In the Company's case, the shareholder appointed Non-Executive Directors (excluding the Chairman) are not a majority on the Board. Further, the Company has four highly capable and experienced Independent Non-Executive Directors.

The Board considers its current composition ensures an appropriate balance of skills, experience, independence and knowledge so that no single group can dominate decision taking and that the Board does not become too unwieldy.

The search for Board candidates is conducted, and appointments and re-appointments are made, on merit, against objective criteria, and with due regard to the benefits of diversity on the Board, including gender diversity. All directors receive induction training on joining the Board and regularly update and refresh their skills and knowledge.

The following were Directors during the year under review:

Executive Directors	Independent Non-Executive Directors	Shareholder Non-Executive Directors
Colin Skellett	Gillian Camm (Senior Non-Executive Director)	Francis Yeoh (Chair)
Mark Watts	Huw Davies	Hann Yeoh (Kathleen Chew as alternate)
Andy Pymmer – appointed 1/8/2016	Fiona Reynolds	Hong Yeoh
James Rider – appointed 1/8/2016	Richard Keys	Mark Yeoh
		David Barclay

Chairman

Throughout the financial year under review Francis Yeoh was the Company's Chairman.

The Chairman leads the Board, ensuring its effectiveness while taking into account the interests of all stakeholders and promoting the highest standards of business ethics and governance. The Chairman is responsible for ensuring that Directors receive accurate, timely and clear information. The Chairman also promotes a culture of openness and debate by facilitating the effective contribution of Non-Executive Directors, in particular ensuring constructive relations between Executive and Non-Executive Directors, and ensuring effective communication with the Company's shareholder. Board agendas are agreed in consultation with other Directors and the Company Secretary.

Any Director or the Company Secretary may request an item be included on the agenda.

New Directors receive a full, formal and tailored induction on joining the Board (including an opportunity to meet with representatives of the shareholder). Further training is given as required.

Governance Report (continued)

In his role as Managing Director, Andy Pymer has responsibility for the day to day business of the Company, making proposals for its strategic direction and communicating with customers and other stakeholders.

Senior Independent Director

The Board has appointed Gillian Camm as the Senior Independent Director. Gillian is a member of the Remuneration Committee and the Nominations Committee. As Senior Independent director, Gillian would chair Board meetings if the Chairman were unavailable. The Senior Independent Director's role is to act as a sounding board for the Chairman and to serve as an intermediary for the other Directors when necessary as well as an additional point of contact for the shareholder and other stakeholders.

As the Senior Independent Director appointed in accordance with the Licence, Gillian is well placed to provide an independent link to Ofwat, our regulator. Her responsibilities during the reporting year included leading an independent evaluation of the Board's performance including the Chairman's.

Independent Non-Executive Directors

The Company's Independent Non-Executive Directors are appointed from a range of different backgrounds to bring to the Board external experience and insight. They provide independent thought and challenge to the Board's decision making. The Board has reviewed their status and concluded that they are all independent. In particular, the Board considers these Directors to be independent in character and judgement. The Board are not aware of any relationships or circumstances which are likely to affect, or could appear to affect, any Independent Non-Executive Director's judgement.

Independent Non-Executive Directors are appointed, after consultation with Ofwat and with the agreement of the Company's shareholder, for an initial three-year term (subject to statutory provisions relating to removal) that may be extended.

Any term beyond six years for an Independent Non-Executive Director is subject to particularly rigorous review and takes into account the need for progressive refreshing of the Board balanced against the requirement for skills, experience, independence and knowledge. Continuity of appointment of some Independent Non-Executive Directors between Ofwat price reviews is desirable to facilitate scrutiny of Company performance against its business plan. Accordingly, David Barclay stepped down as a Senior Independent Director in May 2016 (remaining as a Non-Executive Director).

On the 1st May 2016 Richard Keys was appointed as an Independent Non-Executive Director. Richard is a chartered accountant with 37 years' experience at PricewaterhouseCoopers LLP and was a partner there for 26 years holding a number of senior management positions, most recently that of global chief accountant. In the last six years he has taken on a number of non-executive roles and is also a director at Merrill Lynch International, NATS Holdings Ltd, the Department for International Development and formerly at Sainsburys Bank plc.

Independent Non-Executive Director	Appointed	Current term expires
Richard Keys	01/05/2016	01/05/2019
Gillian Camm	01/11/2011	01/11/2017
Huw Davies	01/09/2014	31/10/2017
Fiona Reynolds	01/08/2012	30/09/2018

All Independent Non-Executive Directors are appointed on written terms setting the time commitments and standards required of them. In accordance with Code Provision B.3.2, terms of engagement are regulated by letters of appointment (copies of which are available on the Company's website). Non-Executive Directors representing the Company's sole shareholder do not have formal terms of appointment and receive no payments from the Company with the exception of David Barclay, who receives an annual fee under a formal appointment, details of which are published on our website. In accordance with Code Provision B.4.1, all Directors are required to participate in an induction process to familiarise themselves with the Company's governance arrangements, business, regulatory framework and ethos. Introductory meetings are held with all Executive and Non-Executive Directors, the Company Secretary and senior managers across the Company's business.

Visits are made to the Company's principal offices and representative operational sites. The training and development needs of the Executive Directors and Independent Non-Executive Directors are reviewed annually by the Chairman.

Governance Report (continued)

Company Secretary

All Directors have access to the Company Secretary and the Company's internal solicitors. The Company Secretary's responsibilities include ensuring good information flows within the Board and its Committees and between senior management and Non-Executive Directors, as well as facilitating induction and assisting with professional development as required. The Company Secretary is responsible for ensuring that the Company's O&CA and Board procedures are followed, and for advising on suggested changes.

Leigh Fisher-Hoyle was appointed as Company Secretary in 2015. As Company Secretary her role is to provide legal and regulatory advice as required by the Board or any Director and is responsible for advising the Board through the Chairman on governance matters. The Board is kept informed of major changes to law and regulation affecting the Company's business. The Company Secretary also advises on Directors' duties and conflicts. All Directors are aware that any conflicts of interest must be reported to and registered with the Company Secretary.

The Board meets a minimum of six times a year at approximately bi-monthly intervals, which is considered sufficiently regularly to enable the Board to discharge its duties effectively. It may meet on such further occasions as may be required.

Board attendance in the financial year under review was as follows:

Board Attendance 2016-17			
Colin Skellett	6/6	James Rider	6/6
David Barclay	6/6	Francis Yeoh	5/6
Gillian Camm	6/6	Hann Yeoh	6/6
Mark Watts	6/6	Hong Yeoh	6/6
Huw Davies	6/6	Mark Yeoh	6/6
Fiona Reynolds	5/6	Andy Pymmer	6/6
Richard Keys	6/6		

Board Committees and Advisory Panels

Four formal committees operated throughout the financial year under review:

- Audit Committee
- Remuneration Committee
- Nominations Committee
- Corporate Responsibility Committee.

These Committees operate under the authority of the Board and assist the Board in carrying out its duties. The Committees report back to the Board on decisions and actions taken together with any specific recommendations. Reports from the Chair of each of the Committees are included in the Governance Report.

The Board also receives reports from two liaison panels and a customer partnership panel as part of the Company's commitment to wide stakeholder engagement.

The Futures Panel is chaired by Fiona Reynolds. It keeps under review emerging issues facing all companies today (including sustainability, health and the environment). By invitation a range of external scientific and technical expertise is brought to this panel.

The Wessex Water Partnership including our key organisational stakeholders, scrutinises and assesses the Company's delivery against customer related outcomes and performance commitment. The Partnership is independently chaired by Dan Rogerson who was previously Water Minister under the coalition Government.

The Catchment Panel helps to inform the Company's decision making about sustainable land and water resource use in the context of the Company's services, constructed and natural assets and entitlements. The panel includes representatives of the Environment Agency, Natural England, the Drinking Water Inspectorate, the National Farmers' Union and the Country Landowners Association. The panel is chaired by Dr Richard Cresswell.

Board, Committee and Director Performance

The Board has agreed to review its own performance, and the performance of its Committees, the Chairman, the Executive Directors and the Independent Non-Executive Directors, annually in accordance with the Code. Generally, the Board will engage the services of an external consultant at least one year in three. Between external evaluations, reviews are facilitated by the Company Secretary. Evaluation of the Board considers the Board's balance of skills, experience, independence and knowledge of the Company and how the Board works together as a unit, and other factors related to its effectiveness.

Governance Report (continued)

Several improvements were identified in the 2016 review. The Independent Non-Executive Directors now have a wider visibility of the Group's activities outside the regulated entity through the Independent Directors' performance committee that sits prior to each Company Board.

For the financial year under review, Indepen Ltd was instructed to carry out a comprehensive review not just of Board effectiveness but also of the governance arrangements. The intention was not simply to review past performance but to identify issues that could have implications for Wessex Water's governance in future and for the effectiveness of the Board. It was felt that the wide range of work carried out by Indepen for regulators would provide constructive feedback for the Board.

A questionnaire was sent to relevant parties within Wessex and a series of structured interviews set up with internal stakeholders and external ones including OFWAT, EA and DWI. The results will be presented to Directors for discussion and action.

Directors' Remuneration

Details of Directors' remuneration are set out in the Remuneration Committee Report on page 28.

Directors' Interests and Conflicts

Directors are aware of the requirement to disclose interests in contracts with the Company and any conflicts of interest. No such interests or conflicts were disclosed during the year.

Whistleblowing

The Company has adopted and publicised to all its employees a whistleblowing policy for reporting instances of malpractice or inappropriate activity across all areas of business, including water regulation, health and safety, bribery, corruption and fraud. All reports are treated on a strictly confidential basis. Reports on whistleblowing are made to the Audit Committee and details are set out in the Audit Committee Report.

Anti-corruption

The Company has adopted a formal policy on business ethics. Directors and employees are expected to commit to the highest standards of professional and ethical conduct in order to protect the Company's reputation and standing. Bribery and corruption is not tolerated. All Directors and employees are made aware of the Company's policy and that breaching it will result in disciplinary action. No instances of a breach of the policy were recorded in the year.

Procurement

The Company has in place procurement rules that ensure awards of contracts for works, services and supplies are made after compliance with the Utilities Contracts Regulations 2006 and for contracts below the relevant thresholds in accordance with clear internal rules. The rules promote fair competition for potential suppliers. All relevant staff are required to certify to internal audit through the year that they have complied with the rules or to disclose non-compliance. No material instances of non-compliance were recorded during the year.

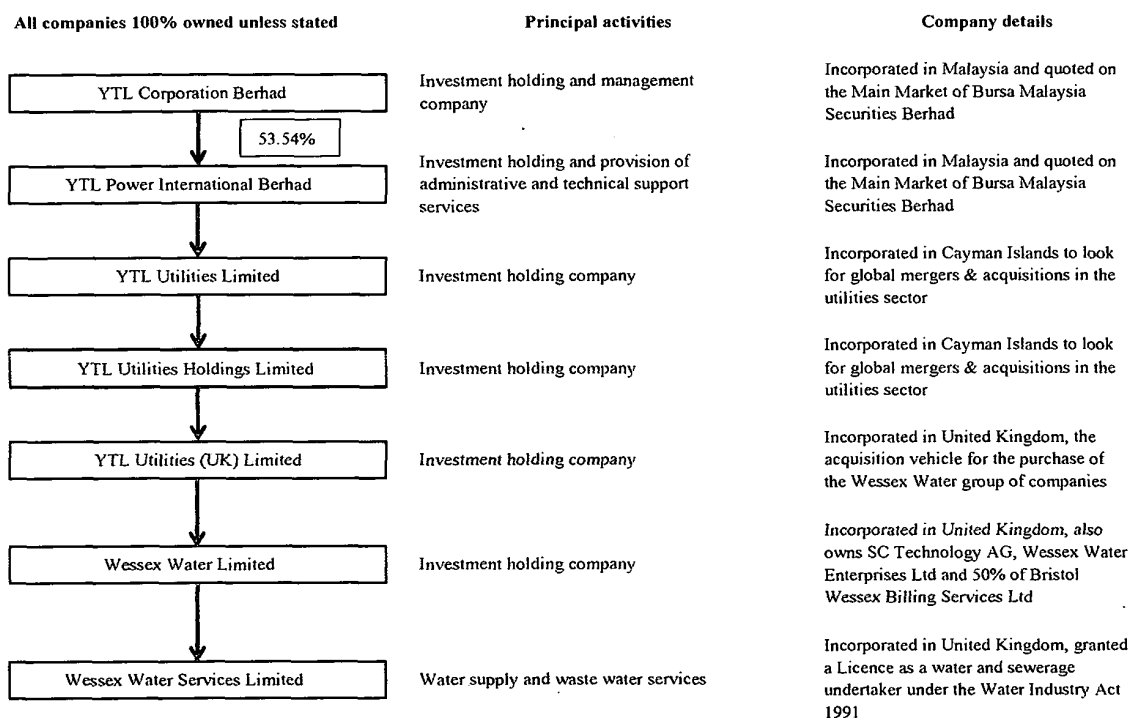
Group Structure

Ofwat's published document Board Leadership, Transparency and Governance – Holding Company Principles sets out the principles it expects the holding companies of a regulated water company to follow to demonstrate adherence to the highest standards of governance, particularly in its interaction with a regulated water company. The Holding Company Principles build upon and supplement the Company's licence provisions dealing with its relationship with its owners.

The Company's ultimate holding company is a Malaysian company YTL Corporation Berhad that is listed on the main market of Bursa Malaysia Securities Berhad. It addresses the Holdco Principles as described in the paragraphs below.

A diagrammatic representation of the Group's structure appears below showing ownership of the regulated Company through to YTL Corporation Berhad and each company's country of incorporation and role in the structure. YTL Corporation Berhad at 30 June 2017 was 51.24% owned by third party shareholders and 48.76% owned by Yeoh Tiong Lay & Sons Holdings Sdn Bhd.

Governance Report (continued)



The following Directors of the Company are also Directors of the Group companies above:

Colin Skellett, Mark Watts and Andy Pymer are Directors of Wessex Water Ltd. Colin Skellett and Mark Watts are directors of YTL Utilities (UK) Ltd and YTL Utilities Holdings Ltd.

Francis Yeoh and Mark Yeoh are Directors of Wessex Water Ltd, YTL Utilities (UK) Ltd, YTL Utilities Ltd, YTL Power International Berhad and YTL Corporation Berhad. Hong Yeoh is a Director of Wessex Water Ltd, YTL Utilities (UK) Ltd, YTL Utilities Holdings Ltd, YTL Utilities Ltd, YTL Power International Berhad and YTL Corporation Berhad. Hann Yeoh is a Director of YTL Utilities Holdings Ltd.

YTL Corporation Berhad's consolidated debt and equity are shown in its annual accounts available at its YTL Corporation website. The Company has no borrowings with other Group companies.

The Company operates independently. There are no matters specifically reserved to the shareholder. In practice the Board operates (and has operated continuously for more than a decade) without the requirement for shareholder resolutions. A list of those Directors of the Company who also hold office within the Group structure appears above. Disclosure of the interests of such Directors has been made to the Company.

Governance of YTL Corporation Berhad is in accordance with the requirements of Bursa Malaysia and corporate law in Malaysia which include a requirement to publish statements in its annual accounts on corporate governance, risk, risk management and internal control and the workings of its audit committee.

YTL Corporation Berhad and YTL Power International Berhad gave undertakings to Ofwat in 2002 upon the acquisition of the Company that they and their subsidiaries would comply with the requirements of Licence Condition P. The Condition P undertaking provides that:

- they would give the Company all information as may be necessary to enable the Company to comply with the conditions of its appointments as a water and sewerage undertaker;
- to refrain from any action which would cause or may cause the company to breach any of its obligations under the Water Acts or the conditions of its Licence;
- to ensure that at all times the Company's Board contains not less than three Independent Non-Executive Directors.

Governance Report (*continued*)

YTL Corporation Berhad has confirmed that it:

- fully understands the duties and obligations of the Company arising under statute and its Licence;
- is aware of and is complying with the obligations of Condition P of its Licence;
- discharges these obligations by various means including through its knowledge of the terms of the Licence, the appointments of shareholder directors to the Board of the Company and their involvement in the affairs of the Company and the advice of its UK corporate lawyers;
- will provide the Company with the information it legitimately needs to assure itself that it is not at risk from activities elsewhere in the YTL Group;
- will identify and disclose to the Company promptly in writing any issues, if such should arise, within the YTL Group which may materially impact upon the Company for publication on the Company's website or disclosure in its annual report any relevant announcements made on Bursa Malaysia;
- will facilitate, so far as it is reasonably able, compliance with the Company's Code of Practice for Corporate Governance;
- will support the Company's decision making processes so that it can make strategic and sustainable decisions in the interests of the Company for the long term.

Audit Committee Report

All the independent non-executive directors of the Board as below were members of the Audit Committee throughout the financial year under review:

Huw Davies (Chair)
Gillian Camm
Fiona Reynolds
Richard Keys

The Board is satisfied that all members of the Audit Committee are independent and that through Huw Davies and Richard Keys, the Committee has relevant financial experience.

Role and Report on Activities

In accordance with Code Provision C.3.2. and C3.3., our Governance Arrangements are available on the Company's website and provide full terms of reference for the Audit Committee.

This report provides details of the role of the Audit Committee and the work it has undertaken during the financial year under review.

The members of the Audit Committee receive updates on financial reporting, the regulatory framework and performance throughout each financial year. In addition to the Committee members the following routinely attend the Committee meetings by invitation: the Director of Finance, the Managing Director of Wessex Water Services Limited, The Director of Regulation and Reform, Financial Controller, Head of Internal Audit, and the audit partner from the external auditor KPMG. Other senior management and the Company's external technical auditor are also invited to attend as appropriate. The technical editor for the Wessex Water Partnership is also invited to the Audit Committee meeting which considers the Annual Review and Performance Report.

Following each meeting the chair of the Audit Committee reports to the subsequent meeting of the Board on the Audit Committee's work.

The Audit Committee met four times in the financial year under review, which it considered sufficient to enable it to discharge its duties effectively. Its work focused on:

- overseeing the Company's financial reporting processes and accounting policies
- ensuring that the Company has adequate internal controls and that they are appropriately reviewed and implemented
- overseeing the internal and external audit programmes
- ensuring compliance with the regulatory reporting obligations of the Company, including the Risk and Compliance Statement and the Company's performance commitments.

Governance Report (*continued*)

In accordance with Code Provision C.3.8, key issues discussed during the financial year under review included:

- detailed review of the Company's preparedness for Open Water with the chair of the Committee signing the first of the three assurance letters required by the *Open Water methodology*
- detailed review of the Company's Information Assurance Statement and Information Assurance Plan in accordance with Ofwat's Company Monitoring framework – final position and recommending their approval to the Board
- Company performance on a number of internal processes to deliver regulatory outputs and performance commitment data
- detailed independent consideration of the half year results, the Annual Review documents incorporating the Annual Performance Report prior to their ultimate approval by the Board
- consideration of the material subjective assessments within financial reporting to ensure that the Company's treatment of these matters was properly addressed within the Company's regulatory accounts
- the review and agreement of the annual internal audit programme, the monitoring of internal audit progress and the consideration of 17 internal audit reports in the year.

In reviewing the regulatory accounts the Audit Committee considered the content, accuracy and tone of the regulatory accounts, the principal risks to the business on page 14.

KPMG reported to the Audit Committee on their audit of the regulatory accounts.

Internal Controls

The Audit Committee monitors the effectiveness of the system of internal control assisted by internal audit. It also reviews management reports received from the external auditor.

The Audit Committee receives reports on any whistleblowing allegations made to the Company from either internal or external sources, concerning fraud, bribery or other matters. Reports include the outcomes of resulting investigations and the management action taken. Where appropriate the Audit Committee is asked to approve the proposed management actions. Three anonymous whistleblowing allegations were received and investigated in the year. For the completed investigations no corroboration of the allegations has been found.

Financial Reporting

Material issues considered by the Audit Committee in relation to the regulatory accounts (as also reported by the external auditor) were as follows:

Bad Debt Provision

The Committee considered the key financial risk that arose due to the subjective nature of the provision. It reviewed the methodology of the provision in relation to the different components of the debt and the reasonableness of the differing provision made against each component.

Pension Deficit

The Committee considered the key financial risk that the assumptions made by the Company in association with the independent actuary, in arriving at the pension deficit under IAS 19, could lead to an overly prudent or aggressive position. In particular, the assumptions in relation to inflation, discount rate, pension and salary increases, return on equity and life expectancy were tested against the range of assumptions used by other companies.

Classification of Capital Expenditure

The Committee considered the key financial risk of the degree of judgement involved in the classification of expenditure between operating expenses and capital expenditure. In doing so they considered the level of capital expenditure, the Regulatory Accounting Guidelines and International Financial Reporting Standards, the recharges from overhead to capital projects and the controls of the Company.

Taxation

The Committee also considered the amounts recorded for corporation tax and deferred taxation in the income statement and balance sheet. They reviewed the split between current and prior year taxation, the overall tax reconciliation and current taxation issues as highlighted by the external auditor.

The Committee was satisfied that each of the above issues had been adequately explained and correctly recorded in the regulatory accounts of the Company.

Governance Report *(continued)*

Misstatements

Management confirmed to the Audit Committee that they were no material misstatements or immaterial misstatements in the regulatory accounts to achieve a particular presentation. The external auditor reported to the Committee that in the course of their work no material misstatements had been found. The Committee was satisfied that the external auditor had fulfilled its responsibilities to the Audit Committee and the Company.

Oversight of Internal Audit and External Audit

The Audit Committee oversees the work of the Company's internal audit function, monitoring and reviewing the effectiveness of the internal audit activities, and manages the relationship with its external auditor. The Audit Committee reviews the performance of the internal and external auditor to ensure that they are effective.

The Audit Committee regularly holds discussions at the end of its meetings with both the internal and external auditor in the absence of executive management.

Internal Audit

The annual programme of planned internal audits is agreed by the Audit Committee prior to the start of each financial year based on a balance of topics which represent major business risks, and internal business processes which affect either financial or regulatory compliance. A total of 17 individual audit reports were submitted to the Committee in the year.

At the request of either Executive Directors, senior managers or the Audit Committee, additional audits are undertaken throughout the financial year to address any issues that arise in the financial year.

The Head of Internal Audit reports back on reviews of performance and the effectiveness of the Company's internal controls and their adequacy in managing business risk and performance. This work is summarised and reported to the Audit Committee on a regular basis.

The audit plans and the level of resources of the internal audit function are reviewed at least annually by the Audit Committee. The Head of Internal Audit is free to raise any issues with the Audit Committee or its Chairman at any time during the financial year.

External Auditor

KPMG were appointed as the Company's auditor in 2002 and the audit contract has not been put out to tender since. Although KPMG's appointment exceeds the normal 10-year period suggested in the FRC UK Corporate Governance Code, it is consistent with the transitional arrangements as published by the FRC, that re-tender can take place at the end of the current audit partner's term of office in 2017. The Committee intends to re-tender the Company's external audit services at that time.

The audit partner attends by invitation meetings of the Committee, and the Committee monitors the effectiveness of the external auditor throughout the year taking into account their own experience of the auditor's effectiveness in the year.

KPMG was paid £159k for audit fees and a total of £27k for advice on tax and other matters. The individual commissions for non-audit work were considered to have no impact on the auditor's objectivity and independence. As a matter of policy, fees paid to the external auditor for non-audit services will not exceed 50% of the annual audit fee unless approved in advance by the Chair of the Audit Committee.

KPMG reports to Ofwat in respect of the Company's Annual Performance Report.

As part of the assurance process for this Annual Review document the Audit Committee also receives a report from its technical auditor on non-financial regulatory performance information provided in the Annual Review including the performance commitment data. The technical auditor services were re-tendered in 2015-16 and a new technical auditor, Mott McDonald, was appointed for the first three years of AMP6.

Audit committee attendance	
Huw Davies	4/4
Gillian Camm	3/4
Fiona Reynolds	4/4
Richard Keys	4/4

Governance Report *(continued)*

Nominations Committee Report

The following were members of the Nominations Committee throughout the financial year under review:

Francis Yeoh (Chair)
 David Barclay
 Gillian Camm
 Huw Davies
 Fiona Reynolds
 Richard Keys
 Colin Skellett
 Hong Yeoh

The Nominations Committee is chaired by a Non-Executive Director appointed by the shareholder, by way of exception to the relevant Code Provision. The relevant Code Provision envisages a majority of the members being Independent Non-Executive Directors and the Chairman or an Independent Non-Executive Director chairing the Committee. This is intended to ensure a formal, rigorous and transparent procedure for the appointment of new Directors to the Board in the case of a listed company with disparate shareholders. However, during the year the Company's Nominations Committee complied with the Principles and spirit of the Code and its composition reflects the requirements of a private company with a sole shareholder.

Role and Report on Activities

The Nominations Committee's full terms of reference are available on the Company's website.

This report provides details of the role of the Nominations Committee and its work over the financial year under review.

The purpose of the Nominations Committee is to ensure that appropriate procedures are in place for the nomination, selection, training and evaluation of Directors. It reviews Board structure, size and composition.

The role of the Nominations Committee is to evaluate the balance of skills, experience, independence and knowledge on the Board.

The Nominations Committee met once during the financial year under review under the chair of Francis Yeoh. Its role includes monitoring the independence of Independent Non-Executive Directors, advising the Board on any conflicts of interest and reviewing executive succession planning.

The Committee commenced the recruitment and appointment process for the appointment of a Chief Financial Officer for Wessex Water Services Limited, due to place in December 2017, but this recruitment was subsequently terminated.

Nominations committee attendance	
Francis Yeoh	1/1
Hong Yeoh	1/1
David Barclay	1/1
Gillian Camm	0/1
Huw Davies	1/1
Fiona Reynolds	0/1
Richard Keys	1/1
Colin Skellett	1/1

Governance Report *(continued)*

Corporate Responsibility Committee

The following were members of the Corporate Responsibility Committee throughout the financial year under review:

Gillian Camm (Chair)
 Fiona Reynolds
 Richard Keys

Chaired by an Independent Non-Executive Director, the principal purpose of this Committee established in 2013 is to make recommendations to the Board about the Company's corporate and social obligations to its employees and other stakeholders. The Committee invited one current and one former executive director to the Company, Andy Pymer and David Elliott to attend.

Role and Report on Activities

The Committee's full terms of reference are available on the Company's website.

Corporate responsibility is central to the values against which our business operates. The Company's long-term success depends on meeting the values of our customers, employees and other stakeholders.

During the year the Committee commented on and reviewed progress on diversity including a revised recruitment protocol ensuring that, where operationally feasible, vacancies are advertised as available for flexible working and the use of LinkedIn and armed forces options to widen advertising reach. The committee reviewed efforts made by the company to promote volunteering by its employees in the community, promote and encourage flexible working and flexible retirement and the development of a carer's policy to provide flexible working options for employees who have significant caring responsibilities.

At each meeting, the diversity metrics have been reviewed and challenged by the Committee. It is recognised that progress is being made to attract, develop and retain a more diverse workforce but that it takes time for initiatives to show progress.

The committee reviewed the Company's apprentice strategy and the progress made during the year in developing the apprentice programme including the first Higher Level Apprenticeship cohort and 12% female apprentice intake in traditionally male dominated areas of water technicians, electrical, mechanical and construction. The success of apprenticeship open days was reported to the committee together with plans to maximise the drawdown on the apprenticeship levy introduced from April 2017.

The Committee reviewed a number of reports throughout the year including the use of the Corporate Hospitality Register, charitable giving, health and safety and the Gender Pay Gap reporting. Health and safety has been a key theme throughout the year and progress against the current five-year health and safety strategy. The Committee has reviewed progress in relation to occupational health and employee assistance service provision.

The Committee has reviewed the Company's Sustainability Vision, environmental accounting approaches and catchment reporting, all of which are being amended to take account of our longer term plans beyond 2020. The suggestions made by the Committee have been considered, and will be reflected within these publications when produced later in 2017.

Corporate responsibility committee attendance	
Gillian Camm	2/2
Fiona Reynolds	2/2
Richard Keys	1/2

Governance Report (continued)

Remuneration Committee Report

The following were members of the Remuneration Committee throughout the financial year under review:

Hong Yeoh (Chair)
David Barclay
Gillian Camm
Huw Davies
Mark Yeoh
Richard Keys

The Remuneration Committee is chaired by a Non-Executive Director appointed by the shareholder, by way of exception to the relevant Code Provision. The relevant Code Provision envisages at least three Independent Non-Executive Directors on the Remuneration Committee. This is intended to ensure a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual Directors in the case of a listed company with disparate shareholders. However, the Company's Remuneration Committee complies with the Principles and spirit of the Code and reflects the requirements of a private company with a sole shareholder, resulting in a formal and transparent procedure for developing policy on executive remuneration.

Role and Report on Activities

The Remuneration Committee's full terms of reference are available on the Company's website.

The Remuneration Committee determines, on behalf of the Board, the Company's policy on the remuneration (including pension rights and any compensation payments) of Executive Directors, the Chairman and senior executive managers. The Committee seeks to link rewards to performance to promote the long-term success of the Company and does not reward poor performance.

This report sets out the remuneration policy for the Directors of Wessex Water and discloses the amounts paid to them in the financial year ended 30 June 2017. The policy also applies to the remuneration of the Company's senior managers.

The Remuneration Committee met twice during the financial year under review, which was considered sufficient to enable it to discharge its duties effectively.

The Remuneration Committee continued to monitor the Company's remuneration policy to take account of evolving best and market practice. The annual bonus plan is designed to promote the success of the Company over the five-year regulatory period, and is based on a portfolio of KPIs linked to the Company's performance scorecard and Ofwat's measures of success.

Salary and bonus levels were benchmarked against the Hay Group Industrial and Service, National Utilities and South West Utilities market sectors with jobs sized in relation to scope, role responsibilities and impact to determine salary. The Remuneration Committee continued to take a proactive approach to responding to developments in legislation, best practice and the wider market, as well as the corporate strategy, in order to ensure that the Company's senior executive reward policy remained market competitive and fit for purpose.

The Remuneration Committee addressed the need to ensure that changes in senior executive remuneration are proportionate in the context of workforce pay. While it has not set a specific policy on the relationship between Executive Directors' pay and that of the rest of the workforce, it aims to ensure that executive salary movement is appropriately aligned to the rest of the workforce and it specifically considers this aspect as part of its decision making process.

To ensure that the Company's remuneration practices are competitive but not excessive, the Remuneration Committee has access to detailed external research on market data and trends from experienced specialist consultants.

Recruitment of Executive Directors

The base salary for any new Executive Director takes into account market data for the relevant role, relativity with the salaries of existing Executive Directors, the individual's experience and current base salary. In the event that an individual is recruited at below market level, their base salary may be aligned over a period of time to the upper quartile position of the relevant market position subject to their performance in the role.

Individual Executive Directors participate in a senior manager bonus scheme, governed by the Remuneration Committee. Executive Directors have their target bonus set at 50% of base salary and their maximum bonus at 100% of which a proportion is withheld until 2020 under LTIP arrangements.

Governance Report *(continued)*

During the year, the Remuneration Committee took advice from their independent advisers, Hay Group. Hay Group provided detailed market analysis and advice to the Committee for the senior management group, including Executive Directors and Non-Executive Directors. Hay Group’s fee for providing such advice was £17,000 for the year. In line with best practice, the Committee assesses from time to time whether the appointment of its current independent remuneration advisers remains appropriate and whether the role should be put out to tender.

The Remuneration Committee also considers what compensation commitments (including pension contributions and all other elements) Directors’ terms of appointment would entail in the event of early termination. The aim is to avoid rewarding poor performance, and the Remuneration Committee would take a robust line on reducing compensation to reflect departing Directors’ obligations to mitigate loss.

The Group Chief Executive (Colin Skellett) and the Group Director of Human Resources (Mark Nicholson) attended the Remuneration Committee meetings to provide advice and respond to specific questions. They did not participate in any discussion concerning their own remuneration.

The moves to introduce greater competition into the water industry and the development of group companies made it necessary to evolve the UK Group organisation. Accordingly, two Executive Directors were appointed to Wessex Water Services on 1 August 2016. Andy Pymmer was appointed Managing Director and James Rider was appointed Chief Operating Officer.

Remuneration Committee Attendance	
David Barclay	2/2
Gillian Camm	1/2
Huw Davies	2/2
Richard Keys	2/2
Hong Yeoh	2/2
Mark Yeoh	2/2

The remuneration policy for senior executives is aligned to the Company’s four key focus areas, as shown below.

Key Focus	Remuneration Policy
Customer service delivery and business costs	Target annual bonus potential just below the median when compared to industrial and service and national utilities market, supported by competitive base salary at or below market upper quartile. Financial based KPIs within the annual bonus are set with close regard to Ofwat’s determination, ensuring that we closely manage our performance within the regulatory limits. Customer focused KPIs form a substantial part of the annual bonus scorecard.
Employee alignment	The Remuneration Committee aims to ensure that the executive salary movement is aligned to the rest of the workforce. The performance scorecard is used for the annual bonus throughout the Company. KPIs within the annual bonus for all employees include health and safety, engagement and training compliance factors.
Environment performance	KPIs within the annual bonus for all employees include environmental factors.
Financial performance	A variety of financial KPIs are used within the annual bonus plan with the aim of delivering a fair return to our shareholder.

Governance Report (continued)

The Remuneration Committee continues to monitor variable pay arrangements for the Executive Directors and senior managers. The Remuneration Committee believes that the arrangements are appropriately managed and that the choice of performance measures and targets does not encourage undue risk taking by the executives so that the long-term performance of the business is not put at risk by considerations of short-term value. The arrangements incorporate a range of internal and external performance metrics, measuring both operational and financial performance providing a rounded assessment of overall company performance to ensure that a significant portion of executive remuneration is performance-related.

Policy for loss of office

There are no specific provisions for compensation on early termination (except for payment in lieu of accrued but untaken holidays) or loss of office due to a change of ownership of the Company. The Committee will review all contractual obligations and will seek legal advice as and when necessary on the Company's liability to pay compensation in such circumstances. The Committee will seek to reduce the level of compensation payable taking into account, amongst other factors, the Company's and the individual's performance, the Executive Director's obligation to mitigate loss, and length of service.

Early termination payments made in the year

No Executive Director left the Company during the year.

Relative importance of spend on pay

Note 4 to the accounts shows the total employment costs of the Company, and the movement from last year.

	2016-17 £m	2015-16 £m	Movement £m	Movement %
Wages and salaries	81.1	71.5	+9.6	+13.4
Social security costs	8.5	7.0	+1.5	+21.4
Other pension costs	12.4	11.0	+1.4	+12.7
Total employment costs	102.0	89.5	+12.5	+14.0

Charged to:

	2016-17 £m	2015-16 £m	Movement £m	Movement %
Capital schemes	39.8	33.0	+6.8	+20.6
Manpower costs	62.2	56.5	+5.7	+10.1

The relative importance of total employment costs can be shown as:

Percentage of	2016-17 %	2015-16 %	Source
Turnover	19.2%	17.2%	Income statement
Profit before tax	64.6%	57.0%	Income statement
Profit after tax	67.6%	53.8%	Income statement
Dividends	110.9%	91.8%	Note 8
Capital expenditure	52.6%	50.1%	Cash flow statement

Remuneration Arrangements for Executive Directors 2016-17

The following table sets out the elements of the Company's Executive Directors' remuneration package:

- Basic salary
- Bonus (non-pensionable) subject to individual and company performance
- Pension plan
- Company car
- Private fuel allowance
- Private health insurance and executive medical screening
- Share option scheme of a parent company YTL Power International Berhad.

Governance Report (continued)

The table below highlights the key elements of executive remuneration and the link to company strategy, how executive remuneration is operated in practice and the link to relevant performance metrics.

Element of Pay	Purpose and link to Company strategy
Base Salary	To attract and retain the high calibre Executive Directors and Senior Managers needed to implement the Company's strategy and maintain its leading position in the industry. To provide a competitive salary relative to comparable companies in terms of size and complexity.
Taxable Benefits	To attract and retain high calibre Executive Directors and Senior Managers and to remain competitive in the market.
Pension	To attract and retain high calibre Executive Directors and Senior Managers and to remain competitive in the market.
Annual Bonus	To motivate and reward Executive Directors and Senior Managers for the achievement of demanding financial objectives and key strategic measures (including measures of customer satisfaction, service quality and environmental performance) over the financial year and five year regulatory period. The performance measures set are stretching in the context of the nature, risk and profile of the Company.
LTIP	To motivate and reward Executive Directors for the achievement of demanding financial objectives and key strategic measures (including measures of customer satisfaction, service quality and environmental performance) over the five year regulatory period to promote the long term success of the Company.
How operated in practice	
Base Salary	Reviewed annually and takes effect from 1 April. Review takes into consideration; <ul style="list-style-type: none"> • Individual responsibilities, experience and performance • Salary levels for similar sized roles in utilities and south west industrial and service markets • The level of pay increases awarded across the Company • Economic and market conditions • The performance of the Company Salaries are paid monthly.
Taxable Benefits	Benefits include: <ul style="list-style-type: none"> • Company car • Private medical insurance • Executive health screening • Private fuel allowance
Pension	All Executive Directors participate in the Company's defined benefit pension scheme. Executive Directors are also insured for a lump sum of up to four times their pensionable salary on death in service.
Annual Bonus and Long Term Incentive Plan	The Board of Directors sets annual performance targets for the Company prior to the commencement of each new financial year. Company and individual performance against those targets is measured at the end of the financial year and the level of bonus payable is calculated at that point. Bonuses are paid in April. From 1 April 2015 the remuneration Committee established a Long Term Incentive Plan for Executive Directors whereby 20% of any above target bonus element earned will be held back for payment at the end of AMP6 in 2020. The Company will match the value of the retained bonus payment, up to 100%. The long term incentive payment will be paid to Directors in April 2020. The Committee has the discretion to, and does consider the effect of corporate performance on environmental and governance risks when reviewing Executive Director and senior management bonuses to ensure variable remuneration incentivises and rewards appropriate behaviour. Part of the bonus may be forfeited for under performance in respect of customer service, environmental, regulation and employee related performance targets. Annual bonus is not pensionable.

Maximum opportunity	
Base Salary	There is no prescribed maximum increase. However, Executive Director salary increases are aligned to the increases provided to all Company employees. Such increases are negotiated by the joint staff council involving management and trade union representatives.
Taxable Benefits	N/A
Pension	18.2% of base salary
Annual Bonus	Maximum bonus opportunity is 100% of base salary.
Description of performance metrics	
Base Salary	N/A
Taxable Benefits	N/A
Pension	N/A
Annual Bonus	A combination of 29 key performance indicators relating to financial, customer, environment & assets and employee related measures and targets. An equal weighting is applied to each of the four categories. The committee has absolute discretion in making bonus payments.
Change to policy	
Base Salary	No change
Taxable Benefits	No change
Pension	No change
Annual Bonus	No change except that there were three less performance indicators this year.

A detailed explanation of each of these follows and the table below highlights some of the elements.

Component 2016/17	Colin Skellett Group Chief Executive	Mark Watts FD	Andy Pymmer MD	James Rider COO
Target bonus (% of salary)	50	50	50	50
Maximum bonus (% of salary)	100	100	100	100
Actual bonus paid (% of salary)	63	67	56	57
Actual bonus held as LTIP (% of salary)	3	4	2	2
Share options (maximum)	Approved 87,000 Unapproved 1,913,000	Approved 87,000 Unapproved 913,000	Approved 87,000 Unapproved 913,000	Approved 87,000 Unapproved 213,000
Pension arrangement	Defined benefit - Pension in payment	Defined benefit	Defined benefit - Pension deferred	Defined benefit
Benefits	See below	See below	See below	See below

Benefits were company car based on list price and CO2 emissions, fuel £4,310, private medical insurance £1,784 (family).

Base Salaries and Benefits

Executive Directors' remuneration is reviewed annually by the Remuneration Committee and takes effect from 1 April. Salaries are set with reference to individual performance, experience and contribution, together with development in the relevant employment market (having regard to the upper quartile position for high performers in similar roles in the relevant employment market) and internal relativities.

Differences between Executive Directors' and Employees' Remuneration

The following differences exist between the Company's policy for the remuneration of Executive Directors and its policy for the remuneration of employees:

- Executive Directors pay is benchmarked against the upper quartile position of the South West Utilities market whilst we benchmark median pay and benefits against the South West Industrial and Service market for all fully qualified and experienced employees
- A lower level of target and maximum annual bonus opportunity applies to various employees when compared to Executive Directors. However, all employees, including Executive Directors and Senior Managers were subject to the same negotiated pay award increase

Governance Report (continued)

- Executive Directors (and senior managers) participate in a bonus scheme that is not available to other employees to motivate and reward them for achievement of demanding financial objectives and key strategic measures.

In general, these differences arise from the development of remuneration arrangements that are market competitive for the various categories of staff ranging from employees to Executive Directors.

The Remuneration Committee gives due consideration to the current economic climate and current market practice regarding executive salary reviews and the broader employee salary review policy at the Company.

We do not normally link pay levels to company performance measures, as this is done where appropriate through the bonus arrangements.

The Remuneration Committee has reviewed 2016-17 salaries and has determined that salaries for Executive Directors will be increased from 1 April 2017 by 2.0% for Colin Skellett and Andy Pymer, 3.6% for Mark Watts and 3.3% for James Rider. For Colin Skellett and Andy Pymer the increase is in line with the agreed increase across the rest of the Company and for the other Directors the Remuneration Committee considered that a higher increase in salary was warranted as salaries were low compared to the South West Utilities upper quartile.

Executive Directors' Bonuses 2016-17 Scheme

The annual bonus of Executive Directors is performance-related and designed to promote the long-term success of the Company. It is dependent on the achievement of Company and individual targets. Bonus disclosed is in relation to the performance in the year, and is paid in April following the regulatory year-end.

The Company targets are 29 key performance indicators covering financial measures, customer service, environmental and asset measures and employee matters, as shown below.

Financial – profit after corporation tax / operational costs / net capital expenditure / cash flow before dividends / dividends declared.

Customers – Service Incentive Mechanism combined score / customers rating service good or very good / compliance with drinking water standards / customer contacts about drinking water quality / volume of water saved through water efficiency / properties suffering supply interruptions > 3 hours / volume of water leaked / restrictions on water use / internal flooding incidents per 10,000 properties / overall risk of flooding risk score.

Environment and Assets – EA's Environmental Performance Assessment / bathing water failures due to WWSL activities / Biodiversity Action Plan landholding assessed and managed / greenhouse gas emissions / proportion of electricity self-generated / all regulatory outputs met / compliance with abstraction licences / monitoring of CSO's presenting a risk to the environment / collapses and bursts on sewerage network.

Employees – RIDDOR incidents per 1,000 employees / employee rating company as a good employer / compliance with training plan / staff turnover / diversity plan progress as assessed by Corporate Responsibility Committee.

The target bonus for the Executive Directors was calculated as follows (Andy Pymer and James Rider 11 months):

Target Bonus 2016-17	Colin Skellett CEO	Mark Watts FD	Andy Pymer MD	James Rider COO
Financial				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	26,506	18,760	22,000	18,637
Customer				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	26,506	18,760	22,000	18,637
Environment and Assets				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	26,506	18,760	22,000	18,637
Employees				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	26,507	18,760	22,000	18,637
Individual				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	26,507	18,760	22,000	18,638
Total				
% of salary	50%	50%	50%	50%
Amount £	132,532	93,800	110,000	93,186

Governance Report (continued)

In the financial year under review, 28 of the 29 Company targets were achieved or bettered.

The only target not achieved was compliance with drinking water standards where mean zonal compliance was 99.95% against the target of 99.97%. There were 23 failures out of over 33,000 tests of which 18 were attributed to customers' domestic plumbing and 5 to Company assets. There is no financial penalty for this level of under-performance.

The actual bonus payments are shown in the Directors' Emoluments table. The detail of how these bonus payments were calculated is shown below.

Actual Bonus 2016/17	Colin Skellett CEO	Mark Watts FD	Andy Pymer MD	James Rider COO
Financial				
% of salary	12.7%	13.5%	11.3%	11.4%
Amount £	33,621	25,192	24,933	21,327
Customer				
% of salary	12.7%	13.4%	11.3%	11.4%
Amount £	33,621	25,192	24,933	21,327
Environment and Assets				
% of salary	12.7%	13.4%	11.3%	11.4%
Amount £	33,621	25,192	24,933	21,328
Employees				
% of salary	12.7%	13.4%	11.4%	11.5%
Amount £	33,622	25,192	24,934	21,328
Individual				
% of salary	12.6%	13.4%	11.4%	11.5%
Amount £	33,622	25,192	24,934	21,328
Total				
% of salary	63.4%	67.1%	56.7%	57.2%
Amount £	168,107	125,960	124,667	106,638

Annual bonus payments to Executive Directors are not pensionable.

Pensions

Executive Directors are members of the Wessex Water defined benefit pension scheme.

The scheme is a HMRC registered defined benefit occupational pension scheme. The Executive Directors are members of the WPS section, which provides:

- A normal retirement age of 65 years
- A pension at normal retirement age based on 1/60th of completed pensionable service and final pensionable salary
- Life cover of four times basic salary including bonus
- A pension payable in the event of retirement on grounds of ill health
- A dependant's pension on death of two thirds of the member's pension
- Guaranteed increases in line with price inflation (subject to a maximum of 5% each year).

Members' contributions are payable at the rate of 8% of basic salary, with the Company making a further 18.2% contribution. Early payment of pension is available from age 55 with the consent of the Company. Any pension would be subject to a reduction, based on rates the trustees consider appropriate, acting on actuarial advice, to reflect the expected longer payment of the pension. No additional pension will become receivable by a Director if that Director retires early.

In the event of incapacity, an unreduced pension is payable immediately. Incapacity pensions can be paid on either a "partial" or "full ill health" basis depending on the conditions met. A full ill health pension is topped up to give additional service to age 65, subject to a maximum of 20 years.

Under the Trust Deed and Rules, pensions in payment in excess of any guaranteed minimum pension are guaranteed to increase in line with price inflation subject to a maximum of 5% each year. In the calculation of individual cash equivalent transfer values, allowance is made for such increases.

Governance Report (continued)

As a result of the changes in pension legislation for high earners, Wessex Water has introduced the following options for individuals under age 55 who are affected by the tax changes:

- continue in the scheme, with individuals meeting any tax liabilities as they fall due; or
- continue in the scheme with a capped pensionable salary which restricts pension growth to the annual allowance limit (£50,000 pa) and receive a cash supplement in lieu of pension entitlement on the excess salary. The cash supplement is based on the employer contribution rate to the scheme, currently 18.2%.

Executive Directors' Service Contracts

All Executive Directors' service contracts are terminable by either the Company or the Executive Director providing 12 months' notice. There is a theoretical maximum payment in case of redundancy of 100% of salary inclusive of allowances and benefits plus their redundancy entitlement. There are no specific contractual payments or benefits which would be triggered in the event of a change in control of the Company.

Executive Directors	Date of current agreement	Date of appointment as Executive Director	Notice Period
Colin Skellett	01/04/2014	01/09/1989	12 months
Mark Watts	01/04/2014	16/03/2010	12 months
Andy Pymmer	21/07/2016	01/08/2016	12 months
James Rider	21/07/2016	01/08/2016	12 months

Executive Directors' service contracts are available for inspection during normal office hours at the registered office, Wessex Water, Claverton Down Road, Bath BA2 7WW.

The Remuneration Committee will continue to review the contractual terms for Executive Directors to ensure they reflect best practice and are compliant with employment law. Two new Executive Directors were appointed during the financial year under review.

None of the Executive Directors served as a Non-Executive Director for another company.

Non-Executive Directors

The remuneration policy for Independent Non-Executive Directors is determined by the Board. The remuneration reflects the time commitment and responsibilities of the role.

The breakdown of the Independent Non-Executive Directors' fees from 1 April 2016 is shown in the Directors' Emoluments table below. Independent Non-Executive Directors do not participate in share or bonus schemes or any other performance-related scheme, nor is any pension provision made.

Independent Non-Executive Directors are normally appointed for three-year terms (subject to statutory provisions relating to the removal of a Director) that may be renewed. They do not have service contracts but their terms of engagement are regulated by letters of appointment (copies of which are available on the Company's website).

Any term beyond six years for an Independent Non-Executive Director is subject to particularly rigorous review and takes into account the need for progressive refreshing of the Board balanced against the requirement for skills, experience, independence and knowledge.

Non-Executive Directors appointed by the shareholder do not receive any fees or other payments from the Company.

Governance Report (continued)**Directors' Emoluments**

The table below shows the emoluments for the current year.

The auditor is required to report on the information in the following tables for 2016-17.

2016-17	Salary £000	Bonus £000	LTIP £000	Benefits £000	Pension contributions £000	Total £000
David Barclay	85	-	-	-	-	85
Gillian Camm	84	-	-	-	-	84
Huw Davies	80	-	-	-	-	80
Richard Keys	66	-	-	-	-	66
Andy Pymer	257	124	4	16	47	448
Fiona Reynolds	68	-	-	-	-	68
James Rider	194	107	3	21	35	360
Colin Skellett	266	168	9	19	-	462
Mark Watts	189	126	8	17	26	366
Total £000	1,289	525	24	73	108	2,019

1. No emoluments earned by Francis Yeoh, Hann Yeoh, Hong Yeoh, Mark Yeoh or Kathleen Chew.
2. Benefits comprise private medical insurance, company car and fuel benefits.
3. Employer pension contributions may be received as payment into the Company pension scheme or as a cash benefit.
4. Three Directors received emoluments for services to other Group Companies, Colin Skellett £449k, Mark Watts £371k and David Barclay £6k. The Audit Committee was satisfied that services provided to other Group Companies do not reduce the effectiveness of the Directors' provision of services to the Company.

The table below shows the emoluments for the prior year.

2015-16	Salary £000	Bonus £000	LTIP £000	Benefits £000	Pension contributions £000	Total £000
David Barclay	85	-	-	-	-	85
Gillian Camm	66	-	-	-	-	66
Huw Davies	66	-	-	-	-	66
Richard Keys	11	-	-	-	-	11
Fiona Reynolds	66	-	-	-	-	66
Colin Skellett	350	217	11	25	-	603
Mark Watts	213	136	8	17	38	412
Total £000	857	353	19	42	38	1,309

Governance Report (continued)

Chief Executive

No remuneration was paid to the Chairman (2016 – £nil). The total remuneration for the Chief Executive (Colin Skellett) was:

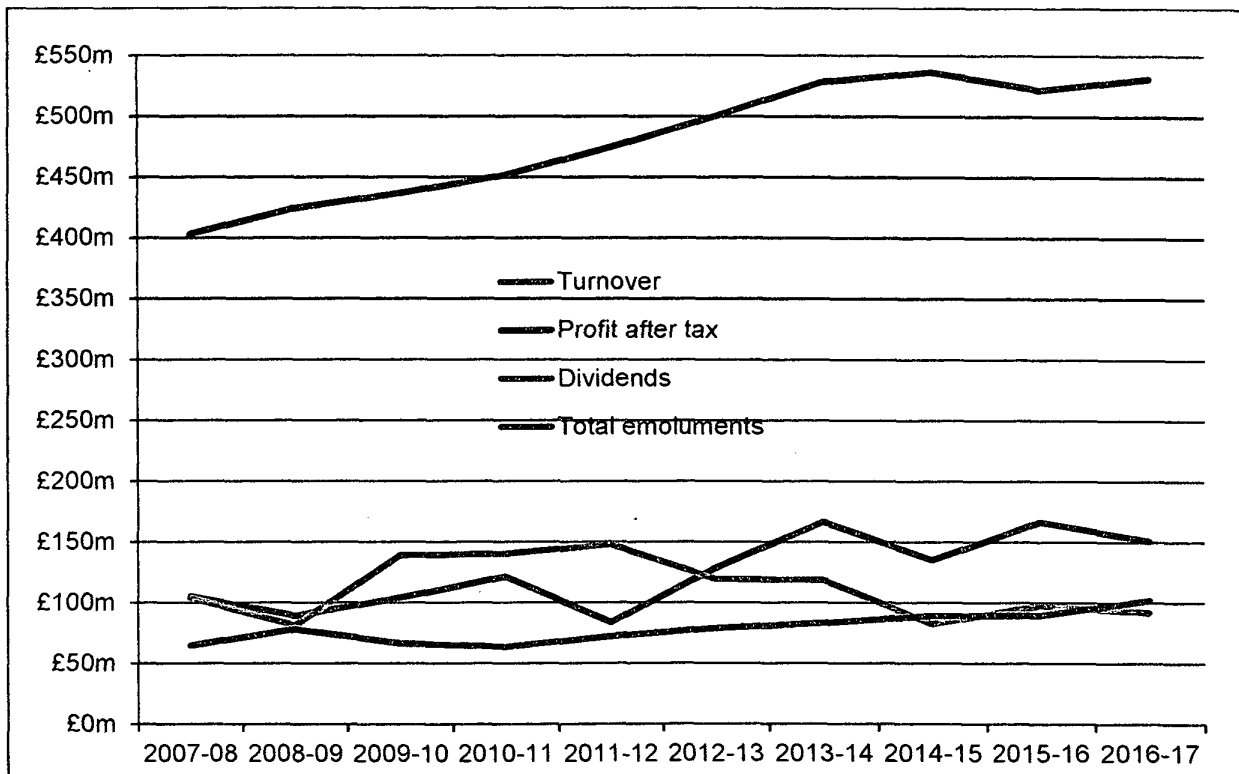
	Remuneration 2016-17 £000	Remuneration 2015-16 £000	% change
WWSL			
Salary	266	350	(24.0)%
Bonus	168	217	(22.6)%
LTIP	9	11	(18.2)%
Benefits	19	25	(24.0)%
Other group companies			
Salary	178	88	102.3%
Bonus	252	194	29.9%
LTIP	6	3	100.0%
Benefits	13	6	116.6%
Total	911	894	+1.9%
All employees WWSL			
Wages and salaries	81,100	71,500	13.4%
Social security costs	8,500	7,000	21.4%
Other pension costs	12,400	11,000	12.7%
Total	102,000	89,500	+14.0%

Comparison with remuneration increase for all employees:

The pay increase awarded to the employees of the Company on 1 April 2016, for the year 2016-17, was a 1.0% increase over the preceding year.

Remuneration Link to Performance

The table below compares the movement over ten years in total emoluments of the Company with the movement in the key financial performance measures of turnover, profit after tax and dividends.



Dividends are as declared in the year. Total emoluments include Director's emoluments.

Governance Report (continued)

Executive Directors' Defined Benefit Pension Provision

	Pension service completed in years (1)	Normal retirement date at 65	Accrued pension at 30/6/2016 £pa	Change in accrued pension during the year £pa	Accrued pension at 30/6/2017 £pa
Colin Skellett	42	(2)	171,252	4,224	175,476
Mark Watts	28	(2)	119,042	(49,042)	70,000
Andy Pymer	23	(3)	61,861	1,557	63,418
James Rider	32	7/4/2030	51,032	20,751	71,783

- (1) Including transfers in and bonus years
 (2) Pension in payment
 (3) Deferred pension

Executive Directors' Share Interests

Share Options

YTL Power International Berhad (a parent company and itself a subsidiary of YTL Corporation Berhad) operates a share option scheme under which options are granted to employees of the Company. The terms of the scheme are specified under the YTL Power ESOS (2011 UK part) known as the "2011 UK Plan".

The majority of options are issued under terms approved by HMRC (the "Approved" scheme) but some are issued to senior employees under an "Unapproved" scheme. The options are for ordinary shares in YTL Power International Berhad of Malaysian Ringgit RM0.50 each.

The Executive Directors have been granted ordinary share options of Malaysian Ringgit RM0.50 each in YTL Power International Berhad under the 2011 UK Plan. The exercise of share options granted is not subject to any performance criteria, other than continued employment within the group.

Share options held by Executive Directors at the start and end of the financial year, and the exercise price of those share options are shown in the table below:

	Opening number 30/6/2016	Exercise price RM	Date of grant	Exercise date	Expiry date	Closing number 30/6/2017
Colin Skellett	87,000	1.65	1/6/2012	1/6/2015	31/3/2021	87,000
Colin Skellett	1,913,000	1.41	1/6/2012	1/6/2015	31/3/2021	1,913,000
Mark Watts	87,000	1.65	1/6/2012	1/6/2015	31/3/2021	87,000
Mark Watts	913,000	1.41	1/6/2012	1/6/2015	31/3/2021	913,000
Andy Pymer	87,000	1.65	1/6/2012	1/6/2015	31/3/2021	87,000
Andy Pymer	913,000	1.41	1/6/2012	1/6/2015	31/3/2021	913,000
James Rider	87,000	1.65	1/6/2012	1/6/2015	31/3/2021	87,000
James Rider	213,000	1.41	1/6/2012	1/6/2015	31/3/2021	213,000

Approved options were granted at an exercise price of RM1.65. Unapproved options were granted at an exercise price of RM1.49, which was adjusted to RM1.41 following the distribution to all shareholders of one share for every 20 ordinary shares held as at 13 March 2014.

The share price at 30 June 2017 was RM1.45 or £0.26.

Governance Report (continued)

Shares Held

There are no shares held by the Directors in the Company or the UK parent company. The Executive Directors held the following ordinary shares of Malaysian Ringgit RM0.50 each in YTL Power International Berhad (a parent company), at the start and end of the accounting period.

	Opening number 30/6/2016	Closing number 30/6/2017
Mark Watts	388,030	388,030
Andy Pymer	53,815	53,815

The share price at 30 June 2017 was RM1.45 or £0.26.

Remuneration Arrangements for Executive Directors 2017-18

Component	Colin Skellett CEO	Mark Watts FD	Andy Pymer MD	James Rider COO
Target bonus (% of salary)	50	50	50	50
Maximum bonus (1) (% of salary)	100	100	100	100
Share options (maximum)	Approved 87,000 Unapproved 1,913,000	Approved 87,000 Unapproved 913,000	Approved 87,000 Unapproved 913,000	Approved 87,000 Unapproved 213,000
Pension arrangement	Defined benefit - Pension in payment	Defined benefit - Pension in payment	Defined benefit - Pension deferred	Defined benefit
Taxable Benefits	Company car, fuel and private medical insurance			

(1) Of which a proportion is withheld until 2020 under LTIP arrangements

Bonus scheme 2017-18

Target Bonus 2017-18	Colin Skellett CEO	Mark Watts FD	Andy Pymer MD	James Rider COO
Financial				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	27,037	19,430	30,600	21,700
Customer				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	27,037	19,430	30,600	21,700
Environment and Assets				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	27,037	19,430	30,600	21,700
Employees				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	27,036	19,430	30,600	21,700
Individual				
% of salary	10.0%	10.0%	10.0%	10.0%
Amount £	27,036	19,430	30,600	21,700
Total				
% of salary	50%	50%	50%	50%
Amount £	135,183	97,150	153,000	108,500

For 2017-18 there are 29 performance indicators set to reflect the corporate targets in the current regulatory period, as shown below:

Financial – profit after corporation tax / operational costs / net capital expenditure / cash flow before dividends / dividends declared.

Customers – Service Incentive Mechanism service score / customers rating service good or very good / compliance with drinking water standards / customer contacts about drinking water quality / volume of water saved through water efficiency / properties suffering supply interruptions > 3 hours / volume of water leaked / restrictions on water use / internal flooding incidents per 10,000 properties / overall risk of flooding grid score.

Governance Report (continued)

Environment and Assets – EA’s Environmental Performance Assessment / bathing waters passing EU standards / Biodiversity Action Plan landholding assessed and managed / greenhouse gas emissions / proportion of electricity self-generated / all regulatory outputs met / compliance with abstraction licences / monitoring of CSO’s presenting a risk to the environment / river water quality improved.

Employees – RIDDOR incidents per 1,000 employees / employee rating company as a good employer / compliance with training plan / staff turnover / diversity plan progress as assessed by Corporate Responsibility Committee.

Long term incentive scheme from 1 April 2015

In September 2014, the Financial Reporting Council published a revised code of practice of the UK corporate governance code, which introduced new provisions relating to executive remuneration, including a change meaning that remuneration policies must be designed to promote the long term success of the Company.

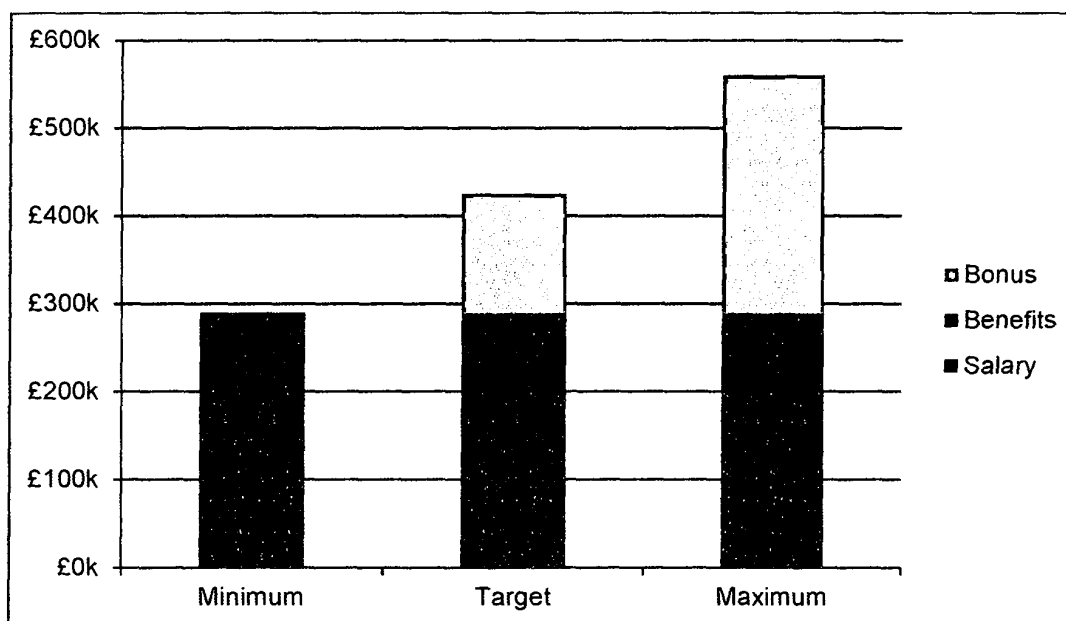
The Remuneration Committee approved the establishment of a long term incentive plan (LTIP) for Directors whereby 20% of any above target bonus element earned will be held back for payment at the end of AMP6 in 2020. The Company will match the value of the retained bonus payment, up to 100%. The LTIP will be paid to Directors in April 2020.

Amounts of bonus held back from Executive Directors under the LTIP scheme were as follows:

Bonus held back as LTIP	Colin Skellett CEO	Mark Watts FD	Andy Pymmer MD	James Rider COO
March 2015/16	£10,608	£8,000	-	-
March 2016/17	£9,634	£8,430	£2,667	£2,445
Total	£20,242	£16,430	£2,667	£2,445

Illustrations of Remuneration Policy

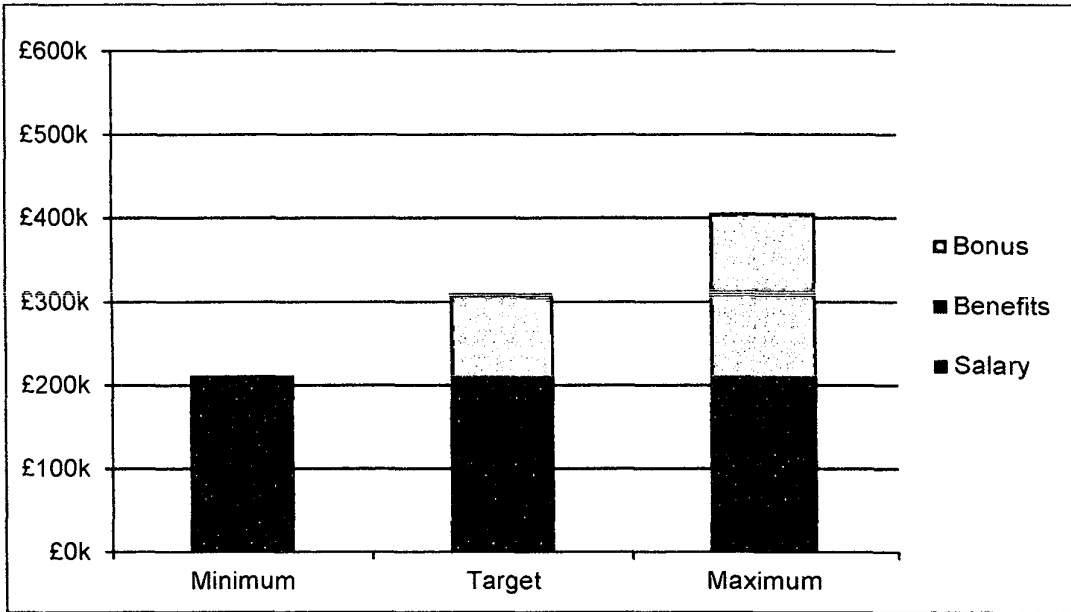
A) Colin Skellett - CEO (using estimated 2017-18 data)



Minimum assumes no bonus earned, target assumes 50% bonus earned and maximum assumes 100% bonus earned. No employer pension contributions.

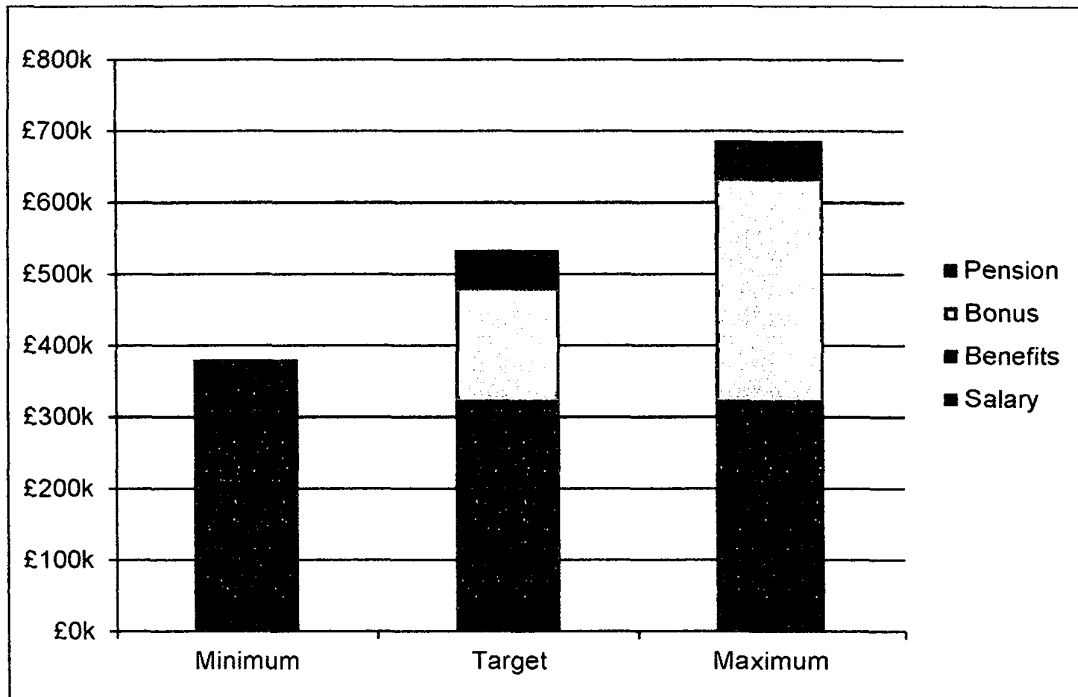
Governance Report (continued)

B) Mark Watts – FD (using estimated 2017-18 data)



Minimum assumes no bonus earned, target assumes 50% bonus earned and maximum assumes 100% bonus earned. No employer pension contributions.

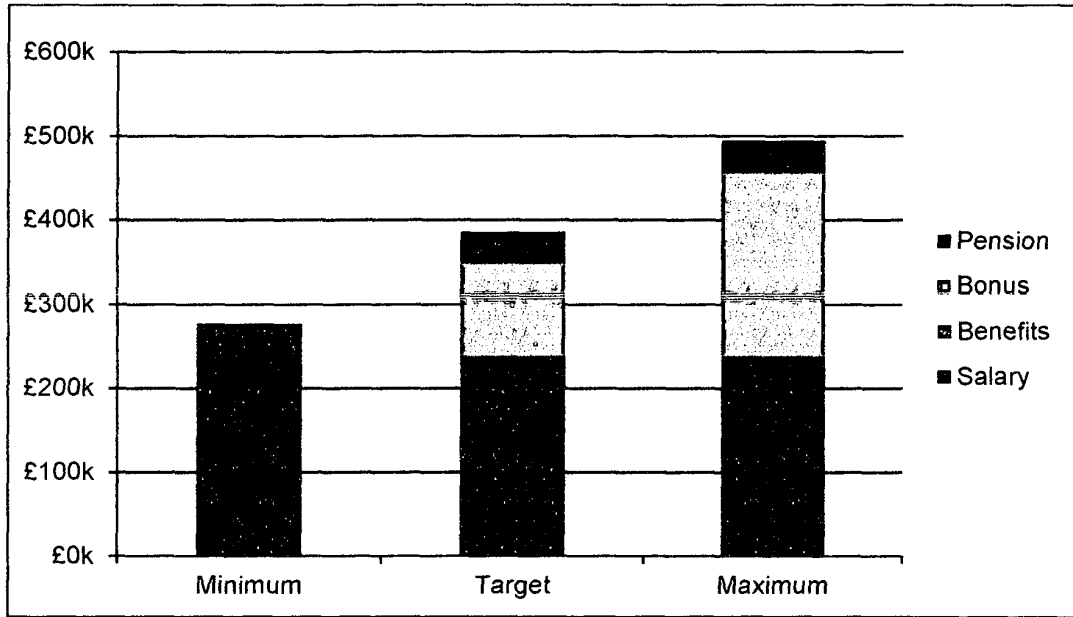
C) Andy Pymmer – MD (using estimated 2017-18 data)



Minimum assumes no bonus earned, target assumes 50% bonus earned and maximum assumes 100% bonus earned.

Governance Report (continued)

D) James Rider – COO (using estimated 2017-18 data)



Minimum assumes no bonus earned, target assumes 50% bonus earned and maximum assumes 100% bonus earned.

Directors' Report

The Directors have pleasure in presenting their report and the audited statutory accounts (subsequently referred to as accounts) for the year to 30 June 2017.

The Directors consider the annual report and financial statements taken as a whole, to be fair, balanced and understandable and it provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

Principal Activities

The main activities of the Company are the supply of water and the treatment and disposal of waste water.

In December 2014 the industry regulator Ofwat announced the final price control determination for the five-year period to March 2020. The price control for this period has been extended from one price control to four price controls covering wholesale water, wholesale waste water, household retail and non-household retail. The Directors accepted the price review for the next five years.

On 1 April 2017 all non-household customers were able to choose their retailer for water services. From that date the Company continued to offer wholesale services to those customers, but retail services were offered through Water2Business Ltd a joint venture between Wessex Water Ltd and Bristol Water Holdings Ltd.

Sustainability

Wessex Water Services Ltd has a sustainability vision that guides our progress towards being a sustainable water company. The sustainability vision is reviewed bi-annually.

Ethical Policy

We are determined to maintain our reputation as a Company that observes the highest standards of personal and corporate integrity by adhering to a strict code of business ethics. We aim to be the best and value everyone's contribution in our pursuit of excellence. We are honest in the way we conduct our business. We treat one another, our customers and the environment with respect.

Employment

Wessex Water Services Ltd is an equal opportunities employer. No person or group of persons applying for a job with the Company is treated less favourably than any other person or groups of persons because of their gender, race, class, colour, nationality, ethnic origin, marital status, sexual orientation, age, trade union membership or activity, religious belief or physical or mental disability.

Selection procedures and criteria ensure that individuals are selected and promoted on the basis of their relevant merits and abilities. These procedures are monitored and regularly reviewed. Where necessary, the Company provides staff with ongoing professional development to enable them to compete or qualify for positions, or to progress, within the Company.

The Modern Slavery Act 2015

Wessex Water is committed to meeting the aims of the Modern Slavery Act 2015. We strongly oppose slavery and human trafficking in our supply chains and in any part of our business. To be trusted to do the right thing is one of our core values. We would never knowingly engage with suppliers or contractors involved in slavery or human trafficking. In accordance with the requirements of the Act we have published on our website a Slavery and Human Trafficking Statement 2016.

Environmental Policy

Wessex Water Services Ltd protects conserves and improves the environment and operates in a socially responsible manner. Working practices are continually revised as improved techniques and technologies become available. The environment policy is reviewed annually.

Research and Development

The Company carried out research and development in support of existing activities to improve the reliability and effectiveness of water and waste water services.

Market Value of Land and Buildings

In the opinion of the Directors, the market value of land and buildings of the Company exceeds the book value of these assets at 30 June 2017.

Charitable and Political Donations

£337,615 was donated to UK charities (2016 – £432,000). No political donations were made in either year.

Other information

An indication of likely future developments in the business and particulars of significant events which have occurred since the end of the financial year have been included in the Strategic Report on pages 2 to 13. Information on the use of financial instruments by the Company are shown in note 21 to the financial statements.

Directors' Report (continued)

Viability Statement

Provision C.2.2 of the UK Corporate Governance Code 2014 requires the Directors to assess the viability of the Company over a longer period than the 12 months required by a Going Concern statement.

The Directors have determined that the period to 31 March 2020 is an appropriate period over which to provide its Viability Statement. The Directors recognise that the normal business cycle for the Company is five years, but that the Company is already two years into the current cycle. The end of this three-year period coincides with the end of the current five-year regulatory control period that began on 1 April 2015 and for which a detailed business plan was approved by the Directors and submitted to the Water Services Regulation Authority (WSRA/Ofwat).

The Directors have reviewed the principal risks shown on page 14 of the Annual Review Summary. They have taken into account the current financial position of the Company, its cash deposits and available funds. The regulatory model allows some certainty over the turnover of the Company over the next three years subject to assumptions on inflation. The regulatory model also allows for turnover to be adjusted upwards in the event of a substantial adverse effect on the financial position of the Company, where this effect would not have been avoided by prudent management action. It also allows for turnover to be adjusted where a new legal obligation imposed on the Company as a water and sewerage undertaker has led to a material increase in the costs incurred.

There is a large capital expenditure programme over the next three years, of a similar nature to that delivered in previous regulatory control periods, allowing the Directors to be able to predict the cost of construction with some certainty. The borrowing facilities in place are long term and maturing after 31 March 2020 with the exception of one £140m loan. The mix of borrowings is spread between fixed, floating and index linked. Interest rates are a historically low and stable level and predictions of future increases are moderate.

All of the above has allowed the Directors to prepare a robust model of future trading performance and cash flows that can then be tested under various scenarios, to determine if the Viability Statement can be made. The key areas considered by the Directors were:

- the liquidity of the Company over the next three years, and the probability that the Company will be able to replace the £140m loan with another borrowing facility
- compliance with financial covenants in respect of gearing and interest cover
- the impact of increased interest rates
- the impact of decreased inflation
- the impact of a higher than expected accounting pension deficit
- mitigations in place in respect of the principal risks.

Following these assessments the Directors confirm that they have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due up to 31 March 2020.

Supplier Payment Policy

The policy in respect of suppliers is to agree the payment terms for transactions in advance and to make payments in accordance with those terms. At 30 June 2017 trade creditors represented approximately 33 days of trade purchases (2016 – 34 days). The Company does not follow any specific external code or standard on payment policy.

Disclosure of Information to Auditor

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

Auditor

KPMG LLP are engaged as auditor of the Company for the current financial year, after which the partner has to rotate off the audit. In accordance with best practice, the Company will take that opportunity to seek tenders for the audit service for the next financial year.

By order of the Board
Leigh Fisher-Hoyle – General Counsel
Claverton Down
Bath BA2 7WW
19 September 2017



STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE STRATEGIC REPORT, THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU) and applicable law.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

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 responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF WESSEX WATER SERVICES LIMITED

Opinion

We have audited the financial statements of Wessex Water Services Limited ("the Company") for the year ended 30 June 2017 which comprise the Income Statement, Statement of Other Comprehensive Income, Balance Sheet, Statement of Changes in Equity, Cash Flow Statement and related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 30 June 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

Strategic Report and Directors' Report

The Directors are responsible for the Strategic Report and the Directors' Report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the Strategic Report and the Directors' Report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the Strategic Report and the Directors' Report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

Matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

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

We have nothing to report in these respects.

Directors' responsibilities

As explained more fully in their statement set out on page 45, the Directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; 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 they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF WESSEX WATER SERVICES LIMITED (continued)

Auditor's responsibilities

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 our opinion in an Auditor's Report. Reasonable assurance is a high level of assurance, but does not 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 aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

The purpose of our audit work and to whom we owe our responsibilities

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.



Andrew Campbell-Orde (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
66 Queen Square
Bristol
BS1 4BE
19 September 2017

Income Statement

For the year ended 30 June 2017

	<i>Note</i>	2017 £m	2016 £m
Revenue	2	531.1	521.8
Raw materials and consumables used		(30.3)	(31.6)
Staff costs		(62.2)	(56.5)
Depreciation and amortisation		(99.5)	(101.9)
Other expenses		(105.6)	(101.2)
Total expenses	3	(297.6)	(291.2)
Operating profit	2	233.5	230.6
Financial income	6	0.9	0.8
Financial expenses	6	(76.6)	(74.3)
Net financing expense		(75.7)	(73.5)
Profit before tax		157.8	157.1
Taxation	7	(7.0)	9.4
Profit for the year		150.8	166.5

Statement of Other Comprehensive Income
For the year ended 30 June 2017

	2017	2016
	£m	£m
Profit for the year	150.8	166.5
Other comprehensive income		
<i>Items that will not be reclassified to profit or loss:</i>		
Remeasurements of defined benefit liability	(35.6)	(37.8)
Income tax on items that will not be reclassified to profit or loss	4.5	6.8
Other comprehensive income for the year, net of income tax	(31.1)	(31.0)
Total comprehensive income for the year	119.7	135.5

Balance Sheet

At 30 June 2017

	Note	2017 £m	2016 £m
Non-current assets			
Property, plant and equipment	9	3,443.0	3,362.9
Investments in subsidiaries	10	-	-
		<u>3,443.0</u>	<u>3,362.9</u>
Current assets			
Inventories	11	7.0	5.1
Trade and other receivables	12	170.2	181.8
Cash and cash equivalents	13	91.4	118.2
		<u>268.6</u>	<u>305.1</u>
Total assets		<u><u>3,711.6</u></u>	<u><u>3,668.0</u></u>
Current liabilities			
Other interest-bearing loans and borrowings	14	(5.5)	(5.0)
Trade and other payables	15	(172.6)	(181.2)
		<u>(178.1)</u>	<u>(186.2)</u>
Non-current liabilities			
Other interest-bearing loans and borrowings	14	(2,000.5)	(1,994.0)
Other payables	15	(0.4)	(0.4)
Employee benefits	16	(196.8)	(159.9)
Deferred income	17	(255.3)	(251.2)
Provisions	18	(0.1)	(0.2)
Deferred tax liabilities	19	(319.9)	(343.3)
		<u>(2,773.0)</u>	<u>(2,749.0)</u>
Total liabilities		<u><u>(2,951.1)</u></u>	<u><u>(2,935.2)</u></u>
Net assets		<u><u>760.5</u></u>	<u><u>732.8</u></u>
Equity			
Share capital	20	-	-
Retained earnings		<u>760.5</u>	<u>732.8</u>
Total equity		<u><u>760.5</u></u>	<u><u>732.8</u></u>

These financial statements were approved by the Board of Directors on 19 September 2017 and were signed on its behalf by:



Mark Watts - Director

Company registered number: 2366648

Statement of Changes in Equity

For the year ended 30 June 2017

	Note	Share capital £m	Retained earnings £m	Total equity £m
Balance at 1 July 2015		-	694.8	694.8
Effect of change in accounting policy		-	-	-
Balance at 1 July 2015 restated		-	694.8	694.8
Total comprehensive income for the year				
Profit for the year		-	166.5	166.5
Other comprehensive income		-	(31.0)	(31.0)
Total comprehensive income for the year		-	135.5	135.5
Transactions with owners, recorded directly in equity				
Dividends	8	-	(97.5)	(97.5)
Total contributions by and distributions to owners		-	(97.5)	(97.5)
Balance at 30 June 2016		-	732.8	732.8
Balance at 1 July 2016		-	732.8	732.8
Total comprehensive income for the year				
Profit for the year		-	150.8	150.8
Other comprehensive income		-	(31.1)	(31.1)
Total comprehensive income for the year		-	119.7	119.7
Transactions with owners, recorded directly in equity				
Dividends	8	-	(92.0)	(92.0)
Total contributions by and distributions to owners		-	(92.0)	(92.0)
Balance at 30 June 2017		-	760.5	760.5

Included in retained earnings are £562.4m of un-distributable reserves (2016 - £561.0m) created on first time adoption of IFRS when restating infrastructure assets to fair value.

Cash Flow Statement

For the year ended 30 June 2017

	<i>Note</i>	2017	2016
		£m	£m
Cash flows from operating activities			
Profit for the year		150.8	166.5
<i>Adjustments for:</i>			
Depreciation, amortisation and impairment		99.5	101.9
Financial income		(0.9)	(0.8)
Financial expense		76.6	74.3
Taxation		7.0	(9.4)
		<u>333.0</u>	<u>332.5</u>
Decrease in trade and other receivables		12.2	1.1
(Increase) / decrease in inventories		(1.9)	2.7
(Decrease) in trade and other payables		(9.1)	(1.7)
(Decrease) in provisions and employee benefits		(3.6)	(7.5)
		<u>(2.4)</u>	<u>(5.4)</u>
Tax paid		<u>(23.6)</u>	<u>(14.2)</u>
Net cash from operating activities		<u>307.0</u>	<u>312.9</u>
Cash flows from investing activities			
Proceeds from sale of property, plant and equipment		7.7	1.2
Interest received		1.0	0.7
Acquisition of property, plant and equipment		(193.8)	(178.8)
Proceeds from infrastructure charges and capital contributions		10.0	9.3
Net cash from investing activities		<u>(175.1)</u>	<u>(167.6)</u>
Cash flows from financing activities			
Proceeds from new loan		-	50.0
Interest paid		(61.7)	(60.3)
Payment of finance lease liabilities		(5.0)	(4.5)
Dividends paid		(92.0)	(94.0)
Net cash from financing activities		<u>(158.7)</u>	<u>(108.8)</u>
(Decrease) / increase in cash and cash equivalents		<u>(26.8)</u>	36.5
Cash and cash equivalents at 1 July		<u>118.2</u>	<u>81.7</u>
Cash and cash equivalents at 30 June	13	<u>91.4</u>	<u>118.2</u>

Notes to the financial statements

1. Accounting policies

1.1 Basis of preparation

Wessex Water Services Limited (the "Company") is a private company incorporated, domiciled and registered in England in the UK. The registered number is 2366648 and the registered address is Wessex Water Operations Centre, Claverton Down, Bath, BA2 7WW.

The Company financial statements have been prepared and approved by the Directors in accordance with International Financial Reporting Standards as adopted by the EU ("Adopted IFRSs").

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

Judgements made by the Directors, in the application of these accounting policies, that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 28.

Group accounts have not been prepared as under section 400 of the Companies Act 2006 the Company and its subsidiary are included in the consolidated financial statements of Wessex Water Ltd (see note 26).

1.2 Measurement convention

The financial statements are prepared on the historical cost basis. Non-current assets and disposal groups held for sale are stated at the lower of previous carrying amount and fair value less costs to sell.

1.3 Going concern

The Directors have considered the financial position of the Company and have concluded that they will be able to meet their liabilities as they fall due for the foreseeable future. For these purposes the foreseeable future is taken to mean a period of at least 12 months from the date of approval of these accounts.

1.4 Foreign currency

Transactions in foreign currencies are translated into sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement.

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

1.5 Financial instruments

Investments

Investments held as fixed assets are stated at cost less any provision for impairment. Those held as current assets are stated at the lower of cost and net realisable value.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and bank deposits. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are included as a component of cash and cash equivalents for the purpose only of the cash flow statement.

Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost using the effective interest method, less any impairment losses.

Notes to the financial statements (continued)

1. Accounting policies (continued)

1.6 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Leases in which the Company assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. Where land and buildings are held under leases the accounting treatment of the land is considered separately from that of the buildings. Leased assets acquired by way of finance lease are stated at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and less accumulated impairment losses.

Under IFRIC 18 sewers adopted at nil cost to the Company are included in fixed assets at a fair value, which is cost of construction and depreciated at the same rate as infrastructure assets.

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. The estimated useful lives are as follows:

- Buildings and operational assets 15 to 80 years
- Infrastructure assets 108 years
- Plant, machinery and vehicles 3 to 30 years
- Other assets 4 to 15 years

Infrastructure assets comprise 8 components whose weighted average life is 108 years:

Impounding reservoirs 150 years, raw water mains 100 years, treated water mains 100 years, communication pipes 60 years, sewers 125 years, sewage pumping stations 60 years, combined sewer overflows 80 years and sea outfalls 60 years.

Depreciation methods, useful lives and residual values are reviewed at each balance sheet date.

1.7 Intangible assets

Research and development

Expenditure on research activities is recognised in the income statement as an expense as incurred.

1.8 Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is based on the first-in first-out principle and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs in bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.

1.9 Impairment excluding inventories and deferred tax assets

Financial assets (including receivables)

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

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

Non-financial assets

The carrying amounts of the Company's non-financial assets, other than inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time.

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

Notes to the financial statements (continued)

1. Accounting policies (continued)

1.10 Employee benefits

Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Company's net obligation in respect of defined benefit pension plans and other post-employment benefits are calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of any plan assets are deducted. The Company determines the net interest on the net defined benefit liability for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability.

The discount rate is the yield at the reporting date on bonds that have a credit rating of at least AA that have maturity dates approximating the terms of the Company's obligations and that are denominated in the currency in which the benefits are expected to be paid.

Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which the Company pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement in the periods during which services are rendered by employees.

Re-measurements arising from defined benefit plans comprise actuarial gains and losses and the return on plan assets. The Company recognises them immediately in other comprehensive income and all other expenses related to defined benefit plans in employee benefit expenses in profit or loss.

When the benefits of a plan are changed, or when a plan is curtailed, the portion of the changed benefit related to past service by employees, or the gain or loss on curtailment, is recognised immediately in profit or loss when the plan amendment or curtailment occurs.

The calculation of the defined benefit obligations is performed by a qualified actuary using the projected unit credit method. When the calculation results in a benefit to the Company, the recognised asset is limited to the present value of benefits available in the form of any future refunds from the plan or reductions in future contributions and takes into account the adverse effect of any minimum funding requirements.

The Company's employees are members of the Wessex Water Ltd Group pension scheme. The Company recognises a cost equal to its contribution payable for the period. The assets of the scheme are held separately from those of the Group. The scheme has been closed to new members since 2009.

Short-term benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

Share-based payment transactions

YTL Power International Berhad operates an equity settled share-based payment scheme for the employees of the group. The fair value of the share-based payment awards is recognised as an expense over the period of the award. The amount recognised is adjusted to reflect the actual number of awards for which service and performance conditions are met at the vesting date. Where YTL Power International Berhad grants rights to its equity instruments to the Company's employees, they are accounted for as equity settled in the consolidated accounts. In the Company accounts they are accounted for as a charge to the profit and loss account and an inter-company liability.

1.11 Provisions

A provision is recognised in the balance sheet when the Company has a present legal or constructive obligation as a result of a past event, that can be reliably measured and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects risks specific to the liability.

1.12 Revenue

Turnover represents income receivable in the ordinary course of business, excluding VAT, for services provided. Turnover is recognised to the extent that it is probable that economic benefits will flow to the Company. For measured customers turnover includes an estimate of the sales value of units consumed between the last meter reading and the end of the period. Where premises are unoccupied or where no services are provided, charges are not raised and no turnover is recognised.

Notes to the financial statements (continued)

1. Accounting policies (continued)

1.13 Deferred income

Grants and contributions in respect of specific expenditure on non-infrastructure fixed assets are treated as deferred income and recognised in the profit and loss account over the expected useful economic lives of the related assets.

Grants and contributions relating to infrastructure assets are amortised over 108 years.

Under IFRIC 18 sewers adopted at nil cost to the Company are shown in deferred income at a fair value, which is cost of construction, and amortised at the same rate as infrastructure assets are depreciated.

1.14 Bad debt policy

Debt is written off for one of four reasons;

- It is considered or known to be uncollectible
- It is considered uneconomic to collect
- Older debt is written off by agreement with the customer in return for the receipt of monthly payments to pay-off current year debt as part of our "Restart" and "Restart Plus" policies
- Write off is ordered by the County Court. In these cases the Court may set payment at a proportion of the outstanding debt. When this level of payment is reached the Court will instruct that the rest is to be written off.

The policy for calculating the bad debt provision is to analyse the outstanding debt between payment categories and to make provision according to the historical non collection rate for that payment category. The categories selected are direct debit, instalments, standing orders, DSS, bankruptcy and all other. The profile of provision differs between categories, but for all categories debt that is 4 years old is fully provided.

1.15 Expenses

Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

Finance lease payments

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Financing income and expenses

Financing expenses comprise interest payable, finance charges on shares classified as liabilities and finance leases recognised in profit or loss using the effective interest method, unwinding of the discount on provisions, and net foreign exchange losses that are recognised in the income statement (see foreign currency accounting policy). Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that takes a substantial time to be prepared for use, are capitalised as part of the cost of that asset. Financing income comprises interest receivable on funds invested, dividend income, and net foreign exchange gains.

Interest income and interest payable is recognised in profit or loss as it accrues, using the effective interest method. Dividend income is recognised in the income statement on the date the entity's right to receive payments is established. Foreign currency gains and losses are reported on a net basis.

Notes to the financial statements (continued)

1. Accounting policies (continued)

1.16 Taxation

Tax on the profit for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of goodwill; the initial recognition of assets or liabilities that affect neither accounting nor taxable profit other than in a business combination, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

1.17 Dividends

Dividends are proposed by the board and immediately afterwards are authorised by the shareholder, and are therefore recognised as a liability in the accounts until paid.

1.18 Adopted IFRS not yet applied

The following Adopted IFRSs have been issued but have not been applied in these financial statements:

- Disclosure initiative – Amendments to IAS7 (Mandatory for years commencing on or after 1 January 2017)
- Recognition of Deferred Tax Assets for Unrealised Losses – Amendments to IAS12 (Mandatory for years commencing on or after 1 January 2017)
- IFRS 9 Financial Instruments (Mandatory for years commencing on or after 1 January 2018)
- IFRS 15 Revenue from Contracts with Customers (Mandatory for years commencing on or after 1 January 2018)
- IFRS 16 Leases (Mandatory for years commencing on or after 1 January 2019)
- Classification and Measurement of Share-Based Payment Transactions – Amendments to IFRS 2
- Annual Improvements to IFRSs – 2014-2016 Cycle

The Company does not currently expect that adoption of these standards will have a significant effect on the results or financial position of the Company, but may affect disclosure requirements.

Notes to the financial statements (continued)

2 Segmental analysis

	2017 £m	2016 £m
<i>Turnover</i>		
Regulated	522.7	513.8
Unregulated	8.4	8.0
	<u>531.1</u>	<u>521.8</u>
<i>Operating profit</i>		
Regulated	233.5	230.6
Unregulated	-	-
	<u>233.5</u>	<u>230.6</u>
<i>Net assets</i>		
Regulated	760.5	732.8
Unregulated	-	-
	<u>760.5</u>	<u>732.8</u>

3 Expenses and auditor's remuneration

Included in profit are the following:

	2017 £m	2016 £m
Impairment loss on other trade receivables and prepayments	11.6	11.7
Research and development expensed as incurred	0.2	0.1

	2017 £'000	2016 £'000
<i>Auditor's remuneration:</i>		
Audit of these financial statements	159	156
Taxation compliance services	7	9
Other tax advisory services	20	-
	<u>186</u>	<u>165</u>

Notes to the financial statements (continued)

4 Staff numbers and costs

The average number of employees (including Directors) during the year was as follows:

	Number of employees	
	2017	2016
Average number of employees	<u>2,151</u>	<u>2,012</u>

The aggregate payroll costs of these employees was:

	2017	2016
	£m	£m
Wages and salaries	81.4	71.5
Social security costs	8.5	7.0
Pension costs	12.1	11.0
	<u>102.0</u>	<u>89.5</u>

These costs were allocated as follows:

Capital schemes	39.8	33.0
Operating expenses	62.2	56.5
	<u>102.0</u>	<u>89.5</u>

5 Directors' remuneration

	2017	2016
	£'000	£'000
Total Directors' remuneration including benefits in kind	<u>2,019</u>	<u>1,309</u>
Remuneration of highest paid Director	<u>462</u>	<u>603</u>

Details of Directors' remuneration can be found in the Governance Report. Directors' remuneration is in respect of four Executive Directors, four Non-Executive Directors and five YTL appointed Directors (2016 - two Executive Directors, five Non-Executive Directors and five YTL appointed Directors).

Notes to the financial statements (continued)

6 Finance income and expense

Recognised in the income statement

	2017	2016
	£m	£m
<i>Finance income</i>		
Interest receivable on short-term bank deposits	0.9	0.8
Total finance income	<u>0.9</u>	<u>0.8</u>
<i>Finance expense</i>		
To fellow subsidiary undertakings	(66.3)	(64.3)
Net interest on net defined benefit pension plan liability	(4.7)	(4.6)
On bank loans and leases	<u>(5.6)</u>	<u>(5.4)</u>
	<u>(76.6)</u>	<u>(74.3)</u>
Net interest payable	<u>(75.7)</u>	<u>(73.5)</u>

In accordance with IAS 23 borrowing costs of £1.7m (2016 - £1.5m) associated with the funding of eligible capital projects have been capitalised at an interest rate of 4.3% (2016 – 3.9%).

7 Taxation

Recognised in the income statement

	2017	2016
	£m	£m
<i>Current tax expense</i>		
Current year	26.6	27.7
Adjustments for prior years	<u>(0.7)</u>	<u>(3.1)</u>
Current tax expense	<u>25.9</u>	<u>24.6</u>
<i>Deferred tax expense</i>		
Origination and reversal of temporary differences	4.3	2.0
Reduction in tax rate	(20.7)	(38.1)
Adjustments for prior years	<u>(2.5)</u>	<u>2.1</u>
Deferred tax (credit)	<u>(18.9)</u>	<u>(34.0)</u>
Tax expense/(credit) in income statement	<u>7.0</u>	<u>(9.4)</u>

Notes to the financial statements (continued)

7 Taxation (continued)

Income tax recognised in other comprehensive income

	2017 £m	2016 £m
Remeasurements of defined benefit liability	6.1	6.8
Change in tax rate	<u>(1.6)</u>	<u>-</u>
Tax credit	<u>4.5</u>	<u>6.8</u>

Reconciliation of effective tax rate

	2017 £m	2016 £m
Profit for the year	150.8	166.5
Total tax expense / (credit)	<u>7.0</u>	<u>(9.4)</u>
Profit excluding taxation:	157.8	157.1
Tax using the UK corporation tax rate of 19.75% (2016 - 20.0%)	31.2	31.4
Reduction of tax rate on deferred tax balances	(21.4)	(38.1)
Non-deductible expenses	1.0	0.1
(Over) provided in prior years	(3.2)	(0.9)
Group relief for nil consideration	(0.6)	(1.3)
Other	<u>-</u>	<u>(0.6)</u>
Total tax expense (including tax on discontinued operations)	<u>7.0</u>	<u>(9.4)</u>

Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and 18% (effective from 1 April 2020) were substantively enacted in October 2015. A further reduction to the UK Corporation Tax rate to 17% (effective from 1 April 2020) was substantively enacted in September 2016. Consequently, the deferred tax balances at the balance sheet date have been remeasured at that date. This has resulted in a credit to the income statement of £20.7m and a charge in reserves of £1.6m.

8 Dividends

The dividend policy is to declare dividends consistent with the Company's performance and prudent management of the economic risk of the business.

	2017 £m	2016 £m
Interim dividends for the current year	71.0	76.5
Final dividend for the current year	<u>21.0</u>	<u>21.0</u>
	<u>92.0</u>	<u>97.5</u>

Notes to the financial statements (continued)**9 Property, plant and equipment**

	Land & buildings £m	Infra-structure assets £m	Plant, equipment & vehicles £m	Office & IT equipment £m	Company total £m
Cost					
Balance at 1 July 2015	848.8	1,929.9	1,493.9	25.0	4,297.6
Additions	15.3	74.0	118.8	1.8	209.9
Disposals	(1.0)	(1.5)	(11.3)	-	(13.8)
Balance at 30 June 2016	863.1	2,002.4	1,601.4	26.8	4,493.7
Balance at 1 July 2016	863.1	2,002.4	1,601.4	26.8	4,493.7
Additions	6.0	66.4	112.9	4.2	189.5
Disposals	(0.3)	(1.5)	(11.4)	(0.1)	(13.3)
Balance at 30 June 2017	868.8	2,067.3	1,702.9	30.9	4,669.9
Depreciation and impairment					
Balance at 1 July 2015	(257.1)	(32.2)	(737.3)	(12.4)	(1,039.0)
Depreciation charge for the year	(14.2)	(17.6)	(68.1)	(2.7)	(102.6)
Disposals	0.4	-	10.4	-	10.8
Balance at 30 June 2016	(270.9)	(49.8)	(795.0)	(15.1)	(1,130.8)
Balance at 1 July 2016	(270.9)	(49.8)	(795.0)	(15.1)	(1,130.8)
Depreciation charge for the year	(14.1)	(18.0)	(70.3)	(2.8)	(105.2)
Disposals	0.2	-	8.9	-	9.1
Balance at 30 June 2017	(284.8)	(67.8)	(856.4)	(17.9)	(1,226.9)
Net Book Value					
At 1 July 2015	591.7	1,897.7	756.6	12.6	3,258.6
At 30 June 2016	592.2	1,952.6	806.4	11.7	3,362.9
At 30 June 2017	584.0	1,999.5	846.5	13.0	3,443.0

Notes to the financial statements (continued)

9 Property, plant and equipment (continued)

Infrastructure assets comprise a network of systems of mains and sewers, impounding and pumped raw water storage reservoirs, dams, sludge pipelines, sea outfalls and infrastructure investigations and studies.

Included in infrastructure assets at 1 July 2014 is £703.5m fair value adjustment on first time adoption of IFRS.

There is no impairment loss recognised in these financial statements.

At 30 June 2017 the net book value of leased plant and machinery was £9.9m (2016 - £13.5m). The leased equipment secures lease obligations (see note 14).

Assets under construction included in the values above were £243.7m (2016 - £193.1m).

Cumulative borrowing costs capitalised and included above were £6.7m (2016 - £5.0m).

Included in freehold land and buildings above is an amount of £13.2m (2016 - £12.3m) in respect of land which is not depreciated.

10 Investments in subsidiaries

The Company has an investment of £13,000 (2016 – £13,000) in 100% of the ordinary share capital of a subsidiary company Wessex Water Services Finance Plc, whose registered address is Wessex Water Operations Centre, Claverton Down, Bath, BA2 7WW.

11 Inventories

	2017	2016
	£m	£m
Raw materials and consumables	3.0	3.0
Work in progress	4.0	2.1
	<u>7.0</u>	<u>5.1</u>

Raw materials, consumables and work in progress recognised as “Other expenses” in the year amounted to £3.4m (2016 - £3.2m). There was no write-down of inventories to net realisable value in either year.

12 Trade and other receivables

	2017	2016
	£m	£m
Trade receivables	56.8	62.5
Owed by parent company	23.7	25.8
Owed by fellow subsidiary company	22.4	12.4
Owed by other group company	0.6	-
Prepayments and accrued income	61.8	76.3
Other debtors	4.9	4.8
	<u>170.2</u>	<u>181.8</u>

13 Cash and cash equivalents

	2017	2016
	£m	£m
Short-term bank deposits	90.0	112.0
Cash at bank	1.4	6.2
	<u>91.4</u>	<u>118.2</u>

Notes to the financial statements (continued)**14 Other interest-bearing loans and borrowings**

This note provides information about the contractual terms of the Company's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Company's exposure to interest rate and foreign currency risk, see note 21.

	2017 £m	2016 £m
Non-current liabilities		
Bank loans	415.0	415.0
Finance lease liabilities	1.4	6.9
Inter-company loans	<u>1,584.1</u>	<u>1,572.1</u>
	<u>2,000.5</u>	<u>1,994.0</u>
Current liabilities		
Current portion of finance lease liabilities	<u>5.5</u>	<u>5.0</u>
	<u>5.5</u>	<u>5.0</u>

Terms and debt repayment schedule

	Currency	Nominal interest rate	Year of maturity	Face value 2017 £m	Carrying amount 2017 £m	Face value 2016 £m	Carrying amount 2016 £m
Bank loans	Sterling		2018- 2025	415.0	415.0	415.0	415.0
<i>Inter-company loans</i>							
Bond	Sterling	5.375%	2028	198.8	198.4	198.7	198.3
Bond	Sterling	5.75%	2033	347.1	346.1	346.9	345.9
Bond	Sterling	4.00%	2021	198.9	198.9	198.6	198.6
Bond	Sterling	4.00%	2021	103.9	103.9	104.8	104.8
Index Linked Bond	Sterling	3.52%	2023	75.5	75.5	74.4	74.4
Index Linked Bond	Sterling	2.186%	2039	62.9	62.9	61.0	61.0
Index Linked Bond	Sterling	1.75%	2046	101.6	101.6	100.1	100.1
Index Linked Bond	Sterling	1.75%	2051	101.6	101.6	100.0	100.0
Index Linked Bond	Sterling	1.369%	2057	101.6	101.6	100.0	100.0
Index Linked Bond	Sterling	1.374%	2057	101.6	101.6	100.0	100.0
Index Linked Bond	Sterling	1.489%	2058	64.0	64.0	63.0	63.0
Index Linked Bond	Sterling	1.495%	2058	64.0	64.0	63.0	63.0
Index Linked Bond	Sterling	1.499%	2058	64.0	64.0	63.0	63.0
				<u>2,000.5</u>	<u>1,999.1</u>	<u>1,988.5</u>	<u>1,987.1</u>

Notes to the financial statements (continued)

14 Other interest-bearing loans and borrowings (continued)

Finance lease liabilities

Finance lease liabilities are payable as follows:

	Minimum lease payments	Interest	Principal	Minimum lease payments	Interest	Principal
	2017 £m	2017 £m	2017 £m	2016 £m	2016 £m	2016 £m
Less than one year	5.8	(0.3)	5.5	5.4	(0.4)	5.0
Between one and five years	1.5	(0.1)	1.4	7.3	(0.4)	6.9
	7.3	(0.4)	6.9	12.7	(0.8)	11.9

15 Trade and other payables

	2017 £m	2016 £m
Current		
Amounts payable to subsidiary company	31.0	31.1
Amounts payable to other group companies	0.6	0.6
Amounts owed to associate companies	-	0.7
Trade payables	15.1	14.8
Dividend	21.0	21.0
Other creditors	2.6	2.5
Corporation tax	16.4	14.0
Taxation and social security	2.2	2.3
Accruals and deferred income	83.7	94.2
	172.6	181.2
Non-current		
Other payables	0.4	0.4
	173.0	181.6

Notes to the financial statements (continued)**16 Employee benefits****Pension plans**

	2017 £m	2016 £m
Fair value of scheme assets	593.3	544.1
Present value of defined benefit obligations	(788.9)	(702.8)
Net (liability) for defined benefit obligations	(195.6)	(158.7)
Unfunded and compensatory added years pension	(1.2)	(1.2)
Total employee benefits	(196.8)	(159.9)

The Company sponsors a funded defined benefit pension plan for qualifying UK employees. The plan is administered by a separate board of Trustees which is legally separate from the Company. The Trustees are composed of representatives of both the employer and employees. The Trustees are required by law to act in the interest of all relevant beneficiaries and are responsible for the investment policy with regard to the assets plus the day to day administration of the benefits.

Under the plan, employees are entitled to annual pensions on retirement using an accrual rate, final pensionable salary and service. Benefits are also payable on death and following other events such as withdrawing from active service.

No other post-retirement benefits are provided to these employees.

Liabilities for an unfunded arrangement and a compensatory payment for added years' service are held outside the defined benefit scheme. The Company also operates a defined contribution section within the main pension scheme.

a. Profile of the Scheme

The defined benefit obligation includes benefits for current employees, former employees and current pensioners. Broadly, about 34% of the liabilities are attributable to current employees, 17% to former employees and 49% to current pensioners. The Scheme duration is an indicator of the weighted-average time until benefit payments are made. For the Scheme as a whole, the duration is around 20 years reflecting the approximate split of the defined benefit obligation between current employees (duration of 25 years), deferred members (duration of 25 years) and current pensioners (duration of 15 years).

b. Funding requirements

UK legislation requires that pension schemes are funded prudently. The last funding valuation of the Scheme was carried out by a qualified actuary as at 30 September 2013 and showed a deficit of £94.6 million. The Company is paying deficit contributions of:

- £8.6M by 31 March 2014 and 31 March 2015;
- £7.6M by each 31 March, from 31 March 2016 to 31 March 2020 inclusive;
- £10.2M by each 31 March, from 31 March 2021 to 31 March 2024 inclusive;

which, along with investment returns from return-seeking assets, is expected to make good this shortfall by 31 March 2024.

There was a funding valuation at 30 September 2016, which is in the course of being finalised, and during which the progress towards full funding is being reviewed.

The Company also pays contributions of 18.2% of pensionable salaries in respect of current accrual and non-investment related expenses, with active members paying a further 7.3% of pensionable salaries on average. A contribution of £7.6m is expected to be paid by the Company during the year ending on 30 June 2018.

c. Risks associated with the Scheme

Asset volatility - The liabilities are calculated using a discount rate set with reference to corporate bond yields; if assets underperform this yield, this will create a deficit. The Scheme holds a significant proportion of growth assets (equities, diversified growth fund and global absolute return fund) which, though expected to outperform corporate bonds in the long-term, create volatility and risk in the short-term. The allocation to growth assets is monitored to ensure it remains appropriate given the Scheme's long term objectives.

Notes to the financial statements (continued)

16 Employee benefits (continued)

Changes in bond yields - A decrease in corporate bond yields will increase the value placed on the Scheme's liabilities for accounting purposes, although this will be partially offset by an increase in the value of the Scheme's bond holdings.

Inflation risk - The majority of the Scheme's benefit obligations are linked to inflation and higher inflation will lead to higher liabilities (although, in most cases, caps on the level of inflationary increases are in place to protect against extreme inflation). The majority of the assets are either unaffected by or only loosely correlated with inflation, meaning that an increase in inflation will also increase the deficit.

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 liabilities.

The Trustees insure certain benefits payable on death before retirement.

A contingent liability exists in relation to the equalisation of Guaranteed Minimum Pension ("GMP"). The UK Government intends to implement legislation which could result in an increase in the value of GMP for males. This would increase the defined benefit obligation of the plan. At this stage, it is not possible to quantify the impact of this change.

d. Reporting at 30 June 2017

The results of the latest funding valuation at 30 September 2016 have been adjusted to the balance sheet date taking account of experience over the period since 30 September 2016, changes in market conditions, and differences in the financial and demographic assumptions. The present value of the defined benefit obligation, and the related current service cost, were measured using the Projected Unit Cost Method.

The principal assumptions used to calculate the liabilities under IAS 19 are set out below:

The major assumptions used by the actuary were:

	30.06.17	30.06.16
Rate of increase in salaries – year 1	3.2%	1.6%
Rate of increase in salaries – years 2 (2016 years 2 to 3)	3.2%	2.8%
Rate of increase in salaries – long term	3.7%	3.3%
Rate of increase in pensions in payment	2.2% or 3.1%	1.8% or 2.7%
Rate of increase in pensions in payment - reduced level members	2.2%	2.0%
Discount rate	2.6%	2.9%
Inflation assumption – RPI	3.2%	2.8%
Inflation assumption – CPI	2.2%	1.8%

The mortality assumptions are based upon the recent actual mortality experience of Scheme members, and allow for expected future improvements in mortality rates. The assumptions are that a member currently aged 60 will live, on average, for a further 27.0 years (2016 – 27.0 years) if they are male, and for a further 29.1 years (2016 – 29.3 years) if they are female. For a member who retires in 2037 at age 60 the assumptions are that they will live, on average, for a further 28.2 years (2016 – 28.4 years) after retirement if they are male, and a further 30.4 years (2019 – 30.9 years) after retirement if they are female.

The mortality table adopted is based upon 95% of standard tables S2P(M/F)A adjusted to allow for individual years of birth. Future improvements are assumed to be in line with the CMI 2016 core projection, with a long term improvement rate of 1.0% p.a. for all members.

Sensitivity analysis:

The key assumptions used for IAS 19 are: discount rate, inflation and mortality. If different assumptions are used, this could have a material effect on the results disclosed. The sensitivity of the results to these assumptions are set out below. For the purposes of these sensitivities it has been assumed that the change in the discount rate and inflation has no impact on the value of Scheme assets.

- A reduction in the discount rate of 0.1% from 2.6% to 2.5% would increase the scheme liabilities by £15.1m from £788.9m to £804.0m, increasing the scheme deficit to £210.7m
- An increase in the inflation assumption of 0.1% (from 2.2% to 2.3% for CPI and 3.2% to 3.3% for RPI) would increase the scheme liabilities by £14.5m from £788.9m to £803.4m, increasing the scheme deficit to £210.1m
- An increase in life expectancy of 1 year would increase the scheme liabilities by £32.5m from £788.9m to £821.4m, increasing the scheme deficit to £228.1m.

Notes to the financial statements (continued)

16 Employee benefits (continued)

e. The value of the assets as follows:

	2017	2016
	£m	£m
Equities	260.8	251.9
Property	35.8	28.8
Government Bonds	144.1	145.1
Corporate Bonds	127.5	117.4
Other	25.1	0.9
	<u>593.3</u>	<u>544.1</u>

f. The amounts recognised in comprehensive income are set out below:

	2017	2016
	£m	£m
Operating cost – service cost		
Current service cost	12.0	10.9
Administration expenses	0.6	0.5
Past service cost	0.1	0.1
Financing cost		
Interest on net benefit liability	4.7	4.6
Pension cost recognised in profit and loss	<u>17.4</u>	<u>16.1</u>
Re-measurements in Other Comprehensive Income (OCI)		
Return on plan assets in excess of that recognised in net interest	(41.9)	(12.0)
Actuarial losses due to changes in financial assumptions	100.7	64.0
Actuarial gains due to changes in demographic assumptions	(6.5)	(7.8)
Actuarial gains due to liability experience	<u>(16.7)</u>	<u>(6.4)</u>
Pension cost recognised in OCI	<u>35.6</u>	<u>37.8</u>
Total amount recognised in profit and loss and OCI	<u>53.0</u>	<u>53.9</u>

g. Changes to the present value of the defined benefit obligations during the year:

	2017	2016
	£m	£m
Opening defined benefit obligation	702.8	638.2
Current service cost	12.0	10.9
Interest expense on defined benefit obligation	20.5	24.1
Contributions by scheme participants	0.2	0.2
Actuarial gains due to changes in demographic assumptions	(6.5)	(7.8)
Actuarial losses due to changes in financial assumptions	100.7	64.0
Actuarial gains due to liability experience	(16.7)	(6.4)
Net benefits paid out	(24.2)	(20.5)
Past service cost	<u>0.1</u>	<u>0.1</u>
Closing defined benefit obligation	<u>788.9</u>	<u>702.8</u>

Notes to the financial statements (continued)**16 Employee benefits (continued)**

h. Changes to the fair value of scheme assets during the year:

	2017 £m	2016 £m
Opening fair value of scheme assets	544.1	516.1
Interest income on scheme assets	15.8	19.5
Re-measurement gains on scheme assets	41.9	12.0
Contributions by employer	16.1	17.3
Contributions by scheme participants	0.2	0.2
Net benefits paid out	(24.2)	(20.5)
Administration costs incurred	(0.6)	(0.5)
Closing fair value of scheme assets	<u>593.3</u>	<u>544.1</u>

i. Additional analysis:

Actual return on scheme assets

Interest income on scheme assets	15.8	19.5
Re-measurement gains on scheme assets	41.9	12.0
Actual return on scheme assets	<u>57.7</u>	<u>31.5</u>

Analysis of amounts recognised in Other Comprehensive Income

Total re-measurement losses	(35.6)	(37.8)
Total loss	<u>(35.6)</u>	<u>(37.8)</u>

History of asset values, defined benefit obligations, deficit in the scheme and experience gains and losses

	30.06.17 £m	30.06.16 £m	30.06.15 £m	30.06.14 £m	30.06.13 £m
Fair value of scheme assets	593.3	544.1	516.1	467.7	422.1
Defined benefit obligation	(788.9)	(702.8)	(638.2)	(566.5)	(536.0)
Deficit in the scheme	<u>(195.6)</u>	<u>(158.7)</u>	<u>(122.1)</u>	<u>(98.8)</u>	<u>(113.9)</u>
Experience gains on scheme assets	41.9	12.0	30.1		
Experience gains on scheme liabilities	16.7	6.4	6.9		

Defined contribution plans

The Group also operates a defined contribution pension plan.

The total expense relating to this plan in the current year was £3.1m (2016 - £2.0m).

Notes to the financial statements (continued)**16 Employee benefits (continued)****Share-based payments**

YTL Power International Berhad (a subsidiary of the ultimate parent company YTL Corporation Berhad) operates share option schemes under which options are granted to employees of the Company. The current scheme the "YTL Power International Berhad Employees Share Option Scheme 2011" first issued share options to employees on 1 June 2012. The terms of the 2011 scheme are specified under the YTL Power International Berhad Employees Share Option Scheme 2011 (2011 UK part) known as the "2011 UK Plan".

The majority of options have been issued under terms approved by the Inland Revenue, the "Approved" scheme, but some have been issued to senior employees under an "Unapproved" scheme. The options are for ordinary shares of YTL Power International Berhad of Malaysian Ringgit RM0.50 each.

2011 UK Plan

The exercise price and fair value of the share options are as follows:

Granted – Ordinary shares of RM0.50 each	Vesting date	Expiry date	Exercise price RM	Fair value RM
01/06/2012 Unapproved	01/06/2015	31/03/2021	1.41	0.22
01/06/2012 Approved	01/06/2015	31/03/2021	1.65	0.16

Under IFRS 2 equity settled share-based payments are measured at the fair value at the date of the grant, and the fair value is expensed on a straight line basis over the vesting period. There was no charge recognised in the profit and loss account for IFRS 2 as the share options have passed their vesting date. The key assumptions were as follows:

Scheme	Weighted ave. share price at grant RM	Expected volatility %	Expected option life years	Risk free rate %	Dividend yield %
01/06/2012 Unapproved	1.63	21.2	3	3.14	5.6
01/06/2012 Approved	1.63	21.2	3	3.14	5.6

The following options were outstanding at 30 June 2016 and 30 June 2017:

Granted – Ordinary shares of RM0.50 each	Outstanding at 30 June 2016	Granted	Forfeited	Exercised	Outstanding at 30 June 2017
01/06/2012 Unapproved	7,895,000	0	(52,000)	-	7,843,000
01/06/2012 Approved	38,036,000	0	(602,000)	-	37,434,000
TOTAL	45,931,000	0	(654,000)	-	45,277,000

The share price at 30 June 2017 was RM1.45 or £0.26.

Notes to the financial statements (continued)

17 Deferred income

	Above ground grants £m	Below ground grants £m	Sewer adoptions £m	Total £m
Balance at 1 July 2015	8.3	153.6	56.2	218.1
Received during the year	1.0	8.7	25.9	35.6
Amortisation	(0.3)	(1.5)	(0.7)	(2.5)
	<hr/>	<hr/>	<hr/>	<hr/>
Balance at 30 June 2016	9.0	160.8	81.4	251.2
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
Balance at 1 July 2016	9.0	160.8	81.4	251.2
Received during the year	0.3	9.7	(3.7)	6.3
Amortisation	(0.4)	(1.2)	(0.6)	(2.2)
	<hr/>	<hr/>	<hr/>	<hr/>
Balance at 30 June 2017	8.9	169.3	77.1	255.3
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Sewer adoptions received in the year include a reduction for the revision of previous estimates.

18 Provisions

	Restructuring £m	Total £m
Balance at 1 July 2016	0.2	0.2
Provisions made during the year	0.1	0.1
Provisions used during the year	(0.2)	(0.2)
	<hr/>	<hr/>
Balance at 30 June 2017	0.1	0.1
	<hr/> <hr/>	<hr/> <hr/>
Non-current	-	-
Current	0.1	0.1
	<hr/>	<hr/>
Balance at 30 June 2017	0.1	0.1
	<hr/> <hr/>	<hr/> <hr/>

The restructuring provision is in respect of a reorganisation announced before the prior year-end, delivering efficiencies in the first year of the AMP 6 price review period.

Notes to the financial statements (continued)

19 Deferred tax assets and liabilities

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Liabilities		Assets		Net	
	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m
Property, plant and equipment	377.1	542.0	(23.7)	(169.8)	353.4	372.2
Employee benefits	-	-	(33.4)	(28.8)	(33.4)	(28.8)
Provisions	-	(0.1)	(0.1)	-	(0.1)	(0.1)
Tax (assets) / liabilities	377.1	541.9	(57.2)	(198.6)	319.9	343.3
Net of tax liabilities/(assets)	-	-	-	-	-	-
Net tax (assets) / liabilities	377.1	541.9	(57.2)	(198.6)	319.9	343.3

Movement in deferred tax during the year

	1 July 2016 £m	Recognised in income £m	Recognised in equity £m	30 June 2017 £m
Property, plant and equipment	372.2	(18.8)	-	353.4
Employee benefits	(28.8)	(0.1)	(4.5)	(33.4)
Provisions	(0.1)	-	-	(0.1)
	343.3	(18.9)	(4.5)	319.9

Movement in deferred tax during the prior year

	1 July 2015 £m	Recognised in income £m	Recognised in equity £m	30 June 2016 £m
Property, plant and equipment	409.2	(37.0)	-	372.2
Employee benefits	(24.7)	2.7	(6.8)	(28.8)
Provisions	(0.1)	-	-	(0.1)
	384.4	(34.3)	(6.8)	343.3

Notes to the financial statements (continued)**20 Capital and reserves**

	2017	2016
	£	£
Issued at 1 April	1	1
Issued at 31 March	1	1
<i>Allotted, called up and fully paid</i>		
Ordinary shares of £1 each	1	1
	1	1
Shares classified as liabilities	-	-
Shares classified in shareholders' funds	1	1
	1	1

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

21 Financial instruments**(a) Fair values of financial instruments**

Fair value is the amount at which a financial instrument could be exchanged in an arms-length transaction between informed and willing parties, other than a forced or liquidation sale. The fair value of short term and floating rate borrowings approximate to book value. The fair value of long term fixed rate borrowings has been calculated using market values or discounted cash flow techniques.

The fair value of long term fixed rate inter-company loans are classified as level 1 in the IFRS 13 fair value hierarchy and have a carrying value of £1,584.1m and a fair value of £2,240.9m. Short term and floating rate borrowings have a carrying value and fair value of £330.5m.

The IFRS 13 fair value hierarchy is a categorisation relating to the extent that the fair value can be determined by reference to comparable market values. The hierarchy ranges from level 1 where instruments are quoted on an active market through to level 3 where the assumptions used to derive fair value do not have comparable market data.

It is the Company's policy to recognise all the transfers into the levels and transfers out of the levels at the date of the event or change in circumstances that caused the transfer. No liabilities are classified as level 2 or level 3.

Notes to the financial statements (continued)

21 Financial instruments (continued)

The fair values of all financial assets and financial liabilities by class together with their carrying amounts shown in the balance sheet are as follows:

	Carrying amount	Fair Value	Level 1	Carrying amount	Fair Value	Level 1
	2017	2017	2017	2016	2016	2016
	£m	£m	£m	£m	£m	£m
Loans and receivables						
Cash and cash equivalents (note 13)	(91.4)	(91.4)	(91.4)	(118.2)	(118.2)	(118.2)
Total financial assets	<u>(91.4)</u>	<u>(91.4)</u>	<u>(91.4)</u>	<u>(118.2)</u>	<u>(118.2)</u>	<u>(118.2)</u>
Other interest-bearing loans and borrowings (note 14 current)	5.5	5.5	5.5	5.0	5.0	5.0
Other interest-bearing loans and borrowings (note 14 non-current)	<u>2,000.5</u>	<u>2,657.3</u>	<u>2,657.3</u>	<u>1,994.0</u>	<u>2,377.2</u>	<u>2,377.2</u>
Total financial liabilities	<u>2,006.0</u>	<u>2,662.8</u>	<u>2,662.8</u>	<u>1,999.0</u>	<u>2,382.2</u>	<u>2,382.2</u>
Total financial instruments	<u><u>1,914.6</u></u>	<u><u>2,571.4</u></u>	<u><u>2,571.4</u></u>	<u><u>1,880.8</u></u>	<u><u>2,264.0</u></u>	<u><u>2,264.0</u></u>

(b) Credit risk

Financial risk management

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from customers and investment securities.

Cash and cash equivalents are short term deposits with counterparties that have a credit rating of A1+/P1 or A1/P1, and hence there is no exposure to credit risk for these values.

	2017	2016
	£m	£m
Cash and cash equivalents	91.4	118.2
	<u>91.4</u>	<u>118.2</u>

The concentration of credit risk for trade receivables (see note 12) at the balance sheet date by geographic region was:

	2017	2016
South West England	56.8	62.5
	<u>56.8</u>	<u>62.5</u>

Notes to the financial statements (continued)

21 Financial instruments (continued)

Trade receivables are from domestic and business customers. No individual customer or industrial sector has a material balance outstanding at either year end.

The aging of trade receivables at the balance sheet date was:

	Gross	Impairment	Gross	Impairment
	2017	2017	2016	2016
	£m	£m	£m	£m
Less than 1 year	37.0	(5.5)	40.5	(4.3)
1 to 2 years	18.5	(6.3)	20.4	(7.5)
2 to 3 years	15.0	(6.5)	16.5	(7.6)
3 to 4 years	12.0	(7.4)	12.0	(7.5)
More than 4 years	13.3	(13.3)	17.8	(17.8)
	95.8	(39.0)	107.2	(44.7)

The movement in the provision for bad debts in respect of trade receivables during the year was as follows:

	2017	2016
	£m	£m
Balance at 1 July	(44.7)	(44.0)
Written off	17.3	11.0
Charge to profit and loss	(11.6)	(11.7)
Balance at 30 June	(39.0)	(44.7)

The bad debt policy is shown in the accounting policies (note 1).

(c) Cash flow hedges

The Company does not have any cash flow hedges (2016 – none).

(d) Liquidity risk

Financial risk management

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due.

The Company is a regulated utility with a five-year settlement with the industry regulator, which allows it to plan to a certain degree of accuracy the financial obligations in the medium term. The Company has also secured long-term funding through bonds issued by its subsidiary company. This means that the need to obtain additional finance has been spread over future years and is not considered onerous in any one regulatory period.

Notes to the financial statements (continued)**21 Financial instruments (continued)**

The following are the contractual maturities of financial liabilities, including estimated interest payments and excluding the effect of netting agreements:

	Carrying amount	Contractual cash flows	Year 1	Years 2 to 5	Over 5 years
	2017	2017	2017	2017	2017
	£m	£m	£m	£m	£m
Non derivative financial instruments					
Finance lease liabilities	6.9	7.3	5.8	1.5	-
Secured bank loans	415.0	441.2	4.8	230.3	206.1
Inter-company loans	1,584.1	3,854.0	56.7	530.3	3,267.0
Total financial instruments	<u>2,006.0</u>	<u>4,302.5</u>	<u>67.3</u>	<u>762.1</u>	<u>3,473.1</u>

	Carrying amount	Contractual cash flows	Year 1	Years 2 to 5	Over 5 years
	2016	2016	2016	2016	2016
	£m	£m	£m	£m	£m
Non derivative financial instruments					
Finance lease liabilities	11.9	12.8	5.5	7.3	-
Secured bank loans	415.0	449.9	5.6	159.1	285.2
Inter-company loans	1,572.1	3,053.2	56.1	226.3	2,770.8
Total financial instruments	<u>1,999.0</u>	<u>3,515.9</u>	<u>67.2</u>	<u>392.7</u>	<u>3,056.0</u>

(e) Market risk

There is no exposure to equity or foreign currency risk, the interest rate risk is shown below.

Interest rate risk

At the year end the interest rate profile of the Company's interest-bearing financial instruments was:

	2017	2016
	£m	£m
Fixed rate instruments	947.3	947.6
Floating rate instruments	321.9	326.9
Index linked instruments	736.8	724.5
	<u>2,006.0</u>	<u>1,999.0</u>

The Company policy is to keep a significant proportion of total financial instruments in each of the three categories.

Sensitivity

The floating rate instruments are sensitive to interest rate movements. If there was a 1% increase in interest rates on those floating rate instruments at the balance sheet date, there would be an additional interest charge to the income statement of £3.2m.

Notes to the financial statements (continued)

22 Operating Leases

There were no non-cancellable operating lease rentals payable by the Company.

During the year £2.3m was recognised as an expense in the income statement in respect of operating leases (2016 - £1.8m) and £1.0m (2016 - £1.0m) was recognised as rental income by the Company.

23 Commitments

Capital expenditure contracted but not provided at 30 June 2017 was £65.6m (2016 - £108.6m).

The Company has guaranteed Bonds of £1,584.1m (2016 - £1,572.1m) issued by its wholly owned subsidiary company Wessex Water Services Finance Plc.

24 Contingencies

There are no material contingent liabilities at 30 June 2017 for which provision has not been made in these accounts.

25 Related parties

There were no transactions with key management personnel. Directors' emoluments have been disclosed in the Governance Report.

There have been no transactions with the holding companies described in note 26.

26 Ultimate parent company and parent company of larger group

The smallest group into which the financial statements of the Company are consolidated is that headed by Wessex Water Ltd, a company incorporated in England whose registered address is Wessex Water Operations Centre, Claverton Down, Bath, BA2 7WW.

The pre-penultimate, penultimate and ultimate holding companies are YTL Power International Berhad, YTL Corporation Berhad and Yeoh Tiong Lay & Sons Holdings Sdn Bhd respectively, all registered in Malaysia.

The largest group in which the results of the Company are consolidated is that headed by YTL Corporation Berhad incorporated in Malaysia. The consolidated financial statements of these groups are available to the public and can be obtained from Yeoh Tiong Lay Plaza, 55 Jalan Bukit Bintang, 55100 Kuala Lumpur, Malaysia.

27 Subsequent events

There are no subsequent events requiring disclosure in these financial statements. The final dividend for the year was declared in June 2017 and paid in July 2017.

28 Accounting estimates and judgements

In preparing the financial statements and applying the accounting policies, the Company is required to make reasonable estimates and judgements based on the available information, the most significant of which are;

a) Defined benefit pension scheme deficit

In recognising the deficit on the balance sheet there are a number of assumptions concerning inflation, rate of increase of salaries and pensions, mortality rates and interest rates that can have a significant effect on the deficit recorded. These assumptions are discussed with independent qualified actuaries and disclosed in note 16 to the financial statements.

b) Bad debt provision

The methodology behind the provision is based upon the age of the debt and the method of payment of the debt. Historical evidence is used to determine a percentage of debt to be provided according to the age and payment type.

c) Classification of capital expenditure

Due to the high value of capital expenditure the judgements made on the classification of expenses as operating or capital, and within capital between maintenance and enhancement, are key to the preparation of the accounts. The Company follows both accounting standards and guidelines issued by Ofwat in making these judgements.